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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CURRENT ECONOMIC SITUATION IN CEYLON

(in two volumes)

VOLUME II

PUBLIC FINANCE, AGRICULTURE AND INDUSTRY

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South Asia Department

CURRENCY EQUIVALENTS

Currency Unit	-	Ceylon Rupee

Prior to November 21, 1967

US $1.00	=	Rs. 4.76
Rs. 1.00	=	US $ 0.21
Rs. 1 million	=	US $ 210,000

After November 21, 1967

US $1.00	=	Rs. 5.95
Rs. 1.00	=	US $ 0.17
Rs. 1 million	=	US $ 167,000

PREFACE

This report was prepared by a mission comprising Mr. Manfred G. Blobel (Chief of Mission), Mr. Alfred S. Cleveland (General Economist), Mr. Vladimir Dragomanovic (Industrial consultant), Mr. Basil G. Kavalsky (General Economist), Messrs. Stanley Please and Walter B. Stolber (Fiscal Economists) and Mr. Tae-Hee Yoon (Agricultural Economist). The mission was in Ceylon from mid-November to early December 1970.

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BASIC DATA

Area:	25,332 square miles
Population: (1970 estimate)	12.6 million
Rate of growth (1970 estimate)	2.55 p.a.
Population density: (per sq. mile)	
to total area	496
to arable land (1964)	1,171
Gross National Product: (1969) (at current market prices)	Rs. 11,770 million
Rate of growth at constant prices (1969)	5.7%
Rate of growth at constant prices (1960-1969)	4.5%
Real income growth (1960-1969)	3.5%
GNP per capita (US$ equivalent at official rate)	$157
Gross Domestic Product at Factor Cost (1969)	Rs. 10,925 million
Of which (%): Agriculture	34.8
Manufacturing	11.7
Construction	6.0
Transport and Communication	10.0
Trade	15.7
Other Services	21.9

% of GDP at Market Prices	1969	(Average) 1961-69
Gross investment	19	15.4
Gross savings	13	13.1
Balance of payments current account deficit	5.9	2.3
Investment income payments	0.9	0.6
Government revenue	21.1	21.5
Resource gap as a percent of investment	35.6	18.1

	Sept. 30, 1970 Rs. million	Average Annual Change (%) 1961-1970
Total money supply	2,065	5.6
Time and savings deposits	933	11.9
Bank credit to public sector (net)	2,576	12.0
Commercial Bank credit to private sector (gross)	1,232	10.1

Public Sector Operations	Rev. Estimates 1969/70 (Rs. million)	Average Annual Change (%) 1960/61-1969/70
Government current receipts	2,760	7.3
Government current expenditure	2,576	7.1
Surplus/Deficit	184	Irregular
Government capital expenditure	930	6.7
Total external assistance to public sector (net)	189	Sharp decrease from 1968/69

External Public Debt (US$ million)	December 1970	January 1968
Total debt outstanding (including IMF drawings) - US$ million	574.8	304
Debt service ratio to export earnings (excluding IMF repurchases)	1970 (est.) 15.5%	1968 8.0%
Short-term Debt (less than 1 year) - US$ million	129	2

Balance of Payments (US$ million)	1970 (Provisional)	1969	1968
Total exports	335	321	332
Total imports	403	446	396
Current invisibles (net)	-20	-15	-
Net current account balance	-88	-140	-64
Increase in exchange reserves (-)	11	56	-

Commodity Concentration of Exports	1970 (Provisional)	1961-66 Average
Tea, rubber, coconut products (3 major exports)	90%	93%

Exchange Reserves (US$ million)	1970 (Provisional)	1969	1961-66 Average
Liquid Balances Abroad	4.4	2.6	14
IMF drawings outstanding	88	105	29

External Financial Assistance (US$ million)	1969	1968	1967	1966-69 Average
Total disbursements	129	81	48	76

I. PUBLIC FINANCE

A. INTRODUCTION

1. Volume I (The Main Report) has emphasized the crucial choices which Ceylon has to face if it is going to achieve a better balance between its social and growth objectives. The external constraints upon the economy necessitate that the rate of growth of consumption be kept below that experienced in the 1960's if the flow of resources required for undertaking the structural changes in the economy is to be adequate. These structural changes are in their turn essential if in the longer run output is to rise more rapidly thus permitting consumption levels also to increase more rapidly.

2. Central to this basic policy problem which confronts Ceylon is the budgetary problem. Briefly this arises from the fact that, unlike most developing countries, Ceylon began its existence as a national sovereign state both with a high tax-GNP ratio and with a structure of commitments to social policies -- particularly food subsidies and education -- which have entailed growing recurrent expenditure obligations. Had Ceylon experienced rapid economic growth, it is possible that these expenditure commitments could have been met and, in addition, that adequate funds could have been mobilized for stimulating and sustaining a high rate of growth of the economy. In fact Ceylon has experienced an average annual rate of growth of less than 5 percent during the 1960's and 2.3 percent per capita. At least one important reason for this has been that domestic resources have not been adequately mobilized for the development of the economy. When all allowances are made for the problems of the market for tea and for the structural problems of the Ceylonese economy, the problem remains that even if obvious growth opportunities were to present themselves, the internal resources required to exploit these opportunities cannot be generated so long as the growth of government expenditure continues to stimulate consumption at the expense of investment. This conclusion is particularly true in a country in which the government has explicitly undertaken the responsibility for ensuring the generation of adequate resources for financing development. The wisdom of this decision is not here in question. What is in question is the recognition by the authorities of the implications of the decision, for what this decision means is that the government cannot simply regard the budget as reflecting its narrow financial needs. The budget and the policies it reflects must be seen as the means by which the government is ensuring, firstly, that funds for development are being mobilized and, secondly that the total call on resources is being kept within the bounds of the total resources available (including a manageable level of capital inflow).

B. GOVERNMENT SAVINGS AND INVESTMENT

3. Table 1 shows in summary form the broad nature of the problem as it has developed over the past decade. Government capital expenditure after being stable at around Rs. 500 million during the first half of the 1960's has now reached a level around Rs. 1,000 million. With government investment running some Rs. 500 million higher than in the early 1960's, the current

surplus being generated by the government is little, if anything, higher than previously. The surplus has fluctuated very considerably during the whole decade so that it is difficult to talk of a trend or of a change in trend or in level. The most favorable interpretation of the statistics is that the level of government savings has been rising from around Rs. 100 million to around Rs. 150 million though with a fall in the estimate for the current year to a figure of Rs. 106 million. In other words, the Rs. 500 million increase in government investment has been matched at best by a mere Rs. 50 million increase in government savings.

4. By any standards both the total level and the incremental contribution of government to total national savings are inadequate. A level of government savings of Rs. 150 million represents little more than one percent of GNP and 5.5 percent of government revenues. Incrementally government revenue has risen by almost Rs. 1 billion since the mid-1960's so that the marginal government savings rate has been about 5 percent. It must be recognized that not only are these percentages extremely small by the normal needs of developing countries but that in the case of Ceylon the needs of government saving are increased by the high level of taxation. Government saving becomes of increasing importance to the extent that private savings capacity is reduced by reductions in disposable income. Government saving also becomes of increasing importance to the extent that the transfer expenditures of government encourage private consumption rather than savings. This is extremely important in the case of Ceylon because one-half of total current expenditure is classified as transfer expenditure of which, once again, approximately one half is on food subsidies and much of the remaining half is on pensions, relief, etc. All these elements in transfer expenditure are likely to encourage consumption rather than private savings.

C. GOVERNMENT REVENUES

5. By all standards the revenue performance of Ceylonese governments has been very impressive. The simple government revenue-GNP ratio throughout the 1960's has been around 22 percent with a slight upward trend. If allowance is made for Ceylon's per capita non-export income, the export ratio and the share of mining in the GNP, it comes eighth in a ranking of the tax effort of 50 developing countries.

6. What is perhaps more impressive than the overall revenue performance considered in aggregate is the manner in which this has been achieved and maintained. Revenues from export duties in the mid-1950's contributed about one-third of total government tax revenues and even in 1960-61, contributed 24 percent. They now represent 16 percent. This decline is, of course, a clear reflection of the cost and world market conditions facing the tea industry and other export sectors and also of the rapid growth of other sources of revenue. In a mechanical sense it is also, of course, a reflection of the structure of export duties on these commodities (these are outlined in an annex).

7. Tea is by far the most important export commodity representing 56 percent of total export earnings followed by rubber (18 percent) and three major coconut products (13 percent). The fall in tea prices in more than recent years together with the fall in rubber prices particularly affected the duty collection. Yet, this decline was more than offset by increasing export quantities, by the increase in the rupee price after the 1967 devaluation and by changes in taxation, thus increasing the yields from export duties in absolute terms even though they fell as a percentage of GNP and of total revenue collections.

8. Revenue from income taxes has also grown sluggishly as a combined reflection of the slow growth of the economy, tax concessions, the incidence on profits of increased indirect taxes and arrears in the assessment and collection of taxes. In any case income taxes only contributed 20 percent of total revenues in 1960/61 and their contribution to the growth of total revenues up to 1968/69 was Rs. 70 million out of the total increase in revenues of over Rs. 1 billion.

9. Given the structural problems of the economy which have made it impossible to maintain a rate of growth of revenues from export duties and income taxes which in combination could approach the growth of the GNP or the rate of growth of government expenditure, governments have had to develop the structure of taxation imposed on both imported goods and on domestically produced goods and services in order to generate additional tax revenue. The record in achieving this has been very impressive as compared with most other developing countries. In aggregate terms the income elasticity of indirect taxes has been 1.7. In order to achieve such a high rate of growth of indirect taxation, a continuing series of tax changes have had to be introduced. These have applied both to imported goods and to domestically produced goods and services. Furthermore, they have both increased the effective rates of taxation and widened the tax net.

10. Of particular importance in relation to the taxation of imports has been the introduction of the FEEC scheme which in effect has represented a tax on all imports other than certain excluded categories. In fact revenues from FEEC sales are now half as large again as revenues from import duties (Rs. 450 million compared with less than Rs. 300 million of import duty revenues). Whilst the primary objectives of the FEEC scheme have been concerned with the management of the balance of payments and particularly the more efficient utilization of foreign exchange, the fiscal impact of the scheme has been enormously important. In essence what the FEEC scheme does from the fiscal point of view is to syphon off into the budget the scarcity rent which is attributable to foreign exchange. Of course to the extent that this high value of foreign exchange is required to induce an increased supply of foreign exchange by stimulating exports, it is not a rent surplus in the economic sense. As a consequence the only surpluses which are deemed to arise under the FEEC scheme are those which accrue to foreign exchange earnings by the traditional export sectors of the economy. Through the FEEC scheme the government mobilizes these surpluses instead of permitting them either to accrue to users of foreign exchange acquired at the official rate of exchange or to unofficial foreign exchange intermediaries.

COMPONENTS OF GOVERNMENT REVENUE

	Revenue (Rs.mn.)	Tax Revenue (Rs.Mn.)	Direct Taxes (Rs.Mn.)	Indirect Taxes (Rs.Mn.) /1	Revenue to GNP %	Taxes to Current Revenue %	Direct Taxes to Total Taxes %	Customs Duties to Total Taxes % /2	Export Duties to Export %	Import Duties to Imports %	Taxes per Capita (Rs. .)	Taxes per Capita in 1959 Prices (Rs.)
1960/61	1454	1212	581	631	21.7	83.4	47.9	60.5	14.8	19.7	122	122
1961/62	1607	1274	582	692	24.0	79.3	45.7	59.6	15.4	23.6	125	125
1962/63	1583	1236	571	665	22.6	78.1	46.2	54.3	14.3	19.7	118	118
1963/64	1617	1362	583	779	22.2	84.2	42.8	55.2	14.7	23.7	129	129
1964/65	1775	1432	637	795	22.8	80.7	44.5	51.6	16.3	20.7	131	131
1965/66	1804	1397	549	848	22.5	77.4	39.3	51.8	12.4	23.1	124	124
1966/67	1970	1486	559	927	21.1	75.4	37.6	50.0	12.5	25.2	130	125
1967/68	2157	1638	656	982	23.8	75.9	40.0	46.9	17.4	24.4	140	128
1968/69	2482	1999	705	1294	23.4	80.5	35.3	40.0	16.0	18.6	167	159
1969/70 /3	2737	2259	825	1434	23.3	82.5	36.5	29.5	16.5	10.6	184	n.a.
1970/71 /4	2766	2359	814	1545	22.2	85.3	34.5	27.7	16.6	11.2	188	n.a.

/1 Including FEEC's.

/2 Excluding FEEC's.

/3 Revised Estimate. This figure differs from the revised estimate of Rs. 2,753 given on page 25 of Volume I which was based on more recent data. This Table has not been amended as it provides the basis for the projection exercise undertaken later in this Report.

/4 Original estimate.

11. The following table shows that whilst the combined revenue from import duties and from FEEC sales has risen more rapidly than the rupee value of imports, this is not true of revenue from import duties on its own. In fact a 30 percent increase in the rupee value of imports during 1960's has been associated with a 30 percent fall in import duty revenue. This fall

IMPORTS, IMPORT DUTIES AND REVENUE FROM FEEC'S

	(i) Imports/1 (mill.Rs.)	(ii) Import Duties/2 (mill.Rs.)	(iii) Import Duties to Imports(in %)	(iv) FEEC	(v) (ii) plus (iv)	(v) as per-cent of(ii)
1961	1794	435	24.2		435	24.2
1962	1906	465	24.4		465	24.4
1963	1869	398	21.3		398	21.3
1964	1960	482	24.6		482	24.6
1965	1922	436	22.7		436	22.7
1966	2018	477	23.6		477	23.6
1967	1985	544	27.4		544	27.4
1968	2356	514	21.8		514	21.8
1969	2653	460	17.3	285	745	28.0
1970	2400	301	12.5	447	748	31.0

/1 Imports are derived from payments data by calendar year.
/2 Including import license fees. The import duties are by fiscal year (Oct.1 - Sept. 30) with the year in the table referring to the Sept. 30 date (e.g., 1961 refers to FY 1960-61).

has been precipitous since 1969. The fall is partly a reflection of the introduction of the FEEC scheme which inter alia replaced the previous import license fee which in 1967/68 had generated Rs. 67 million in government revenue (included in import duties). In part it also reflects the fact that the FEEC scheme replaced import duties on some items such as industrial raw materials.

12. More importantly still is the general impact both of foreign exchange shortage on the pattern of imports and of long-term structural changes in the economy upon this pattern. Both of these factors tend to increase the relative importance in the import bill of those commodities subject to lower rate of

duty. In a period of import austerity, the less essential and more highly taxed imports tend to be the first to be squeezed. It is, furthermore, these imports which are the first to be substituted by the development of domestic productive capacity. This process of substitution is itself encouraged by the high rates of effective protection typically given to such commodities. Unfortunately the detailed statistical information required to substantiate these general propositions is not available on a systematic basis. In any case both the import duty structure and the rates of duty on particular commodities have been changed on several occasions. However on examination of the rates of duty on those imports (classified in the balance of payments data NOT the trade data) which have varied most markedly during the 1960's, confirms the importance of changes in the pattern of imports in determining the fall in import duty revenues. There have been significant reductions in the value of imports of, for instance, dairy products, sugar, tobacco and beverages and textiles, all of which carry high rates of duty whilst significant increases have occurred in imports of chemicals, fertilizer, machinery and equipment, transport equipment, etc., most of which are imported duty free or at low rates of duty. An additional complicating element in this statistical analysis has been the entry into production since 1968 of domestic oil refinery capacity. Previously these refined products had been subject to import duties at the 100 percent rate but domestic production is now subject to turnover tax with a consequent fall in revenue from duties on mineral products from Rs. 154 million in 1968/69 to Rs. 37 million in 1969/70.

13. Revenue from taxes on domestic production has increased from over 100 million in the early 1960's to Rs. 700 million in the current year. Most of this increase has come from an all-round increase in the major sources of excise revenues, namely, sale of arrack, duty on country-made liquor and tobacco tax. Particularly the tobacco tax revenue was extremely buoyant rising during the six-year period 1963/64 to 1968/69 at a rate of 16 percent per annum. The turnover tax which was introduced in 1963/64 is less important than excise duties but it has been continuously increased in both rates and coverage so that revenue from it has risen from around Rs. 40 million in the mid-1960's to Rs. 111 million in 1968/69. Comparison with revenues in 1969/70 and in the current year is distorted by the inclusion of receipts from oil refining (see previous paragraph). In the current year turnover tax revenue is estimated at Rs. 279 million of which about half is likely to be from oil.

14. It would, of course, be wrong to conclude from this review of the tax performance of the Ceylonese authorities that nothing more can, or should, be done to increase revenues. What has undoubtedly been impressive is the extent to which successive governments have adjusted the tax system to reflect changes in the underlying structure of the economy. However it is apparent from the balance of payments problem, from the need of the government to resort to borrowing from the banking system and from the poor government savings performance -- all three magnitudes being interrelated -- that revenue performance has been inadequate given the level of government expenditure. The question arises, therefore, of where additional taxation could be levied. This matter is taken up later in the context of the recent budget proposals and of the general policy issues.

D. GOVERNMENT CURRENT EXPENDITURES

15. An inadequate government savings performance in a period in which revenue performance has been impressive clearly suggests that the major policy problems lie in the field of aggregate current expenditure level and growth. This is certainly a valid judgment on the Ceylonese problem and it is by no means a novel judgment. On the contrary it is a judgment which is in great danger of losing its validity and power through constant repetition. Yet whatever this danger, the logic of the Ceylonese resource problem must be repeated, namely, that just as none of the past revenue measures have generated any marked increase in government savings, so, likewise, no future revenue measures will do so unless the rate of growth of current expenditures can be curtailed. This is not to argue that current expenditure must be cut; only that its rate of growth cannot be sustained.

16. During the 1960's current expenditure increased by Rs. 1.3 billion which roughly equalled the increase in total government revenues and was greater than the increase in tax revenues of Rs. 1.1 billion. The components of this expenditure and their contributions to the increase over the period are given in the following table and the nature of the problem is apparent from the table.

17. Firstly, it is apparent that the problem does not lie with expenditure on economic services (agriculture, communications, fisheries, etc.). Current expenditure on these services has only accounted for around 6 percent of total current expenditure and, until 1969/70, was in fact falling as a percentage of this total. Not only would a relatively large proportionate cut in this expenditure be a small absolute amount, but, more importantly, this expenditure is in most instances an essential complement to investment outlays. It is little use, for instance, increasing investment in irrigation without adequate expenditure on extension services.

18. Social service expenditure is dominated by education with current outlays of Rs. 470 million in 1969/70. Health accounts for Rs. 240 million whilst expenditure on housing, special welfare services and community services are minor. The high ratio of recurrent to capital expenditure in the case of education is well known. The importance of teachers' salaries within the total recurrent expenditure can also be seen in the following table showing the percentage breakdown of education costs:

Education Costs	Per Cent
Teacher salaries	81.2
Non-teacher salaries	1.0
Debt services	1.2
Pupil Welfare Services	3.5
Facilities and Services	2.8
Teacher education	4.9
Administration	5.4

COMPONENTS OF GOVERNMENT EXPENDITURES/1

YEAR	Total Expenditure (Rs.Mn) (1)	Total/2 Expenditure to GNP (%) (2)	Current/2 Expenditure (Rs.Mn) (3)	Capital/2 Expenditure (Rs.Mn) (4)	Percentage of current expenditure to total expenditure (%) (5)	Percentage of capital expenditure to total expenditure (%) (6)	Government/3 consumption to GNP (%) (7)	Economic Services to current expenditure (%) (8)	Social Services to current expenditure (%) (9)	Transfers Payments to Current Expenditure (%) (10)	Food Subsidy to Current Expenditure (%) (11)	Real Expenditure in 1959/6 Prices (Rs.Mn) (12)	Real Current Expenditure in 1959/6 Prices (Rs.Mn) (13)	Public Investment to GNP (%) (14)
1960/61	1838	27.5	1392	446	75.7	24.3	13.6	6.3 (20.7)/4	29.6	45.0	27.3	1838	1392	6.8
1961/62	1937	28.8	1479	458	76.6	23.7	13.8	6.1 (18.7)	29.1	47.5	28.4	1937	1479	7.1
1962/63	1883	26.9	1512	371	80.3	19.7	14.0	7.4 (19.8)	29.5	47.7	28.4	1883	1512	5.3
1963/64	2015	27.6	1588	427	78.8	21.2	13.9	7.3 (19.7)	29.2	48.4	27.4	2015	1588	5.9
1964/65	2101	27.0	1654	447	78.8	21.2	14.0	6.5 (18.8)	29.9	47.6	26.7	2101	1654	5.7
1965/66	2252	28.1	1740	512	77.2	22.8	14.4	5.6 (17.9)	28.9	49.5	28.0	2252	1740	6.4
1966/67	2443	29.3	1836	607	75.1	24.9	13.9	5.9 (17.5)	29.0	49.4	25.3	2358	1772	7.3
1967/68	2772	30.6	2095	677	75.5	24.5	13.6	5.4 (16.2)	28.6	50.2	27.3	2526	1909	7.4
1968/69	3126	29.5	2309	817	73.9	26.1	13.3	5.4 (16.3)	28.1	51.7	26.9	2973	2196	7.1
1969/70	3405	28.9	2575	830	75.6	24.4	12.5	6.4 (15.4)	28.6	51.2	22.9	n.a.	n.a.	7.0
1970/71	3626	29.1	2689	937	74.2	25.8	14.1	6.5 (15.7)	28.2	50.1 (51.2)/5	22.7 (24.9)/5	n.a.	n.a.	7.5

/1 Expenditures have been reclassified except the fiscal year 1961/62, 1962/63 and 1963/64. Yet, the reclassification does not change the total picture basically.
/2 Excluding Government Enterprises.
/3 Annually calculated.
/4 Figures in brackets including Government Enterprises.
/5 Based on revised figure. Not official yet.
/6 Current figures deflated by imputed deflator for Public Administration and Defense in National Income Accounts (Main Report: Tables 2.1 and 2.2).

19. It is apparent that expenditure on education in particular but also that on health services heavily depend on the salary policy of the Government which will be discussed more generally in paragraph 23. In addition, expenditure depends on educational policy decisions. Of importance in this regard is the new Government's commitments to increase pupils' welfare measures (the mid-day's meals are to be improved and other measures are also contemplated.) Compulsory school attendance up to age 14 is to become law next Spring and in addition the new Government is committed to reducing the disparity between urban and rural schools and to increasing the scientific and vocational content of the second level curriculum in relation to manpower needs. This means that there will probably be an enhanced program of teaching agriculture at the second level and perhaps other scientific and technical subjects. It is impossible to indicate what the financial implications of these policy decisions will be and, more importantly, it is not certain that the Ceylonese authorities are aware of their financial implications. This is not to deny the probable benefits to be derived from the policy changes but to question whether, even in a general way, these benefits have been judged against the costs involved in implementing them.

20. The third category of expenditures -- i.e., transfer payments -- is clearly the largest single category of current expenditures and the most rapidly growing. It now represents over 50 percent of total current expenditure compared with 47 percent in 1961/62 having accounted for 55 percent of incremental current expenditure over this period. Simply limiting the rate of growth of this expenditure to the rate of growth of total current expenditures would have more than doubled government savings.

21. Transfer expenditure is dominated by the subsidy payments on rice. This has risen from around Rs. 400 million in the early 1960's to Rs. 600 million in 1969/70 and an estimate for the current year of almost Rs. 700 million. Due to its preponderant importance, even relatively small increases such as those generated by the normal growth in population have a very significant impact on total expenditure. The rice ration and subsidy arrangements have been subject to two major changes -- one in December 1966 (effective as from 1967) and the second in 1970. The change in 1966 had cut the rice ration from two measures (four pounds) to one measure (two pounds) but as partial compensation the previous price of Rs. 0.25 per measure was changed so that the single rationed measure was made available free-of-charge. In 1970 the government restored the ration to two measures of rice, the first of which would still be free but for the second measure the price is to be Rs. 0.75. The budgetary gains which had been expected to result from the changes made in 1966 failed to materialize because they coincided with a very large jump in the world price of rice which in 1967/68 raised its average landed cost in Ceylon by around 50 percent.

22. In Table 7 an estimate is made of the budgetary implications of the 1970 decision to restore the ration to two measures and the related price decision (allowing also for the effect on flour consumption). This estimate suggests that the net budgetary subsidy for rice and flour would have increased slightly by Rs. 10 million in 1970/71 had the ration not been doubled

(from Rs. 447 million to Rs. 457 million). The fall in the world price of rice was more than offset by the increased consumption resulting from an assumed 2.5 percent increase in population but this potential gain in respect of rice has been more than offset by the higher cost of flour. In fact it is estimated that the net rice and flour subsidy in 1970/71 will be raised by over Rs. 90 million as a consequence of the decision to double the rice ration (from Rs. 457 million to Rs. 548 million).

23. In contrast to many other developing countries, Ceylon's government expenditure growth problem during the 1960's does not seem to have been caused either by a rapid growth in government employment or by a rapid increase in the per-capita payments to these employees. The following tables show that government employment went up on average by less than 1.5 per annum from 1963 to 1969. Furthermore of the increase of 27,000 people over this period, over 12,000 were teachers. Wage rates of all government employees including teachers were frozen from 1958 to 1966 and as a consequence their real wages fell during the first half of the 1960's by about 7 percent. Wage increases granted since 1967 have on average restored the real wage rates to the level which existed in the late 1950's and early 1960's and it appears that automatic adjustment of salaries to increases in the cost of living is accepted government policy despite the overall financial and balance of payments problem of the government. However, in an attempt to restrain the expenditure on wages and salaries which this implies, the government has reduced the total outlay on teachers by keeping new recruits in pupil-teacher status beyond the normal period. This probationary status carries a salary of Rs. 100 per month as compared with Rs. 200 per month for non-graduate teachers and Rs. 150 per month, as compared with Rs. 475 per month, for graduate teachers.

GOVERNMENT PERSONNEL AND GOVERNMENT EXPENDITURE

	1963	1964	1965	1966	1967	1968	1969
Government Personnel (in 1000) (including teachers)	299.9	316.2	310.1	313.3	317.2	322.3	327.4
Number of teachers* (in 1000)	81.1	93.8	92.0	88.7	87.8	91.0	93.4
Personnel Expenditure (Rs. million)	964.6	1009.6	1028.0	1046.5	1088.2	1189.2	1361.9
Government Personnel to total population (in percent)	2.82	2.90	2.78	2.74	2.71	2.69	2.67
Government Personnel to Economically Active Population (in percent)	9.37	9.70	9.33	9.25	9.19	9.17	9.14

*Central Bank and Ministry of Education

WAGE RATE INDEX NUMBERS FOR GOVERNMENT EMPLOYEES /a

(1952 = 100)

Year	Technical and Clerical Employees		Minor Employees		Central Government Employees /b		Government School Teachers	
	Wage Rate Index	Real Wage Rates	Wage Rate Index	Real Wage Rates	Wage Rate Index	Real Wage Rates	Wage Rate Index	Real Wage Rates
1957	111.2	108.2	116.0	112.8	113.8	110.7	113.9	110.8
1958	122.3	116.5	130.4	124.3	126.7	120.7	117.4	111.8
1959	122.3	116.3	130.4	124.0	126.7	120.4	117.4	111.6
1960	122.3	118.2	130.4	126.0	126.7	122.4	117.4	113.4
1961	122.3	116.7	130.4	124.4	126.7	120.9	117.4	112.0
1962	122.3	115.0	130.4	122.6	126.7	119.2	117.4	110.4
1963	122.3	112.4	130.4	119.9	126.7	116.5	117.4	107.9
1964	122.3	109.0	130.4	116.2	126.7	112.9	117.4	104.6
1965	122.3	108.7	130.4	115.9	126.7	112.6	117.4	104.4
1966	122.3	108.9	130.4	116.1	126.7	112.8	117.4	104.6
1967	125.4	109.2	136.2	118.6	131.3	114.4	119.4	104.0
1968	140.1	115.4	163.0	134.3	152.6	125.7	129.6	106.7
1969								
1st Quarter	140.1	109.7	163.0	127.6	152.6	119.5	129.6	101.5
2nd Quarter	140.1	107.9	163.0	125.5	152.6	117.5	129.6	99.8
3rd Quarter	140.1	107.5	163.0	125.0	152.6	117.0	129.6	99.4
4th Quarter	157.2	117.2	182.9	136.3	171.3	127.7	141.1	105.2
Average	144.4	110.6	168.0	128.6	157.3	120.4	132.5	101.5

/a These indices do not represent actual earnings of the workers which depend on the number of days worked, number of hours worked overtime and other payments such as bonuses. The sharp increase in 1969 is the result of the payment with effect from October 1, 1969, of consolidated salaries as recommended in the Interim Report of the Salaries and Cadres Commission, 1969.

/b Combined index for clerical and technical employees and minor employees.

Source: Central Bank of Ceylon

E. PROSPECTS, PROBLEMS AND THE 1970/71 BUDGET

24. The following tables present the outcome of budget projections made for 1974/75.

CURRENT REVENUE AND PROJECTIONS

(million of Rs., selected years)

	1961/62	1964/65	Revised Est. 1969/70	Mission's Projection 1974/75
Customs Duties	759	752	673	648
Export Duties	294	316	372	341 /a
Import	366	321	301	307
Receipt from FEEC	-	-	447	420
Excise Duties	169	239	381	682
Turnover Tax	99	150	242	423
of which:				
Revenue from Petroleum Products	(99)	(115)		
Profits from Food Sales	190	187	252	185
Taxes on Income & Profits	288	321	453	421
of which: Income Tax	262	293	440	-
Other Taxes	58	98	69	89
Miscellaneous Receipt	150	144	220	328
Total	1607	1775	2737	3191

Note: Projections derived from historical trends except in case of export duties (see footnote /a).

/a The export duties for 1974/75 were predicted by a regression of the export duties on the export price and the export quantity of tea and the value of other exports, using the data for the period from 1960/61 to 1968/69. The 1974/75 export price and export quantity of tea were IBRD (Economics Department) estimates while the value of other exports for 1974/75 were predicted from the time trend for 1960/61 to 1968/69.

CURRENT EXPENDITURE AND PROJECTIONS
(selected years)

(in millions of Rupees)

	1961/62 /1	1964/65	Revised Estimate 1969/70	Mission's Projection 1974/75 /2
1. Administration and Defense	252	260	441	485 /3
2. Social Services	430	495	737	960
Education	270	328	471	690 /4
Health	141	148	240	270 /5
3. Economic Services	90	108	166	206 /6
4. Transfers	705	791	1322	1985
Food Subsidy (gross)	421	442	596	1020 /7
Interest Public Debt	83	105	281	413 /8
Pensions	95	127	191	243 /8
Other Transfers	107	115	240	309 /10
5. Unallocated FEEC Expenditure	-	-	17	39 /11
6. Under Expenditure Provisions	-	-	-107	-74 /12
Total	1479	1654	2575	3611

/1 1961/62 figures based on revised classification scheme.
/2 Projection in 1970/71 prices.
/3 A 4% growth rate p.a. has been derived from historical data adjusted by applying the implied index of prices of public administration and defense expenditure in the National Accounts for the years 1960/61 to 1970/71.
/4 Based on a projection prepared by the Ministry of Education. In this draft recurrent expenditure for level I and II which comprises about 75% of total expenditure on education had been estimated. 25% were added to this estimate.
/5 A 3% growth rate p.a. has been derived from historical data adjusted by applying the implied index of prices for services. Note that the price index for total services may overstate the prices of the public sector.
/6 Economic services derived from historical data adjusted by the implied price index from administration and defense in National Accounts.
/7 Rice: The total rice requirement under ration in 1970/71 is estimated at 960,000 tons. Taking into account a population increase of 2.2 percent annually, the total requirements of rice in 1974/75 will be around 1,200,000 tons. The estimated production of paddy in 1974/75 is 108 million bushels or a rice equivalent of 1,543,000 tons. Assuming that 60 percent of this production will be available under the GPS Scheme, the local purchases will be around 926,000 tons. Thus the balance requirments of 274,000 tons will have to be met by imports. The cost of local rice of 926,000 tons at Rs. 1,150 per ton will be around 1,065 million Rupees, and the imported rice of 274,000 tons at Rs. 693 per ton will cost around Rs. 190 million. Thus the total cost of rice issued on ration will amount to Rs. 1,255 million. Assuming that the rice issued under the first measure and the second measure will be on the ratio 5:4 respectively, the issue of rice in 1974/75 under the first and second measures will be 670,000 tons and 530,000 tons respectively. Thus the figures for 1974/75 compared with 1970/71 are as follows:

	Revised Estimate 1970/71	Forecast 1974/75
1. Subsidy to the consumer on imported rice) 2. Subsidy to the consumer and producer on locally produced rice)	604	810
3. Subsidy on locally produced red onions	9	10
4. Distribution charges	80	100
5. Rice Subsidy Tax	3	-
6. Total Gross Subsidy (Add 1 to 5 - 6)	689	1020

The assumption in this exercise that 274,000 tons will be imported in 1974/75 is likely to be revised considerably for balance of payments reasons. In this case domestic procurement under GPS which have to be increased above 60 percent. If we assume procurement of an additional 100,000 tons under the scheme this would increase the net subsidy from the budget by about Rs. 45 million to Rs. 1,065 million. Complete self-sufficiency in rice would raise the subsidy by Rs. 125 million to Rs. 1,145 million.

/8 Based on actual expenditure figures received up to July 1970 as reported by the Pensions Division (Rs. 179 million). The estimates are based on the assumption of existing commitments.
/9 The assumptions are: Current financial liabilities less interest of repayments due in the next four years plus interest on loan to be raised (Rs. 300 million p.a. assumed) with 9.5% that is Rs. 301 million. For short-term borrowing the maximum borrowing of Rs. 2,050 million is assumed and applying rates at 4.76% for Commercial Banks and 3.2% for the Central Bank borrowing the total payment is Rs. 69 million. Interest on loans from external sources as actually commited (Rs. 42 million).
/10 A hypothetical figure based on the assumption that "other transfers" in recent years was constantly 9% of total current expenditure. This is an approximation estimate.
/11 No information available yet, after the introduction of the system one might assume that the unallocated FEEC expenditure remains constant.
/12 A hypothetical figure assuming an under-expenditure of 2.1%. This figure might be overestimated since there has been a progressive reduction in under-expenditure since 1966/67. This is an approximation estimate.

25. The aggregate outcome of the projection exercise is very clear. Government savings, which both currently and throughout the 1960's have been seen to be grossly inadequate in relation to the investment financing needs and to the needs of balance of payments management, are projected to be negative by over Rs. 400 million by 1974/75. Argument about the precise basis of any component in the projection exercise should not divert attention from this major conclusion. What has to be emphasized, furthermore, is that the need for generating savings through the budget is even greater than it was during the 1960's as a result of the changes in tax policy introduced by the government in the 1970/71 budget which will be examined later in this section. These changes effectively reduce the ability and willingness of the private sector to save.

26. As regards the need and opportunities for increasing revenue, it is important to recognize that the 1974/75 projections in the above table already imply tax policy changes which will generate increased revenues equivalent to those tax policy changes introduced during the 1960's. This is because the historical experience used for the projections is a measure of revenue buoyancy (i.e., built-in elasticity plus the net revenue effect of autonomous tax changes) and NOT simply a measure of the built-in revenue elasticity of taxation. Unfortunately it has not been possible to measure this latter concept. It is apparent, however, that successive governments in Ceylon have had to introduce new tax measures especially in the area of indirect taxation (including FEEC's) in order to maintain the revenue buoyancy. Government over the next few years will have, therefore, to be as active as past governments in order to achieve the same degree of revenue buoyancy unless it can be assumed that the tax structure is now more income-elastic. In fact this assumption probably has some validity as a consequence, in particular, of the development of more comprehensive taxes such as the turnover tax at selective rates. However an annual rate of growth of revenues of 6 percent (equivalent to the projected rate of growth of current expenditure) would require a built-in elasticity of taxation of 1.5 given a continuation of the average annual rate of growth of real national income of 4 percent during the 1960's. An elasticity this high for the period up to 1974/75 seems unrealistic in relation to a historical buoyancy of approximately unity.

27. The 1970/71 budget indicates the extent to which the present government has had to go in order to ensure that for the current year revenue will increase adequately to meet the growth in current expenditure (at least given the budgetary accounting used by the government). To begin with, the budget contains a series of tax measures which develop and consolidate the tax system in the same direction as similar measures which have been taken over the past decade or more. Most important in this regard are the indirect tax measures. Excise duties on cigarettes, beer and bottled toddy have been increased and so, also, have the business turnover taxes on a whole range of products (petrol, cosmetics, air conditioners, refrigerators, tableware, radios, confectionery, jewelry, non-pure cotton textiles, wines and spirits, clothing, processed foods, electrical goods, etc.). In the same category can also be placed the increased fees on motor vehicles (transfer fees,

driving licence fees and annual motor vehicle license fee). These increases in indirect taxes are expected in aggregate to raise over Rs. 70 million in extra revenues. A further Rs. 60 million in extra revenue is expected from a revision of the level and structure of import duties. This is to be derived in particular from a steep increase in the duty on beedi-leaves from 21 cts. to Rs. 51 per pound, an increase in duty on certain textile imports from 10 cts. to 25 cts. per square yard and a 5 percent duty on a large number of raw materials and capital goods previously allowed duty free.

28. Undoubtedly further increase in the rates of indirect taxes on both domestic production and on imports are in principle possible though, as has already been emphasized, the fact that Ceylon's performance in this area of policy has been very impressive in the past as compared with other developing countries, should sound a cautionary note against exaggerating the extent to which additional measures in any one year are practicable. It is certainly difficult to believe that the tone of emergency in which the 1970/71 budget was presented can be repeated each year and yet it is probably only in this context that further major changes additional to the "normal" increase in indirect taxation, can in practice be presented. One obvious direction in which an extension of the tax base could occur would be to embrace consumer services -- restaurants, hairdressing, dry cleaning, etc. Extension of the tax base in this way is desirable but should, quite obviously, only be pushed as fast as the administrative capacity of the revenue departments permits.

29. An area of revenue generation which is closely related to that of indirect taxation is the generation of additional profits (or reductions of losses) by public sector industries, public utilities and public trading activities.

30. Firstly, the government has continuously made profits from certain food sales. In effect, of course, this represents an excise duty or an import duty on these foods. Most of this tax falls on sugar and to a much lesser extent on flour. From 1970/1971 onwards part of the tax will fall under revenue from FEEC's because sugar imports are to be subject to the FEEC rate of exchange.

31. Secondly, government enterprises have been continuous earners of net revenue for the budget (on a cash basis). However, this has been primarily the outcome of the contributions of the Electricity Department and the Broadcasting Department both of which have recently been converted into public corporations. This sector now consists simply of three groups of activities: railways, ports, harbour and warehouse; and ports and telecommunications. Railways are continuously in deficit and no precise action has yet been announced to alter this situation.

32. Precise action is proposed in the budget for the other two enterprises; viz:

	Estimated Increase in Revenue in Rs. million	
Ports, harbour & warehouse	7	(25% increase in port charges to adjust to new exchange rate)
Ports & Telecommunications	15	(increase in rates on foreign mail, telegraph charges, telephone calls and rental charges)

33. Thirdly are the public corporations. The Budget proposes to raise the contribution of these to general revenues from an original estimate of Rs. 15 million to Rs. 60 million. The major contributors are to be the CWE (Rs. 15 million), the Cement Corporation (Rs. 10 million) and the Petroleum Corporation (Rs. 10 million). The details are as follows:

	Rs. million
CWE	15
Insurance Corporation	5
Electricity Board	5
National Textile Corporation	2
Cement Corporation	10
Petroleum Corporation	10
Ceramics Corporation	3
Salt Corporation	0.5
Plywoods Corporation	0.3
Steel Corporation	2
Eastern Paper Mill Corporation	2
Tyre Corporation	2
Mineral Sands & Parantham Chem. Corps.	0.3
Sri Lanka Sugar Corporation	1
Fertilizer Corporation	0.5
Banks and Joint Stock Companies	0.75
Total (Approx.)	60.00

34. Subsequently the revenue estimates were revised to increase this contribution to Rs. 104 million plus an additional Rs. 10 million in respect of the railways. However even the former estimate of Rs. 60 million would represent a rise from Rs. 22.5 million in 1969/70 (revised estimate). Furthermore, an undetermined part of the total will simply be an internal accounting transfer within the consolidated public sector because it is to represent the allocation of profits to the account of the Central Government

GROSS PUBLIC SAVINGS

(millions of Rs.)

	1965/66	1966/67	1967/68	1968/69	1969/70	Original Estimate 1970/71
Central Government/1	97	164	72	203	184	131
Local Government/2	-25	-25	-25/2	-30	-40/2	n.a.
Public Corporations/3	10	20	53	63	57	n.a.
Employees Provident Fund /4	74	80	86	104	103	138/5
TOTAL	156	239	186	340	304	---

/1 Including extra-budgetary revenue and surplus of government enterprises.
/2 Mission's estimate
/3 Financial year April to March 31. The years 1965/66 and 1966/67 might be under-estimated due to lack of information.
/4 Year lasting from January 1 - December 31.
/5 This estimate has been raised by Rs. 35 million to reflect the increase in E.P.F. rates, coverage, etc., announced in the budget as part of the Compulsory Savings Scheme (the increase in E.P.F. contributions was estimated in the budget for a full year at Rs. 70 million).

GROSS FIXED CAPITAL FORMATION IN THE PUBLIC SECTOR

(Rs. million)

	1965/66	1966/67	1967/68	1968/69	1969/70	Original Estimate 1970/71
Central Government/1	354	425	492	532	565/2	670/2
Local Government	17	17	17	21	21/3	30/3
Public Corporations	210/3	435	406	563	610	610/3
(incl. transfers from Central Government)	(186)	(230)	(257)	(327)	(247)	(274)
TOTAL	578	877	915	1116	1196	1300

/1 Including capital expenditure of government enterprises, excluding acquisition of financial assets, excluding transfers to public corporations and local governments.
/2 Adjusted by under-expenditure provisions.
/3 Proxi estimate.

which is asserting its right to have a prior claim on surpluses rather than being the residual legatee of surplus revenues. The remainder is to come from unspecified measures to raise prices and increase efficiency.

35. These budget proposals relating to government enterprises and public corporations are undoubtedly pointing in the correct direction. Particularly in a situation in which the conventional budget tax policies cannot be relied upon to generate an adequate flow of funds for financing the investment outlays of the autonomous or semi-autonomous public enterprises, these enterprises must become more self-financing on capital account. The following tables show, for instance, that out of total capital expenditure by public corporations of Rs. 610 million, only Rs. 57 million was financed internally. (It should be emphasized that this latter figure is very tentative and that in general much more statistical knowledge of the financing of the public corporations is desirable.) A higher level of self-financing is particularly necessary in the case of those enterprises producing consumer goods and services. For some of these, furthermore, this requires in the first place that they become self-financing on current account. Outstanding in this connection is the Ceylon Transport Board which is currently making a loss of Rs. 35 million and whose level of charges is low not only in relation to costs but also in relation to changes in real and money incomes over recent years. There are clear signs that the government recognizes the need in principle to make the CTB and other public corporations more self-supporting but specific action has still to be taken.

36. In addition to these tax increases in relation to import duties, excise duties, turnover tax and public corporations, the government has also introduced three emergency "once-and-for-all" measures, the revenue from which is budgeted to be much larger than that from the more conventional tax measures. They are expected to generate Rs. 220 million of revenue in 1970/71 as compared with Rs. 171 million from the tax measures. The three measures are:

	Rs. million
a. Tax Revenue from demonetization	100
b. The Capital Levy	5
c. The Compulsory Savings Scheme	115
	220

Tax Revenue from Demonetization

37. The estimate of Rs. 100 million appeared originally to be largely guesswork and a figure of Rs. 20 million for 1970/71 was thought to be a more realistic estimate.1/ However, the demonetization itself has been successful (Rs. 785 million out of Rs. 792 million of currency issue in Rs. 50 and Rs. 100 notes having been surrendered).

1/ The Minister of Finance is reported as having stated in Parliament that the revenue from demonetization was already Rs. 101 million (Source: Sun, 8 March 1971).

38. The revenue to be derived from this measure is clearly of a once-and-for-all nature except to the extent that it indirectly deters future tax evasion. However, the budget admits that settlement of tax liability will be much less than the formal tax arrears so that this amnesty feature is more likely to encourage than to discourage future tax evasion. Certainly the hopes which were expressed at the time of the amnesties of 1964/65 and 1965/66 give little grounds for optimism in this connection.

39. There are arguments for accounting this revenue as a capital item. It clearly does not qualify under the administrative heading "recurrent" revenue. At the same time, from the economist point of view, there are, presumably, reasons to believe that a significant proportion of these notes were being held as financial assets. Ideally, of course, this proportion should go in capital receipts and the balance in current receipts. In the absence of this information and because of its non-recurring nature it should be classified as a capital item rather than being accounted in such a way that it appears to represent an increase in the ability and willingness of government to generate savings.

The Capital Levy

40. This is estimated to raise Rs. 5 million in total. The rates are to rise progressively from 3 percent on the first Rs. 200,000 of leviable capital to 25 percent on leviable capital holdings over Rs. 800,000. It is possible that the levy will be paid out of income at the bottom end of the scale. For instance, at this end of the scale, if a 10 percent rate of return on capital is assumed, the levy amounts to an additional 30 percent tax on income which at the level of income (i.e., Rs. 30,000) would be subject to a marginal tax rate of 30 percent but an average rate of only about 13 percent. For larger capital holders the situation is markedly different. For instance, at the Rs. 1 million level of assessable capital, and an assumed 10 percent income of Rs. 100,000 the marginal capital levy will be 25 percent and the average will be about 12 percent which is, of course, in excess of the assumed income. This pre-tax income will already have been subject to an effective rate of tax of about 62 percent.

41. Arrangements are contemplated by which liability can be met both by installments and by transfer of property to the government though not by the "takeover of properties which are in good production and in efficient condition." Furthermore, the arrangements made for assessing the levy suggest that there will be considerable scope for delaying payment. Despite these arrangements it seems inevitable either that capital will have to be realized (probably at a considerable discount compared with the valuation of 31st March 1970, thus increasing the effective rates of the levy) or there will have to be mortgaging or borrowing from the banking system. Thus the revenue effect of the levy would appear to be far less important than its effect on monetary and financial markets and, of course, on the distribution of property.

The Compulsory Savings Scheme

42. This is a progressive levy on persons and companies. For persons' earnings between Rs. 6,000 and Rs. 12,000 the rate will be 2 percent of total income (collected as a surcharge in respect of E.P.F. contributors) rising to 20 percent on total income for incomes over Rs. 140,000. For companies, it is 50 percent of profits, after deductions of income tax and dividends, unless declared dividend is over 12 percent in which case the compulsory saving levy is 100 percent of the excess. Interest on compulsory savings is to be 5 percent. Whilst there is no provision for repayment it is understood that the Government hopes to convert these compulsory savings into non-marketable 10-year bonds (or other maturities at differing interest rates) during the course of the next three or four years.

43. It is expected that in a full year almost Rs. 175 million will be derived in revenue from the Scheme (Rs. 115 million in 1970/71). This comprises Rs. 35 million under the EPF portion of the Scheme and an assumed Rs. 80 million under the non-EPF portion. The Scheme is conceived as a once-and-for-all emergency measure. As such, it may be met out of consumption or out of discretionary savings. However, if it were to be repeated over several years it would also be likely to reduce contractual saving as well. Furthermore, the Government has undertaken a debt service obligation on the levy which, once again, means that it should be treated as a capital receipt.

44. These three budgetary measures predominantly represent, therefore, a transfer of private savings to the government. The increase in the payments to be made by the public corporations to the government are also, as the budget itself points out, in part a transfer of savings to the government in this case from other parts of the public sector. In general the overwhelming emphasis in the budget (including the revised interest rate policy) is on the transfer of existing savings flows into the government budget rather than the mobilization of additional savings. This is very understandable in the context of a country in which existing tax levels are high. As already emphasized, there are limits to the rate at which tax levels can be increased. These limits derive both from administrative considerations and from the difficulties stemming from the nature of the structural changes which are taking place in the economy -- particularly the problems stemming from the changes in the traditional export sectors and in the level and pattern of imports. There are, in addition, needless to say, the political limitations to increased taxation. In fact it is important to recognize that the level of taxation is not a simple function of political determination, but also of basic constraints stemming from the economic structure of a country and from the need for an effective assessment and collection apparatus of administration.

45. This emphasis in the budget on the transfer of savings rather than on the generation of additional savings must be seen not only in terms of its revenue implications and its aggregative impact on the economy in 1970/71 though these considerations are of great importance. It must also be seen

in terms of the impact which these measures to transfer private savings to the budget will have on the ability and willingness of individuals and companies to save in the medium and longer term. In the case of the capital levy, for instance, not only is the ability of people to save reduced by the reduction in the flow of income they receive from their assets, but it is difficult to believe that their willingness to build up additonal assets will be unaffected by the levy -- or, more specifically, by the expectations of future levies which are thereby created. Theoretically the wealth-effect could more than offset this but it is hard to believe that this would be a realistic assumption to make. Likewise the compulsory levy on companies which effectively sets a ceiling of 12 percent on their dividend distributions seems certain to deter corporate savings generation in the longer run through the discouragement it provides to greater efficiency and general cost consciousness.

46. It seems reasonable to conclude, therefore, that these once-and-for-all emergency measures were taken for a combination of two reasons. Firstly, for meeting the immediate budget needs and, secondly, for distributional reasons. No quarrel can be had with these two objectives providing their implications are realized. Their implication in fact is that the need for mobilizing resources through the budget for financing investment is increased as a consequence of the impact of the measures on private savings. Furthermore, resort cannot by definition be made to once-and-for-all emergency measures regularly each year. If, furthermore, the limits to additional tax revenue generation have been approached if not reached in the 1970/71 budget, then of necessity the government must examine both the level and rate of growth of its current expenditure obligations under existing policies.

F. FINANCING OF GOVERNMENT EXPENDITURE

47. The diminishing current surplus has presented the government with an increasingly urgent problem of financing its investment expenditure. The sharp increase in expansionary financing which occurred in 1969/70 is expected to be reversed in 1970/71 when an increased level of capital expenditure is expected to be financed by an increase in both net foreign loans and grants of Rs. 338 million and, more particularly, in non-bank borrowing of Rs. 441 million. The latter increase is expected to result both from additional government bonds to be bought by the Provident Fund and a further Rs. 80 million from the non-EPF portion of the compulsory savings plan.1/ Borrowing from the Central Bank and commercial banks was originally estimated to be Rs. 97 million but the revised estimates show that the government's current account is likely to be in surplus by only Rs. 13 million and therefore the expansionary financing is likely to rise to at least Rs. 225 million.

48. The following table shows how heavily dependent the government is on outside sources -- from capital inflow, parafiscal funds and the private sector -- for the financing of its investment. Government savings in 1969/70 contributed only very little to the overall capital formation and its share is expected to diminish further if no correcting policy measures are introduced.

1/ Rs. 105 million are included in the original estimate but only about 75 percent of this amount will be collected in the fiscal year.

FINANCING GOVERNMENT CAPITAL EXPENDITURE REVISITED

(million Rs)

	1968/69	Revised Est. 1969/70	Original Est. 1970/71	Revised Est. 1970/71
Capital	937	930	1054	1017
I. Non-expansionary financing	758	440	965	792
(a) Domestic sources	404	251	474	454
(current surplus)	(149)	(23)/1	(131)	(+13)/2
(non-bank borrowing)	(203)	(228)	(343)	(441)
(administrative borrowing)	52	-	-	-
(b) Foreign sources	354	189	491	338
II. Expansionary Financing	179	490	97	225 /3

/1 Current surplus of current account (Rs. 184 million) minus advance payments (net Rs. 161 million). In the original estimate the effect of the advance account was assumed to be neutral.

/2 Public savings (Rs. 106 million) minus advance payments (net) Rs. 93 million.

/3 To finance this gap, the Treasury intends to borrow about Rs. 100 million from bank sources and to obtain Rs. 125 million in trade credits on loan purchases abroad.

69. The problem which is highlighted for 1970/71 in the above table can also be examined in a longer-term context. The following table assumes that government capital expenditure increases by 15.5 percent annually up to 1974/5 and that the revenue and expenditure projections presented on page 13 above for the year 1974/75 can be used to interpolate for the intervening years. The base year is taken as 1969/70 so that the 1970/71 figures do not coincide with the estimates for this year.

GOVERNMENT'S PROJECTED RESOURCES GAP

	1969/70	1970/71	1971/72	1972/73	1973/74	1974/75
Revenue /1	2737	2822	2909	3000	3094	3191
Current Expenditure /1	2576	2756	2948	3154	3374	3611
Adjustments /2	30	30	30	30	30	30
Current Surplus	+190	+ 96	- 9	-124	-250	-390
Total Capital Expenditure /3	930	1074	1240	1432	1654	1910
Advance Payments (Net) /4	160	-	-	-	-	-
Net Cash Deficit	900	978	1249	1556	1904	2300

/1 The revenue and current expenditure projections for the years 1970/71 to 1973/74 have been derived as straight line interpolations of the 1974/75 projections presented earlier (see pages 12 to 13).
/2 Surplus of Government Enterprises and Extra-Budgetary Revenue. Instead of calculating the historic trend which would give a wrong picture a constant is given which seems to be a more realistic estimate.
/3 A 15.5 percent increase per annum had been assumed.
/4 Advance payments are assumed to be neutral.

50. The resource problem raised in this table is very clear. If a reasonable (say, 15.5 percent) rate of increase in government investment is required in order to increase the growth of the economy, and if capital imports must be severely limited for debt-servicing reasons, the resource deficit implicit in present policies very rapidly grows. This growth cannot be met by non-Bank borrowing and it is certainly unlikely that the present revised estimate of Rs. 441 million will be achieved. This estimate is almost double the amount raised in 1969/70. Nevertheless the government should develop financial policies, institutions and instruments both for more effectively generating and mobilizing private savings. To this end the government has proposed the creation of a National Savings Bank which will consolidate and develop the operations

SAVINGS DEPOSITS AND SAVINGS CERTIFICATES
(in Rs.million)

	Dec. 1967	Dec. 1968	Dec. 1969	Change Dec.67/ Dec.68	Change Dec.68/ Dec.69
Post Office Savings Bank	450.6	473.3	489.7*	+ 22.7	+ 16.4
Ceylon Savings Bank	93.2	100.3	98.8*	+ 7.1	- 1.5
Commercial Banks (Time and Savings Deposits)	686.6	801.2	969.3	+ 114.6	+ 168.1
Savings Certificates Outstanding	78.7	91.3	86.6*	+12.6	- 4.7
TOTAL	1309.1	1466.1	1644.4*	+ 157.0	+ 178.3*

Source: Central Bank of Ceylon
*Provisional

of existing small savings institutions particularly in their operations in rural areas. The People's Bank is also intending to step up its savings-oriented activities especially in rural areas.

51. Of central importance in these efforts to mobilize private savings is, of course, interest rate policy. Central Bank policy has been much more concerned with regulating the demand side for commercial bank funds[1] than promoting the supply side. Increases in interest rates offered to depositors have been marginal and in general these rates represent almost a zero real rates -- e.g., time deposits (3-12 months) carry an interest rate of 4 percent and savings deposits 3.75 percent as compared with an average annual increase in the Colombo cost of living index of 3.5 percent during the 1960's. There are now signs that the government recognizes the significance of interest rate policy for savings mobilization. Interest on Post Office Savings Bank deposits has been doubled from 3.6 percent to 7.2 percent and the rate on 5-and 7-year government bonds has been raised from 6 to 9 percent.

52. Whilst the relevance of interest rate policy to savings policy must be emphasized, it must also be emphasized that the servicing of the public debt raises its own budgetary problems for the future.[2] It would clearly be shortsighted for the government to postpone dealing with a current weak budgetary situation by creating an aggravated budgetary situation for future years. Interest on the public debt has been the fastest growing current expenditure item during the 1960's and its undisciplined increase in the future would simply delay and aggravate the need to take budgetary action. If a rational interest rate policy is to be pursued which ensures that interest rates are used for mobilizing and efficiently utilizing private savings, then it can only be pursued in the context of a disciplined budgetary situation. In this regard, interest rate policy is analogous to government wage and salary policy which is commented upon below.

G. SUMMARY

53. Inevitably, therefore, the logic of the Ceylonese resource problem comes back to the current expenditure growth problem. The precise choices to be made in this regard can clearly only be decided by the government itself in the light of its own priorities. There are, however, constraints on its choices particularly in the short run. For instance, expenditure on economic services is already inadequate and in any case represents only 6 percent of total expenditure and an even smaller proportion of incremental current expenditure up to 1974/75. Pensions and interest on debt are contractual obligations which cannot be repudiated though as was emphasized in paragraph 52 above the rate of growth of interest payments depends on how much and how

1/ For instance, the ceiling imposed in October 1968 and its revision in June 1969 sought to limit the expansion of credit by the commercial banks to the private sector by 8 percent and 7 percent, respectively, of the base data chosen. Credits exempted from the ceiling among others are export bills, loans under the agricultural credit scheme, tea factory modernization loans.

2/ In ten years, public debt charges increased from Rs. 83 million to Rs. 309 million. It comprises interest on rupee loans, treasury bills, tax reserve certificates, temporary borrowing from domestic resources, national development bonds and borrowing from foreign sources.

rapidly the budget is brought under control.

54. The table on page 13 shows that at least 40 percent of the projected increase in current expenditure between 1969/70 and 1974/75 will arise from the increase in the gross food subsidy. This represents an increase of over 11 percent per year for an item of expenditure which already accounts for almost a quarter of government current expenditure and which is expected to account for 30 percent by 1974/75. The reintroduction of the second rice ration by the government in 1970 has raised the annual expenditure on the rice subsidy by about Rs. 100 million.

55. Expenditure on public administration, defence, education and health is particularly sensitive to changes in wage and salary payments. Attention has already been drawn (see para. 23 above) to the major problem in this connection. This is that the termination of the wage and salary freeze in 1966 has led to a restoration of real wage rates in the government sector but at the cost of a more rapid rise in government expenditure than was desirable in the light of the fiscal and balance of payments situation. A previous Bank Economic Report regretted the fact that "the Salaries Commission emphasized the cost of living element while in the Commission's terms of reference this criterion ranked second to the cardinal point of the financial resources available to the government." It appears that a more or less automatic adjustment of wages to the cost of living will take place in the future. In addition it seems likely that the restraint on total teacher salaries through the device of extending pupil-teacher status, beyond the normal period, cannot be maintained indefinitely. There are, of course, strong reasons of equity and of economics for ensuring that public sector wages and salaries do not lag behind, or too far behind, those in the private sector, just as there are strong reasons for ensuring that interest rates in the organized financial sector and specifically on the public debt do not lag too far behind their "free market" levels. At the same time there are strong reasons of equity and of economics for ensuring that inflation resulting from a too-expansionary budget policy are avoided and if one of the ways of avoiding these is by restraining government sector wages and salaries, this might on balance be desirable. The question must at least be faced whether "taxing" public employees (and public debt holders -- including post office depositors, pensioners, etc.) through constraint on their earnings is less equitable or has a less distorting effect on the labour (capital) market than an inflation "tax" or a lower rate of economic growth.

56. Finally, one institutional feature which requires emphasizing is that the budget procedure is heavily biased towards a requirements approach. The needs are defined by spending Departments which in turn largely determine the final budget allocation. The emphasis in this procedure is the elimination of extravagance rather than a weighing of alternative expenditure policies. Even the introduction of a Planning-Programming-Budgeting System (PPBS) in 1969/70 on an experimental basis for nineteen selected departments under the Ministries of Education and Cultural Affairs, Health and Land and Irrigation and Power, can only be effective in improving the efficiency of expenditure within these Departments. PPBS can operate effectively in relation to the

policy issues raised in this Report only if it comprises the total budget so that the expenditure implications of different courses of government action can be spelled out. It is also clear from experience that, despite the shortcomings of the present budgeting system, governments have at times seen the need and have had the power to take important expenditure decisions.

Fiscal Statistics

Table 1: SUMMARY OF GOVERNMENT ACCOUNTS

(Rs. million)

	1960/61	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	(Revised Estimate) 1969/70	(Original Estimate) 1970/71	(Revised Estimate) 1970/71
Financial Year Oct. 1 - Sept. 30												
1. Revenue	1454	1607	1583	1617	1775	1804	1970	2157	2482	2737 /3	2766	2796
2. Current Expenditure	1392	1479	1512	1588	1654	1741	1836	2095	2309	2576 /3	2689	2745
3. Surplus of Government Enterprises /1	-19	-12	-12	-3	-2	1	4	-10	7	-4	14	14
4. Extra-budgetary Revenue /1	27	20	20	31	32	33	26	20	23	27	40	40
5. Current Surplus (1+3+4-2)	71	136	30	57	151	97	164	72	203	184	131	106
6. Total Capital Expenditure	519	573	489	518	574	634	734	817	937 /3	930 /3	1062 /3	1017
7. Advance Payments (net) /2	14	19	-18	-1	6	23	33	-29	54	161	-	93
8. Net Cash Deficit (6+7-5)	462	456	391	460	430	562	607	716	788	908	931	1004

/1 Total capital expenditure in Item 6 includes outlays from extra-budgetary funds. Hence extra-budgetary funds have been included as revenue under 3 and 4.

/2 Advance Payments (net) as in Table II(F)3, Central Bank Annual Report (1968) and Table II(F)4 Report 1969 plus Advance Payments on behalf of the Food Commissioner.

/3 These figures differ slightly from those given in Volume I because of availability of more recent information.

NOTE: Current expenditures have been reclassified until 1964/65 which increased public expenditures by about Rs. 10 million per annum. Due to rounding the individual figures may not precisely add up to the totals. Additional information has been made available which allows for an adjustment of 1961/62 as well.

Table 2: FINANCING OF THE DEFICIT

(Rs. million)

	1960/61	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	(Revised Estimate) 1969/70	(Original Estimate) 1970/71	(Revised Estimate) 1970/71
Financial Year Oct. 1 - Sept. 30												
I) Non-Expansionary												
1. Administrative Borrowing	29	105	-34	-2	50	112	72	10	52	-	-	-
2. Net Foreign Loans and Grants	27	56	93	95	100	98	190	190	354	189	491	338
3. Non-Bank Borrowing	165	109	154	208	243	256	297	248	203	228	343	441
Sub-Total	221	270	213	301	393	466	559	448	609	417	834	779
II) Expansionary												
1. Borrowing from Central Bank & Commercial Banks	242	226	178	115	18	162	51	304	68	491	97	225
2. Decline in Cash Balance	2	-40	1	45	20	-47	22	-48	63	-	-	
3. Decline in Commodity Aid Counterpart Funds	-	-	-	-	-	-35	-44	12	48	-	-	
4. Decline in U.S. Aid Counterpart Funds	-	-	-	-	-	20	19					
Sub-Total	242	186	179	160	38	100	48	268	179	491	97	225
TOTAL	463	456	392	461	431	566	607	716	788	908	931	1004

Due to rounding the individual figures may not precisely add up to the totals.

Table 3: GOVERNMENT REVENUE

(Rs. million)

	1960/61	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68	1968/69	(Revised Estimate) 1969/70	(Original Estimate) 1970/71
Financial Year Oct. 1 - Sept. 30											
I. Customs Duties	(733) 2/	660	579	674	637	609	603	701	669	673	661
Export Duties	298	294	281	280	316	259	233	322	347	372	373
Import Duties	(435) /2	366	298	394	321	350	370	379	322	301	288
of which: License Fees	-	-	8	10	13	13	34	67	7	6	8
II. Receipts from FEEC Sales	-	-	-	-	-	-	-	77	285	447	457
III. Excise Duties	136	169	211	218	239	279	283	315	371	381	434
IV. Turnover Tax	-	-	-	16	35	39	72	79	111	242 /3	279 /3
V. Revenue from Petroleum Products	n.a.	99	100	88	115	127	174	135	138	n.a.	n.a.
VI. Profits from Food Sales	132	190	200	84	187	216	265	274	283	252	140
VII. Taxes on Income & Profits	283	288	290	303	321	290	326	334	358	453	441
of which: Income Tax	259	262	259	285	293	277	312	316	343	440	425
VIII. Other Taxes	60	58	64	73	98	66	62	64	74	69	95
IX. Miscellaneous Receipts	110	150	127	160	144	220	184	223	232	220	250
TOTAL REVENUE	1454	1614	1569	1616	1755	1848	1970	2203	2521	2737	2766
C. B. Adjustment /1	-	-7	15	1	-	-44	-	-46	-39	-	-
ADJUSTED TOTAL REVENUE	1454	1607	1583	1617	1775	1804	1970	2157	2482	2737	2766

Due to rounding the individual figures may not precisely add up to the totals.

/1 A few items in the revenue figures in the Government Accounts do not reflect resources available to the Government for spending. These are omitted in the adjustments made by the Central Bank to the figures in the Government Accounts. Also, revenue from the National Development Tax, which is excluded in the Government Accounts, is included by the Central Bank. (See Table 32 in Annual Report 1969 of the Central Bank of Ceylon.)

/2 Including revenue from imports of refined petroleum products. For all the other years (1961/62-1968/69), revenues from petroleum imports have been excluded from Customs duties. They are listed under V.

/3 Including revenue from the business turnover tax levied on the products of the Refinery and the Blending Plant which substituted for the elimination of imports of refined petroleum products.

Source: Estimates of the Revenue and Expenditure of the Government of Ceylon.

Table 4: CURRENT EXPENDITURE OF THE GOVERNMENT 1961/62 TO 1970/71

Items	1961/62 Amount Rs.mn.	%	1964/65 Amount Rs.mn.	%	1965/66 Amount Rs.mn.	%	1966/67 Amount Rs.mn.	%	1967/68 Amount Rs.mn.	%	1968/69 Amount Rs. mn.	%	1969/70 Rev. Est. Amount Rs.mn.	%	1970/71 Orig. est. Amount Rs.mn.	%
Financial Year Oct. 1 - Sept. 30																
1. Administration	252.2	17.0	260.1	15.7	275.9	15.8	287.8	15.7	328.4	15.7	339.3	14.7	440.7	17.1	427.2	15.9
Civil	181.0	12.2	199.1	12.0	210.9	12.1	221.1	12.0	252.0	12.0	256.6	11.1	338.2	13.1	330.2	12.2
Defense	71.2	4.8	61.0	3.7	65.0	3.7	66.7	3.7	76.4	3.7	82.7	3.6	102.5	4.0	97.0	3.6
2. Social Services	430.5	29.1	494.8	29.9	503.0	28.9	530.9	29.0	598.3	28.6	647.5	28.1	737.2	28.6	757.9	28.2
Education	270.4	18.2	327.7	19.8	328.5	18.9	340.4	18.5	396.6	18.0	415.2	18.0	471.0	18.3	490.7	18.3
Health	141.5	9.5	148.5	8.9	156.4	9.0	168.4	9.2	178.1	8.5	210.0	9.1	240.4	9.3	240.1	8.9
Housing	1.1	.0	1.2	0.1	1.3	0.1	1.4	0.1	1.6	0.1	1.5	0.1	1.9	0.1	2.3	0.1
Special Welfare Services	11.0	.7	11.1	0.7	11.1	0.6	11.9	0.7	12.8	0.6	12.9	0.6	15.0	0.6	15.3	0.6
Community Services	6.5	.4	6.3	0.3	5.7	0.3	8.8	0.5	9.2	0.4	7.9	0.3	8.9	0.3	9.5	0.4
3. Economic Services	90.4	6.1	107.6	6.5	97.1	5.6	107.7	5.9	112.5	5.4	123.9	5.4	165.7	6.4	175.0	6.5
Agriculture and Irrigation	44.0	2.9	53.9	3.2	41.6	2.4	51.3	2.8	51.8	2.5	57.0	2.5	79.6	3.1	92.4	3.4
Fisheries	2.1	.1	2.1	0.1	1.5	0.1	1.7	0.1	1.9	0.1	1.9	0.1	2.5	0.1	5.6	0.2
Manufacture and Mining	11.1	.7	11.7	0.7	11.7	0.7	14.3	0.8	13.7	0.7	17.7	0.3	22.5	0.8	24.7	0.9
Trade	13.7	.9	15.6	0.9	16.3	0.9	16.3	0.9	17.5	0.8	17.0	0.7	27.1	1.0	20.6	0.8
Communication	19.5	1.3	24.3	1.4	26.0	1.5	24.1	1.3	27.6	1.3	30.3	1.3	34.0	1.3	31.7	1.2
4. Unallocated FEEC Expenditure	-	0.0	nil	-	nil	-	nil	-	nil	-	nil	-	16.3	1.6	39.5	1.4
5. Intra Governmental Payments	3.1	0.2	3.5	0.2	3.5	0.2	3.7	0.2	3.9	0.2	4.0	0.2	4.0	0.2	4.5	0.2
6. Transfers Payments	702.5	47.5	788.1	47.6	861.2	49.5	906.3	49.4	1052.1	50.2	1194.0	51.7	1318.0	51.2	348.3	50.1
To Private Current Accounts	650.8	44.0	735.7	44.5	802.4	46.1	839.9	45.7	979.6	46.8	1106.9	47.9	1211.8	47.0	1234.1	45.8
Food Subsidies	420.6	28.4	441.8	26.7	487.1	28.0	465.2	25.3	572.7	27.3	620.1	26.9	592.5	22.9	610.4	22.7
Interest on Public Debt	83.2	5.6	105.9	6.4	123.2	7.1	143.5	7.8	166.5	8.0	206.2	8.9	281.3	10.9	309.0	11.5
Pensions	95.3	6.4	126.9	7.7	125.1	7.2	128.7	7.0	154.9	7.4	161.1	7.9	190.8	7.4	186.3	7.0
Direct Relief	0.2	.0	9.6	0.6	12.1	0.7	1.8	0.1	8.8	0.4	2.7	0.1	16.6	0.6	0.8	
Other	51.5	3.4	51.1	3.1	54.9	3.2	100.7	5.5	76.7	3.7	116.8	5.1	130.6	5.0	127.6	4.8
Other Transfers	51.7	3.5	52.8	3.2	58.8	3.4	66.4	3.6	72.5	3.5	87.1	3.8	106.1	4.1	114.2	4.2
To Local Authorities	38.2	2.5	38.5	2.3	43.5	2.5	42.0	2.3	50.5	2.4	60.7	2.6	67.5	2.6	59.6	2.2
To Public Corporations	1.2	.0	-	-	1.0	0.1	4.5	0.2	6.6	0.3	12.4	0.5	12.5	0.5	23.9	0.9
To Other Institutions	10.2	.6	12.7	0.8	12.4	0.7	15.5	0.8	12.5	0.6	10.4	0.5	16.6	0.6	25.8	0.9
Abroad	2.1	.1	1.6	0.1	1.9	0.1	4.4	0.2	2.9	0.1	3.6	0.2	9.6	0.4	4.9	0.2
7. Under-expenditure Provision													107.0	4.2	63.0	2.3
8. Total Current Expenditure	1478.7	100.0	1654.1	100.0	1740.0	100.0	1836.4	100.0	2095.2	100.0	2308.7	100.0	2575.4	100.0	2689.4	100.0

Source: Central Bank of Ceylon

Table 5: CAPITAL EXPENDITURE

(Rs. Million)

Financial Year Oct.1-Sept.30	1961/62	1964/65	1965/66	1966/67	1967/68	1968/69	(Revised Estimate) 1969/70	(Original Estimate) 1970/71
1. Civil Administration	6	7	8	12	13	17	25	19
2. Social Services	85	74	56	80	94	113	147	203
Education	27	31	22	26	33	32	52	68
Health	21	18	16	21	25	37	46	47
Housing	32	19	11	26	31	36	38	50
Special Welfare Services	3	3	3	2	2	3	3	3
Community Services	2	3	3	4	3	5	8	34
3. Economic Services	149	169	209	227	271	301	425	469
Agriculture & Irrigation /1	97	105	124	127	160	191	254	289
Fisheries	1	1	4	-	-	-	2	18
Manufacture & Mining	6	10	10	8	24	5	11	17
Trade	7	3	3	2	3	14	9	34
Communication	38	50	68	90	84	92	149	111
4. Acquisition of Real Assets (1+2+3)	240	250	273	318	379	430	597	691
5. Capital Transfers	130	164	198	244	271	343	316	350
6. Acquisition of Financial Assets	87	33	41	45	27	44	44	52
7. Under-expenditure Provision	-	-	-	-	-	-	159	170
8. Total Capital Expenditure (4+5+6-7)	458	447	512	607	677	817	830 /2	937 /2

/1 Includes extra-budgetary expenditure

/2 Totals for 1969/70 and 1970/71 include unallocated FEEC expenditure amounting to Rs.34 million and Rs.14 million respectively.

Source: Central Bank of Ceylon

Table 6: GOVERNMENT NET FOOD SUBSIDY

(Rs. million)

Items	1965/66	1966/67	1967/68	(Actual Provisional) 1968/69	(Original Estimate) 1969/70	(Revised Estimate) 1969/70	(Original Estimate) 1970/71	(Revised Estimate /6) 1970/71
1. Subsidy to the consumer on imported rice	180.8 /1	218.5	279.9	276.1	237.2	263.9)	524.8 /2	604.0
2. Subsidy to the producer and consumer on local rice	269.9	206.1	250.3	269.2	319.6	252.5)		
3. Subsidy on locally produced red onions	5.3	6.3	6.8	6.8	8.0	8.0	8.5	8.5
4. Distribution expenses and other charges	31.4	34.6	37.2	51.8	48.5	61.1	79.9	79.9
5. Value of rice ration coupons surrendered in repayment of loans issued by Co-operative Societies	-	-	0.4	11.1	-	10.0	-	-
6. Rice Subsidy Tax	0.3	0.3	1.9	3.1	2.0	3.0	3.0	3.0
7. Total Gross Subsidy (1 to 5 - 6)	487.1	465.2	572.7	611.9	611.3	592.5	610.2	689.4
8. Profit on sale of sugar	204.1 /1	224.8	239.5	254.6	210.6	222.6	120.1 /3	124.8
9. Profit on sale of flour	0.5	35.8	41.0	33.9	49.1 /4	33.0	32.2	37.4
10. Profit on sale of other goods /5	4.8 /1	2.7 /1	-4.1	-5.4	-8.2	-3.6	-1.2	-1.2
11. Total (8 - 10)	209.7	263.3	276.4	283.1	251.5	252.0	151.1	161.1
12. Net Food Subsidy	277.4	201.8 /1	296.3	328.8	359.8	340.5	459.1	528.4

NOTE: The "Net Food Subsidy" figures given in this Table will differ from those published in the Government Accounts on account of the fact that collections from Rice Subsidy Tax are netted against the food subsidy.

/1 These figures will differ from those published in Table II(F)5 of 1968 and II(F)7 of 1969 of the Central Bank Annual Report because of certain subsequent adjustments.

/2 It is not possible to provide a reliable estimate of issues (imported and local) under the first and second measures. Hence items 1 and 2 are not computed.

/3 Net of a sum of Rs. 86.1 million being cost of FEECs on imports of sugar.

/4 Includes rebate on import of flour under U.S. PL480 amounting to Rs. 20.6 million.

/5 Includes lentils, maldive fish, red onions and whole wheat.

/6 Figures not officially announced yet.

Source: Food Commissioner.

Table 6a: RICE AND FLOUR CONSUMPTION AND SUBSIDIES UNDER VARIOUS ASSUMPTION

			1969/70 one measure (000 tons)		1970/71 one measure (000 tons)
Consumption					
Rice:			532		545
Ration Requirement					
GPS purchase			297		304
Import			235		241
Flour:			425		436
Subsidy in 1969/70 prices			(Rs. m)		(Rs. m)
Rice:			528.41		541.53
GPS purchase	1163 Rs/t	345.11		353.55	
Import	780 Rs/t	183.30		187.98	
Flour:	570 Rs/t		242.25		248.52
		Total	770.96		790.05
Receipt					
Flour:	762 Rs/t		323.85		332.23
		Net Subsidy	447.11		457.82
Subsidy in 1970/71 prices					
Rice:			508.26		520.56
GPS purchase	1163 Rs/t	345.11		353.55	
Import	693 Rs/t	162.85		167.01	
Flour:	615 Rs/t		261.34		268.14
		Total	769.63		788.78
Receipt					
Flour:	762 Rs/t		323.85		332.23
		Net Subsidy	445.78		456.55

					1970/71 two measures (000 tons)
Consumption					
Rice:					965
1 measure				545	
2 measures				420	
Flour*					325
Subsidy in 1970/71 prices		(000 tons)			
Measure:					950.74
GPS	1162 Rs/t	600		697.80	
Import	693 Rs/t	365		252.94	
Flour:	615 Rs/t	233			197.85
	575 Rs/t	57			
	615 Rs/t	35			
			Total		1148.49
Receipt					
Measure Rs. 75 per two pounds/week					352.80
Flour:	762 Rs/t	325			247.65
			Total		600.45
			Net Subsidy		548.04

*A substitution effect between the consumption of rice and flour has been assumed.

NOTE: No attempt is made to reconcile the value figures used in the above exercise with the budgetary data given in Table 6. It should be emphasized that the latter table covers all food subsidies not just rice and flour. Furthermore the budget figures in Table 6 are on a cash basis not on accrual basis. Moreover the above exercise was undertaken to estimate the change in the rice and flour subsidy consequent to the doubling of the rice ration in 1970, and not specifically to estimate the absolute level of the subsidy.

Table 7: PUBLIC EXPENDITURES ON HEALTH AND EDUCATION
(1963/64 - 1970/71)

(Rs. million)

	HEALTH				EDUCATION			
	Recurrent	Capital	Total	Per Capita	Recurrent	Capital	Total	Per Capita
Fiscal Year Oct.1-Sept.30								
1963/64	147.9	11.5	159.4	14.62	309.3	48.5	357.8	32.83
1964/65	153.5	9.3	162.8	14.58	329.0	40.9	369.9	33.13
1965/66	159.6	11.2	170.8	14.93	331.6	31.0	362.6	31.70
1966/67	170.2	17.6	187.8	16.05	347.7	35.1	382.8	32.72
1967/68	194.4	20.6	215.0	17.97	397.6	40.4	438.0	36.61
1968/69	210.0	37.3	247.3	20.17	415.2	31.8	447.0	36.45
1969/70 (Revised)	240.4	46.3	286.7	22.88	471.0	52.2	523.2	41.75
1970/71 (Original)	240.1	47.3	287.4	22.44	490.7	68.2	553.8	43.24

Source: Central Bank of Ceylon

Table 8: GOVERNMENT ENTERPRISES

(Rs. million)

	1961/62	1964/65	1965/66	1966/67	1967/68	1968/69	(Revised Estimate) 1969/70	(Original Estimate) 1970/71
I. Railway								
Revenue	88	97	100	102	107	110	111	112
Recurrent Expenditure	117	125	128	125	130	141	134	153
Surplus	-29	-28	-28	-23	-23	-31	-23	-41
Capital Expenditure	30	31	22	23	26	29	31	47
II. Electrical Department /1								
Revenue /2	34	49	54	66	70	86	8	-
Recurrent Expenditure /3	21	27	31	29	38	44	11	-
Surplus	13	22	23	37	32	42	-3	-
Capital Expenditure /4	44	26	41	57	68	52	7	-
III. Port, Harbor, Warehouse								
Revenue	28	29	34	34	36	41	48	52
Recurrent Expenditure	22	22	22	24	23	27	31	33
Surplus	6	7	12	10	13	14	6	19
Capital Expenditure	8	11	13	15	13	12	16	21
IV. Post and Telecommunications								
Revenue	47	50	55	57	65	71	78	94
Recurrent Expenditure	65	70	73	78	80	91	98	108
Surplus	-18	-20	-18	-21	-15	-20	-20	-14
Capital Expenditure	4	4	5	9	6	9	17	21
V. Broadcasting & Information /5								
Revenue	9	9	8	2	-	-	-	-
Recurrent Expenditure	5	6	7	3	-	-	-	-
Surplus	4	3	1	-1	-	-	-	-
Capital Expenditure	0	0	0	3	-	-	-	-
TOTAL								
Revenue	206	234	250	261	278	308	245	258
Recurrent Expenditure /6	230	250	261	259	271	303	273	294
Adjusted Current Expenditure /7	218	236	249	257	288	301	259	250
Under-expenditure Provision	-	-	-	-	-	-	9	7
Adjusted surplus/deficit /8	-12	-2	1	4	-10	7	-4	14
Capital Expenditure	86	72	81	107	113	102	71	89
Under-expenditure Provision	-	-	-	-	-	-	14	14
Adjusted Capital Expenditure /7	114	127	121	127	140	131	100	118

Due to rounding the individual figures may not precisely add up to the totals.

/1 Commercialized and non-commercialized activities. In the course of 1969/70 the Electric Department was converted into a Government Corporation.
/2 Net revenue plus capital expenditure out of RERF in that year.
/3 Exclusive of annuities.
/4 Includes expenditure out of Reserve, Extensions and Renewals Fund.
/5 In the course of 1966/67, Broadcasting was converted from a Government enterprise into a Government corporation, as from 1967/68 expenditures of the Department of Information are included in Civil Administration expenditures.
/6 This is the total recurrent expenditure under Votes 1,2,4 and 6 of the Government enterprises; these figures do not include depreciation allowances.
/7 Adjusted current expenditure excludes sinking fund contributions and direct repayments, while expenditure under recurrent votes but of a capital nature is included under adjusted expenditure. Extra-budgetary capital outlays from the Electrical Department's Reserve, Extension and Renewals are included.
/8 Revenue minus adjusted current expenditure.

Source: Estimates of the Revenue and Expenditure of the Government of Ceylon.

Table 9

INTEREST RATES ON CENTRAL GOVERNMENT DOMESTIC BORROWING

	1965/66	1966/67	1967/68	1968/69	1969/70
A. Rupee Loans					
1) 21 - 25 years bonds	4½%	4½%	(4½% (5½%1/	5½%	(5½% (6½%2/
2) 12 - 15 years bonds	3½%	3½%	-	-	6½%3/
3) 5 -7 years bonds	3½%	3½%	-	-	6%
B. Treasury Bills (3 months)	3%	3%	3% to 3.64%	3.64%	3.64% to 4.76%
C. Tax Reserve Certificates	1½%	1½%	1½% to 2%	2%	2% & 3%
D. Central Bank Advances	--Interest Free--				

1/April, 1968.
2/January, 1970.
3/March, 1970.

Source: Central Bank of Ceylon.

TAXES ON TEA AND THE TEA EXPORT DUTY REBATE SCHEME

Taxes

1. At present tea exported in bulk is subject to an export duty of 39 cts. per pound. The export duty on packeted tea is 24 cts. per pound.

Further an ad-valorem sales tax is imposed. Under this scheme all teas which fetch a price of over Rs. 1.85 a pound at the Colombo Tea auctions pay an ad-valorem tax of half the excess over Rs. 1.85 subject to a maximum of 70 cts. per pound. The ad-valorem tax on teas sold at the London tea auctions is also levied on a similar basis after deduction from the London price of export duty, freight, etc. The ad-valorem tax is also levied on teas allowed for export under private sales.

In addition to the export duty and the ad-valorem sales tax cesses under the Tea Control Act, the Tea Subsidy Act, the Medical Wants Ordinance, the Tea Research Ordinance and the Tea Propaganda Ordinance amounting to Rs. 10.30 per 100 lbs. are also levied on teas exported. The yield from these cesses, however, don't accrue to Government Revenue.

Tea Export Duty Rebate Scheme

2. In view of the fall in tea prices in recent years, in January 1968 the Government decided to pay a rebate on the export duty, on a sliding scale. Under this scheme a rebate of 20 cts. a pound is paid on all first-hand teas of the Medium and Low-Grown variety fetching Rs. 1 to Rs. 1.09 a pound. Thereafter, for every 10 cts. increase in price up the price level of Rs. 1.49 and for every 5 cts. increase from Rs. 1.50 up to the price level of Rs. 1.99, the rebate was reduced by one cent a pound. The rebate on teas fetching Rs. 2.00 and over was fixed at 5 cts. a pound. For high-grown teas a rebate of 5 cts. per pound is given. The qualifying lower limit for all factories is Rs. 1.00 a pound.

EXPORT DUTY ON RUBBER

3. With effect from 27th November 1961, the Government abolished the then existing flat rate of export duty on rubber and replaced it with a sliding scale of export duties. The advantages of a sliding scale of duties for a commodity like rubber, which is noted for its price fluctuations are obvious. The sliding scale provides automatic relief to rubber producers when there is a sharp fall in rubber prices, while on the other hand, if the price of rubber rises, as it often does suddenly and sharply, the State, as well as the rubber producer would immediately share in the prosperity of the industry. When the price rises to a very high level, almost the entire excess profits can be siphoned off into the State's coffers.

4. The sliding scale of rubber duties provides for variation of duties from week to week. The duty applicable to each week (commencing midnight Sunday/Monday) is based on the average price of R.S.S. Grade I rubber in the London Market during the previous week. From the London price, the estimated F.O.B. Colombo price is calculated by making certain fixed deductions for freight, insurance, etc. The sliding scale of duties is based on the price of rubber in the London Market and not on the price in the Colombo Market to prevent unscrupulous exporters from manipulating

the duty by artificially depressing the rubber price in the Colombo Market in particular weeks and shipping out large quantities of rubber during this period when duty was low. The details of duties applicable under the sliding scale are presented at Table below:

Where the estimated f.o.b. value per lb. of R.S.S. Grade I rubber as estimated by the Principal Collector of Customs.	Rs. cts.		Rs. cts.	Rs. cts.
is below	0.94	. .	-	-
is	0.94	. .	-	0.01
is not less than	0.95	and not more than	0.96	0.02
"	0.97	" . .	0.98	0.03
"	0.99	" . .	1.00	0.04
"	1.01	" . .	1.02	0.05
"	1.03	" . .	1.04	0.06
"	1.05	" . .	1.06	0.07
"	1.07	" . .	1.08	0.08
"	1.09	" . .	1.10	0.09
"	1.11	" . .	1.12	0.10
"	1.13	" . .	1.14	0.11
"	1.15	" . .	1.16	0.12
"	1.17	" . .	1.18	0.13
"	1.19	" . .	1.23	0.14
"	1.24	" . .	1.28	0.17
"	1.29	" . .	1.33	0.20
"	1.34	" . .	1.38	0.23
"	1.39	" . .	1.43	0.26
"	1.44	" . .	1.48	0.29
"	1.49	" . .	1.53	0.32
"	1.54	" . .	1.58	0.35
"	1.59	" . .	1.63	0.38
"	1.64	" . .	1.68	0.41
"	1.69	" . .	1.73	0.45
"	1.74	" . .	1.78	0.49
"	1.79	" . .	1.83	0.53
"	1.84	" . .	1.88	0.57
"	1.89	" . .	1.93	0.61
"	1.94	" . .	1.98	0.65
"	1.99	" . .	2.03	0.69
"	2.04	" . .	2.08	0.73
"	2.09	" . .	2.13	0.77
"	2.14	" . .	2.18	0.81
"	2.19	" . .	2.23	0.85
"	2.24	" . .	2.28	0.89
"	2.29	" . .	2.33	0.93
"	2.34	" . .	2.38	0.97
"	2.39	" . .	2.43	1.01
"	2.44	" . .		1.05

5. Consequent on the devaluation of the Ceylon Rupee in November 23, 1967, a flat rate of 3 cents per pound was levied on all rubber exports in addition to the duty payable under the sliding scale. In addition to the export duty mentioned above the following cesses are also levied on all exports of rubber.

i) under the Rubber Control Act - 23 cents per 100 pounds.
ii) under the Rubber Research Ordinance - Rs. 1 per 100 pounds.
iii) under the Medical Wants Ordinance - 75 cents per 100 pounds.

EXPORT DUTIES ON COPRA, COCONUT OIL, DESICCATED COCONUT AND FRESH COCONUTS

6. The export duties on coconut products are based on a sliding scale. The duty applicable for each week (commencing midnight Sunday/ Monday) is based on the four weekly moving average price of Philippine copra in the London market during the previous week. From the London price the estimated f.o.b. Colombo price is arrived at by making certain fixed deductions for freight and insurance. The table below gives further details:

EXPORT DUTIES ON COCONUT PRODUCTS

7. The details of the minimum and maximum duties payable are given below:-

Where the average London c.i.f. price of Philippine copra as estimated and notified by the Principal Collector of Customs.			The export duty payable on a ton of			The export duty payable on fresh coconut per '000 nuts shall be
			Copra	Coconut	Desiccated coconut	
	Rs. cts.	Rs. cts.	Rs.cts.	Rs.cts.	Rs.cts.	Rs. cts.
is below	620.00	-	115.00	nil	nil	28.75
is	620.00		115.00	nil	nil	28.75
is more than	620.00	but not more than 630.00	117.93	4.76	4.04	29.48
is more than	1750.00	but not more than 1760.00	680.54	918.91	780.56	169.95

II. AGRICULTURE

A. INTRODUCTION

57. The agricultural sector in Ceylon, employs more than 50 percent of the labor force and contributes approximately 40 percent to GDP. Over 90 percent of the nation's exports originate from agriculture. Thus, the agricultural sector constitutes the main source of Ceylon's economic strength. This strength, however, has been eroded considerably since the mid 1950's by a substantial and continuous deterioration in the export markets for tea and rubber, the two principal exports. The price of tea declined by 23 percent between the mid-1950's and 1965 and by a further 20 percent in the period 1965-1970, that of rubber by 25 and 12 percent, respectively. As a result - and in the absence of a determined drive to exploit fully the growth potential of agricultural exports and to develop new exports which might to some extent have mitigated the effect of these sharp price declines - export earnings first stagnated and then, in the latter half of the 1960's, fell absolutely. At the same time, efforts were directed with increasing intensity at raising domestic production of food so as to reduce food imports which were absorbing about half of total exchange earnings. Significant progress in that direction was made, but not fast enough to offset the failing fortunes of export agriculture. The resulting squeeze on non-food imports has made the structural transformation of agriculture the central development problem of Ceylon.

58. Ceylon is endowed with favorable natural conditions for diversified agricultural production. From an agro-climatic point of view the country can be divided into two parts, the wet zone and dry zone. The wet zone receives 75 to 200 inches annual rainfall which usually remits year-round agricultural production. This zone accounts for about 33 percent of the land area and over 65 percent of the cropped area. It is almost exclusively devoted to the production of the three major export crops: tea, rubber and coconuts; and rice. The dry zone receives 60 to 75 inches annual rainfall and covers about two-thirds of the island. The bulk of its rainfall is concentrated in the Maha season (Northeast monsoon between September and March) while the Yala season (April to August) is dry. Sixty percent of this region is forest and 15 percent is used for shifting agriculture. Twenty percent is used for settled agriculture, mainly with irrigation. About 40 percent of the cultivated dry area is used for rice production.

59. A useful division of Ceylonese agriculture would be export agriculture and domestic agriculture. The export sector includes tea, rubber, coconut and minor export crops and the domestic sector consists of rice, livestock and subsidiary crops. A significant portion of the export sector's plantation crops, particularly tea, is foreign-owned and employs Indian Tamil labor. The area devoted to the three export crops: tea, rubber and coconut, is approximately 55 percent of the cultivated land. The most important domestic crop is rice, occupying about 33 percent of the cultivated area. Approximately two-thirds of the rice comes from irrigated land. Although the production of subsidiary crops has been increasing in recent years, the absolute volume is still small.

B. REVIEW OF OUTPUT TRENDS IN THE SECTOR

60. During the first half of the 1960's the agricultural sector experienced a low rate of growth, contributing to general economic stagnation. This was largely due to:

(a) the predominance of tea and rubber in the export sector during a period of continuous deterioration in world tea and rubber prices;

(b) the government's exchange and fiscal policies which provided inadequate export price incentives for major export crops, relative to the heavy tax burden imposed on these items;

(c) the low productivity in domestic agriculture resulting from the emphasis on providing employment and income for the rural population without sufficient corresponding emphasis on productivity.

61. In the second half of the decade, this sector has experienced more rapid growth. This achievement is attributable to the expansion of domestic agriculture, namely, increased rice production stimulated by subsidies, favorable price incentives provided through expansion of the open market, and improved organization of the rice production drive. The changes in domestic and export agricultural output since 1965 are presented in Table I:

Table I

VALUE OF MAJOR AGRICULTURAL OUTPUT
(Rs. million)

	1965	1966	1967	1968	1969*	1965	1966	1967	1968	1969*
	Constant Prices					Current Prices				
Tea	951.5	926.8	920.8	937.8	915.8	924.7	837.7	701.7	915.6	818.4
Rubber	279.2	309.6	307.6	319.5	324.0	242.7	260.6	234.7	256.9	281.6
Coconut	267.2	243.0	235.1	243.6	234.3	347.1	327.6	317.8	424.1	437.0
Minor Export Crops	42.2	43.5	42.4	48.1	57.3	46.6	45.8	43.5	53.5	66.7
Rice	465.9	470.0	565.3	664.3	677.3	376.6	475.9	663.0	890.4	900.2
Other Food Crops	368.9	376.7	397.3	437.8	450.0	405.8	424.3	459.0	540.2	573.5
Livestock	186.6	189.6	211.8	219.2	219.8	193.5	198.9	223.0	254.7	258.5
Fish	136.7	141.4	154.7	169.0	180.5	148.0	164.0	187.4	224.7	245.5

* Provisional

62. Between 1966 and 1968, the Government of Ceylon introduced a series of important measures, aimed at stimulating economic growth by fostering market forces. These included:

(a) price incentive measures - rises in the free market price through reductions in the subsidized ration for rice, chillies, and other foods, and a ban on potato imports; guaranteed price schemes; and devaluation and other exchange reform measures;

(b) agricultural input subsidies on fertilizer, planting material, farm machinery and credit; and

(c) an expansion in the government's administrative, agricultural extension and other services.

63. The impact of the above measures on production of rice and several other crops has continued through the 1969/70 Maha crop season. The rapid expansion of output and higher producer's prices for these import-substituting crops have resulted in increased levels of agricultural income.

Domestic Agriculture

64. Paddy production, which accounts for approximately 40 percent of domestic agricultural output has been steadily rising during the past decade, but at a much more rapid rate in the last few years. As mentioned above, a number of factors undoubtedly contributed to this achievement. One of the most significant has been the government's successful organization of the paddy production drive, which was reflected in the increased and more timely provision of various agricultural inputs and the expansion of the market system which accompanied the reduction in the rice ration. Production in 1968/69 was affected by a drought in the 1969 Yala season. On the basis of the last Maha harvest, 1969/70 paddy production is expected to reach 73.3 million bushels - about 72 percent of self-sufficiency. Between 1965-1969, the area under irrigation increased by 8 percent. However, as shown in Table II, the recent increase in paddy production is mainly attributable to higher per acre yields.

Table II

PADDY; ACREAGE, YIELDS AND PRODUCTION

	1959			1968			1969			1970(Est.)		
	Maha	Yala	Total	Maha	Yala	Total	Maha	Yala	Total	Maha	Yala	Total
Acreage Harvested (1000 acres)	633	389	1,022	916	473	1,389	979	392	1371	948	501	1,449
Yield Per Acre (bushels)	34.6	37.3	35.6	47.5	44.6	46.5	47.9	48.2	48.0	52.2	47.5	50.6
Production (mil bushels)	21.9	14.5	36.4	43.5	21.1	64.6	46.9	18.9	65.8	49.5	23.8	73.3

Self-sufficiency in rice production appears feasible within 4 to 5 years, provided no major changes take place in paddy production policy. The government's rice production plans, which aim to achieve self-sufficiency by 1975 and a surplus thereafter, are presented in Table 7.12 of the Statistical Appendix.

65. The government has recently restored the second measure of rice to the ration, which had been reduced to one measure in 1966. It was also announced that the government would as soon as practicable become the sole purchaser of paddy, at Rs. 14 per bushel through the G.P.S. (Guaranteed Price Scheme). The second measure of ration rice is issued at 75 cents. The first measure is free. About 80% of the people are thought to be taking up the second measure. Although there is no official figure available, this change is believed to have lowered the average open market rice price by about 20 cents per measure. The implications of the new rice ration policy and paddy purchasing system, for production, the government budget, and foreign exchange requirements have been estimated but their impact is somewhat uncertain at this stage. Since the G.P.S. price is considered to provide sufficient incentive to the producers, the level of rice production is not expected to be affected, assuming the arrangements under the proposed scheme, such as provision of adequate warehousing and increasing points of purchase, work satisfactorily.

66. Production of subsidiary food crops has increased substantially in recent years owing mainly to attractive free market prices and measures mentioned earlier. The 1967 ban on potato imports led to a remarkable expansion of domestic potato production in the suceeding years, which enabled self-sufficiency to be achieved though at a higher price and a lower per capita consumption level. Production of chillies has increased considerably but two-thirds of consumption is still imported. Table III shows production trends for selected subsidiary crops in Ceylon between 1967 and 1969.

Table III

PRODUCTION OF SELECTED SUBSIDIARY CROPS

Crops	Unit	1966/67	1967/68	1968/69
Chillies	Cwt	33,250	58,856	121,984
Red Onions	Cwt	507,500	655,447	843,061
Potatoes	Tons	8,500	24,803	35,127
Maize	Cwt	76,600	180,440	249,607
Groundnut	Cwt	N.A.	55,939	96,895

In the case of Bombay onions, despite the foreign exchange burden, Ceylon continues to depend on large amounts of imports, because agronomic difficulties in domestic production have not yet been solved.

67. One of the most disappointing features of Ceylon's agriculture has been sugarcane production. Despite the large foreign exchange bill, and the existence of the basic agro-climatic conditions for domestic cultivation of sugarcane, Ceylon so far has not been able to achieve a substantial level of domestic production. As shown in Table IV, continuously increasing sugar consumption in Ceylon has been almost entirely met by imports.

Table IV

SOURCES OF SUGAR SUPPLIES
(thousand tons)

	1965	1966	1967	1968	1969
Imports	218	233	226	220	308
(Costs in Rs. millions)	(72)	(105)	(74)	(97)	(115)
Domestic Production	10	4	7	8	9

68. It is difficult to obtain reliable statistics on the livestock sector in Ceylon. Nevertheless, the data in Table 7.8 of the Statistical Appendix provide some indication of general trends. An increasing number of slaughtered cattle and buffalo accompanied by a declining livestock population indicates a long-run problem in the beef industry. Meat production in Ceylon, except for pork, is considered insufficient and this is reflected in the recent meat price rises. A comparison of 1969 and 1970 open market meat prices indicates considerable jumps except for pork. In spite of recent attention given to the dairy industry, large imports of milk and milk products continue.

69. Although the volume of fishery output in Ceylon has expanded, the absolute level of catch is still low, and the large amount of foreign exchange devoted to fish imports shows no reduction. The Fisheries Corporation, which has received substantial government assistance, has continually operated at a loss. The Government of Ceylon is becoming aware of the need and of the potential for improving the fisheries sector. This has led to the creation of an independent Fisheries Ministry and the assistance of an A.D.B. fisheries consultant team which is currently looking into the Fisheries Corporation management as well as the overall fisheries resources of Ceylon.

Export Agriculture

70. The tea industry, the biggest sector in the Ceylonese economy, contributes 15 percent of national income and employs approximately 800,000 workers. This leading industry, which provided 55 percent of foreign exchange earnings in 1969, has been declining for many years. Although the volume of tea production did not fall drastically in these years, the export revenue has been declining sharply as a result of the deterioration in the international tea price. Consequently, the contribution of the tea industry to total export earnings has been decreasing. Table V shows the trends in the tea industry since 1965:

Table V

THE TEA INDUSTRY

Year	Registered Tea Acreage (acres)	Production (million lb)	Exports (Customs Entries) (million lb)	Unit Value of Tea Exports (FOB Price) Rs cts	US cents	Tea Exports as % of Total Exports
1965	594,308	503	494	2.45	51	62
1966	596,445	490	441	2.33	49	60
1967	598,814	487	477	2.22	46	63
1968	597,490	496	460	2.52	42	57
1969	597,500	484	444	2.39	40	55
1970	597,500	468	459	2.44	41	56

71. In view of the recent years' poor rate of fertilizer application and the future reduction of tea land in production because of replanting, Ceylon's tea production is not likely to rise much in the short run. Although Ceylon and India have not reached final agreement as to how the joint tea quota of 928 million lb under the Mauritius Interim Agreement of 1969 would be shared, Ceylon is currently working on the basis of 510 million lb production and 470 million lb export (40 million lb domestic consumption). Production and exports in 1970 fell below these limits. Because of this shortage and due to a similar trend in the Indian tea exports, the 1970 world tea export quota of 1,311 million lb seemed unlikely to be met. The 1970 tea prices on the London auctions averaged 6 - 8 pence per pound higher than in 1969.

72. Based on the long-term prospects for tea export and in order to meet the immediate need to maintain international competitiveness, a fundamental restructuring of the industry by replanting with higher-yielding

clones and diversification of surplus tea land (expected to be ultimately about 350,000 - 400,000 acres) is necessary. This requires the economic use of the resources to be released from the tea industry. In the marketing area Ceylon, as one of the major tea exporters, has had to undertake a leading role in a series of international conferences aimed at receiving an international tea agreement. Both of these objectives have produced limited results so far.

73. The Tea Replanting Subsidy Scheme in 1970 was expected to result in total payments of Rs. 25 million compared to Rs. 21.1 million in 1969. The Crop Diversification Subsidy Scheme continued to operate through 1970, and the government provided some technical guidance for replanting as well as for diversification. In addition to the replanting subsidy of Rs. 3,750 per acre, a further replanting incentive loan scheme has been instituted since 1969, under which loans of up to Rs. 2,000 per acre are granted by the Central Mortgage Bank at low interest rates. Other schemes which have been in effect include the Tea Factory Development Subsidy Scheme and the Tea Fertilizer Subsidy Scheme to smallholders. The tea industry believes that tax burdens are excessive particularly in the face of the short-run financial difficulties associated with accelerated tea replanting and expected increases in production costs with the unionization of tea industry labor. Another factor which might be contributing to the slow replanting rate is the uncertainty of the private tea industry in the face of greater public control of economic activities in general. In 1969, approximately 6,500 acres of tea land were replanted, against the original target of 5,000 acres. It was expected that the lower replanting target of 5,800 acres in 1970 would be achieved. The government is now discouraging the replanting of marginal tea land, because of unsatisfactory results. The past replanting records show that the private estates have been replanting at a faster rate than the smallholders.

74. There is no clear performance criterion for replanting because the "Optimum rate" of replanting tea in Ceylon has not been established. However, the current replanting rate may not be high enough, given the urgency of restructuring the tea industry in Ceylon. The comprehensive tea policies and accelerated replanting and diversification schedules recommended in the previous Bank Economic Mission Report have not yet been formulated. A UNDP group is now studying diversification problems, but its results will not be made available early enough for the formulation of comprehensive plans, particularly concerning the short-term uses of the tea land being released. As to the tea agreement, the present government intends to honor the Mauritius Interim Tea Agreement, but its objective is to reach a long-term tea agreement covering a period of 10 years, with a review point after 5 years. The last meeting of the Consultative Committee on Tea was held in New Delhi during November-December 1970. During the Meeting, the decision to maintain the 1971 global black tea quota at the 1970 level was made. Another meeting was planned for early 1971.

75. Although its absolute magnitude is still small, remarkable progress has been achieved in the production of instant tea. Primarily stimulated by the abolition of the export duty and the extension of the FEEC system, exports of instant tea have shown a sharp increase as is indicated in Table VI:

Table VI

EXPORTS OF INSTANT TEA - (POUNDS)

1965	1966	1967	1968	1969	1970(Target)
26,305	71,923	90,312	281,197	300,000	500,000

76. The rubber industry is an important sector in Ceylon and employs about 200,000 workers. Approximately 95 percent of rubber production is exported, contributing 15-18 percent of export revenues. In contrast to tea, the rubber industry faces no domestic or external demand constraints since domestic rubber consumption is expected to rise and Ceylon's share in the world rubber market is only 5-6 percent. Although the rubber price has declined considerably in the past, the current and projected natural rubber price along with the potential for reducing production costs seem favorable enough for Ceylon to plan considerable expansion in this sector. Rubber production in Ceylon has shown substantial annual increases in the last few years. These increases are mainly attributable to replanting from 1953, under the Rubber Replanting Subsidy Scheme. The average yield per tapped acre has shown a substantial increase and yields on replanted areas are double those on old areas. Table VII shows statistics on rubber production and exports since 1965:

Table VII

RUBBER PRODUCTION AND EXPORTS

Year	Production (m lb)	Exports	Price per lb (US cents)
1965	261	267	24.0
1966	289	275	23.8
1967	315	299	20.4
1968	328	319	17.0
1969	332	316	23.0
1970 (Estimated)	356	346	21.8

77. Although the government has continued to subsidize rubber replanting since 1953, the annual replanting rate has fallen from about 20,000 acres ten years ago to 10,000-12,000 acres in the past 5 years. This performance is below the current annual replanting target of 15,000. There has been little research into the reasons for this slowdown, but inadequate incentives to smallholders is probably the main cause. The 1962 Agricultural Survey revealed that approximately 100,000 acres of marginal land out of the 675,000 acres registered as rubber land had been abandoned. In addition, another 75,000 acres were considered unsuitable for replanting, leaving 500,000 acres to be replanted. The 15,000 acre annual replanting target was based on a 33-year cycle (or 3 percent per annum). Through coordinated activities of the Rubber Research Institute and the Rubber Control Department, it is hoped to accelerate rubber replanting in order to meet the above target. Although the government does not consider it a priority area, a subsidy program for diversifying uneconmic rubber land into other crops has been included in the Crop Diversification Scheme. Some permits for new planting of rubber have been issued, but it is not encouraged and is not subsidized under the Replanting Subsidy Scheme. However, there is a fertilizer subsidy program for the clonal and budded rubber planted under the Replanting Scheme or new planting permits, for smallholdings and small estates. In the manufacturing area, Ceylon is beginning to give more thought to the new processed rubber known as "block rubber", in addition to the conventional sheet rubber. The government is now considering establishing a factory for new processed rubber for smallholders.

78. Coconut cultivation occupies the largest acreages (1.15 million acres) among plantation crops and is socially the most broad-based of the plantation crops. Statistics on coconut production are not reliable, but production in 1970 was expected to reach roughly 2,800 million nuts, compared to 2,600 million nuts in 1969, a year which was affected by bad weather. Although coconut is traditionally considered an export crop, more than 50 percent of total production is now domestically consumed. Coconut exports contribute about 16 percent to the foreign exchange earnings. Production in the past five years was substantially below the level estimated in the Agricultural Development Proposals 1966-70.

79. The potential and need for expansion of this crop on the one hand, and the basic institutional problems associated with organizing smallholders for the coconut expansion drive on the other, are well recognized. One of the difficulties is reflected in the government's unsuccessful effort to increase fertilizer application by smallholders. Even under the 50-50 cost sharing arrangement and despite the demonstrated profitability of fertilizer use the actual fertilizer application fell far below the estimated optimum level. Although the absolute level of fertilizer consumption for coconuts has increased by approximately 50 percent in the past five years, it is still only slightly higher than one-third of the level considered optimum. In addition to fertilizer, the government provides subsidized high quality coconut seedlings through the Coconut Research

Institute. An important coconut production expansion scheme, under which a government subsidy for the rehabilitation of the existing coconut land as well as planting on new land was planned, did not materialize in 1970, as scheduled. The scheme is now under review by the new government.

80. Expansion of the minor agricultural exports have not been significant in absolute volume. Table 7.10 of the Statistical Appendix shows the past three year's trend for these exports. The most notable minor export item which registered growth has been cinnamon products. The government plans to give more emphasis to minor agricultural export crops by creating a special unit for subsidiary crops and minor export crops in the Ministry of Plantation Industries.

C. STRATEGIES FOR AGRICULTURAL DEVELOPMENT

81. Ceylon has undergone a transition in public policy areas since the change of government in 1970. Many of the measures recently undertaken seem to reflect the present government's policy shift toward greater public control of economic activities and a higher priority on social and redistributive goals relative to the objective of growth. However, the agricultural policy revealed so far seems to be fairly consistent with that of the previous government. This is reflected in the new government's implicit recognition of the recent achievements in agricultural production, as well as its acceptance of the last government's Draft Agricultural Development Plan for 1971-1977 as an initial basis for agricultural plans. In addition to this plan, the government has initiated an ambitious employment program in order to create 100,000 additional jobs for which Rs. 200 million has been provided in this year's budget. This program concentrates heavily on agricultural development.

82. The program as proposed suggests that the government is seeking to create permanent employment to increase output rather than "make-work". The essential elements of the agricultural part of the new employment program include: 1/

(a) a coconut program aimed at more intensive use of coconut lands with inter-cropping, pasture and dairy farming, greater use of fertilizer, replanting of old plantations, etc.;

(b) cultivation of cashews on marginal lands;

(c) cultivation of mulberries and development of the silk industry;

(d) rehabilitation of the existing cocoa plantations and establishment of new cocoa plantations;

(e) increasing production of fruit and vegetables and cultivation of flowers by utilizing unused homesteads and gardens;

(f) cultivation of subsidiary food crops including Bombay onions, chillies, and pulses; and

(g) intensification of livestock farming and acceleration of the fisheries program.

83. In 1970, Ceylon completed the Draft of the Agricultural Development Plan for the period 1971-1977. This is now under review by the government. It is understood that the Plan is generally accepted as a framework for agricultural development programs, although the budgetary constraints during the implementation stage might alter the picture. This plan is essentially an extension of Ceylon's Agricultural Development Proposals 1966-1970, which

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1/ As the program was drafted in a short time, its elements may well change considerably as concrete schemes are prepared for execution.

concentrated on import substitution largely through the rice production drive. However, the new plan is more ambitious and comprehensive than the previous proposal as it contains additional dimensions and emphasis, including:

(a) encouragement of crop diversification in paddy fields through more systematic and intensive land use without reducing the area for paddy production, primarily as a means of providing supplemental farm income;

(b) development of a more diversified farming system for individual farm holdings, particularly in the major Colonization Schemes;

(c) regional specialization in agriculture; and

(d) greater recognition of the importance of optimum physical and institutional inputs in agriculture.

84. Given the structure and the current position of Ceylon's economy, the agricultural policies pursued will constitute one of the major determinants of the country's future. Obviously the sectoral policies and priorities must serve national economic objectives. The stated economic objectives of the government are: accelerating economic growth, reducing unemployment, maintaining price stability, improving the balance of payment position, and promoting redistributive justice through greater social control of economic activities. The government has already undertaken a number of measures to achieve some of these objectives, particularly in the areas of employment and distribution policies. The most critical immediate problem Ceylon faces is the balance of payments problem and the shortage of resources for investment. Ceylon's capacity to maintain an adequate level of imports is a necessary condition for maintaining reasonable price stability and an acceptable rate of growth. Since agriculture dominates both Ceylon's exports and imports, and given the poor prospects for an immediate and rapid growth in industrial exports, whatever improvement can be achieved in the balance of trade must be through the agriculture sector. Therefore, the strategy should be geared to the twin objectives of increasing agricultural export revenue and reducing the food import bill by increasing import substitute crops. The difficulty in implementing this policy is that it requires a current consumption to be kept lightly in check, a task which successive governments have so far been unable to accomplish.

85. Since progress in import substitution largely depends on domestic policy variables, whereas increase in export earnings is a function of both domestic productive capacity and external market conditions, Ceylon must fully exploit the potential for expansion of import substitution in the short and medium term. In the long run, the emphasis will have to be shifted toward export expansion if Ceylon is to realize and maintain a high growth rate. Even in the short run, however, there are some positive

measures which should be taken in the export sector. A coconut export drive should be implemented by increasing production through more intensive fertilizer application and providing price incentives for exports. The possibility of increasing rubber production and minor export crops should be fully explored. As to the tea industry, Ceylon should try to maximize her external revenue within the limit of the annual tea export quota. This would require tea replanting to be based on a carefully determined long-run replanting rate which would maximize income from tea exports during the replanting period.

86. Understandably, the reduction of food imports has been a sensitive issue in Ceylon because of its political repercussions. However, Ceylon must critically examine cutting some of the major food import items on the basis of nutritional value, substitutability and technical and economic feasibility for domestic production. Table VIII shows the value of annual food imports by major categories:

Table VIII

Imports of Major Food Items 1965-69
(Rs million)

	1965	1966	1967	1968	1969
All Exports	1949	1700	1690	2035	1916
All Imports	1474	2028	1738	2173	2543
All Food Imports	602	954	781	987	972
Rice	144	367	211	341	257
Flour	98	113	229	250	255
Sugar	72	105	74	97	115
Milk & Milk Products	77	77	66	74	52
Meat & Fish	61	101	56	70	87
Potatoes	18	24	7	-	-
Grams and Pulses	39	64	53	56	78
Onions	21	20	19	17	17
Dried Chillies	30	43	29	34	26
Others	42	40	37	48	85

The returns to the import substitution drive have already been demonstrated by the success stories of potatoes, rice, chillies and other crops. While a rapid increase in domestic crop production may be difficult to achieve in the short run, curtailing the imports of these items would provide an immediate and direct improvement in the balance of payments situation, and the resulting price effect would provide an incentive for domestic production or consumption substitution. Although there has been remarkable progress in paddy production, it may be possible to do more, even in the short run, largely by more efficient water management and optimal use of agricultural inputs, particularly fertilizers. Preventing the apparent waste of water in the Maha to increase water availability in the Yala season should be encouraged. More intensive application of fertilizer in the Maha, particularly in the dry zone, should also increase paddy production. Possible short-run gains from labor-intensive drainage improvement and minor irrigation should be fully exploited. The resources allocation for minor irrigation has been arbitrarily determined at a certain percentage of the total irrigation sector budget. But a social cost/benefit analysis might reveal that resources could be more efficiently allocated to labor-intensive minor irrigation schemes than to large-scale irrigation works. Every step should be taken to ensure the successful operation of the GPS so that price incentives to paddy farms will continue. Considering the fact that 50 percent of the total food import bill consists of rice and flour, the government should not relax its emphasis on paddy production both in the short run and for many years to come. The long-term rice policy beyond the self-sufficiency level and the long-term land use program in general, require a critical examination of the two alternative emphases with respect to irrigation: improvement of existing irrigation vs new irrigation. The pressure of population expansion may lead to supporting new large-scale irrigation expansion, committing large sums of investable resources which may have better alternative uses. The 7-year rice production plan of Ceylon, which aims to achieve 108 percent self-sufficiency by 1976-77, assumes farming of: (a) 126,000 acres to be benefitted by irrigation improvement under the Mahaweli Project, Step 1 of Phase 1; (b) 103,000 acres new irrigation under the Mahaweli Project, Step 2 of Phase 1; (c) part of the 21,000 acres of new land to be made available under the Uda Walawe Development Scheme - a colonization scheme for rice and other crops; and (d) 20,000 additional acres each year under the normal irrigation expansion program. In the final year of the 7-year plan, it is estimated that the total area under paddy production and the per acre yields will have increased by 16 percent and 45 percent, respectively, from the 1969-70 levels. On the basis of current yields, the estimate of the 7-year plan seems reasonable, assuming appropriate policies are followed.

87. The long-run policy issues on the subsidiary crops are basically the same as those in the short run. A continuous effort to reduce imports must be accompanied by a reasonable level of domestic production incentives.

This also applies to other food import items such as sugar, fish, dairy products, chillies and onions. Ceylon should seek the fullest economic exploitation of the fact that domestic production of most major import items is technically feasible. Considering their large import bills, particular emphasis should be given to the problems of fisheries and sugar production. The problems of water supply and price incentives for domestic production of sugarcane are largely matters of government determination. The high per capita sugar consumption rate and the generally held view of the unsubstitutability of imported fish may deserve a careful re-examination. Ceylon's fishery resources have not yet been clearly identified. The ADB study results, due sometime in 1971, may provide a useful basis for determining the long-term relative prospects for coastal and deep water fishing. In any event, the programs for mechanization of fishing boats and improvement of marketing systems will have to be continued for some time to come. Expansion of the livestock industry would also be a desirable objective in the long run. This will require a plan for increased supply of pasture as well as increasing feedgrains. One approach to this sector's growth might be more efficient use of dry zone lands.

88. A number of long-run development policies for agricultural exports, were outlined in last year's Economic Mission Report. The expansion of coconut products exports not only deserves short-run attention but could be a key long-run program. Basically, there are two problems to be solved in this sector: increasing the total output of coconuts and exporting a greater proportion of the total output by restraining domestic consumption. Coconut production can be substantially increased by more intensive use of fertilizer, particularly on smallholdings and small estates which occupy some two-thirds of the total coconut land area. Extension services which are inadequate at present, should be stepped up and an additional effort should be made to demonstrate the profitability of more intensive use of fertilizers. Further investigation would be necessary to identify the reasons for the low rate of fertilizer use in the past, in spite of the government's cost sharing arrangements. If necessary, the government must be willing to increase incentives for fertilizer use. Plans for increasing the land use efficiency of some 1.1 million acres registered as coconut farms should be formulated. Determination of the replantable area and of the replanting rate, the extent of diversification (though it is considered of lower priority), identification of bottlenecks in replanting and rehabilitation such as the shortages of new seedlings at the Coconut Research Institute, should be included as part of this plan. Possibilities for livestock and intercropping on the coconut farms should also be fully explored. It is understood that some of these approaches are now being considered by the government and the UNDP crop diversification study team.

89. In view of Ceylon's balance of trade deficit and the market constraint the tea industry is faced with, the Government of Ceylon should give far more attention to rubber exports than in the past. Considering the relatively favorable long-term projection of natural rubber demand and prices, and the potential for increasing the per acre yield and for reducing costs by replanting rubber with improved clones, Ceylon should accelerate the current rate of replanting and explore the possibility of expanding rubber land. In order for Ceylon to maintain a competitive position with other natural rubber-producing countries, this reduction of production costs is a necessary step. Any accelerated replanting program must be carefully planned and some new land should be planted in order to avoid jeopardising production levels. The government should consider subsidizing new planting and increasing the replanting subsidy, if this is necessary to accelerate the pace. The 33-year replanting cycle should be re-examined to determine the optimum rate of replanting. This optimum rate should be determined on the basis of both technical information and a reasonable assumption of Ceylon's ability to implement an accelerated replanting cycle after identifying the causes of the poor replanting performance in recent years. The increasing attention now given by the government to "block rubber" manufacturing is an encouraging sign. A more vigorous plan is desirable in this area, and in this connection Ceylon's current target of 30,000 tons of block rubber production by 1977 should be re-examined. Above all, it is important to assure sufficient price incentives to the rubber producers, if Ceylon is to exploit fully the foreign exchange earning potential of the rubber industry.

90. Although prospects for expansion are poor, tea export earnings will continue to be Ceylon's main source of foreign exchange within the foreseeable future. A basic long-term tea policy objective should be to maintain and possibly expand the current level of tea export revenue. Ceylon must maintain the current level of production with less resource commitment by replanting with high yielding clones, and restructuring the tea industry in such a way as to realize the most economic use of the surplus resources which will be released from the tea industry. In the previous Economic Report, it was recommended that the Government of Ceylon formulate and announce a comprehensive tea policy and detailed replanting and diversification schedules during 1970. The report also pointed out that Ceylon needs to work toward: (a) reaching a long-term tea agreement without retarding the growth of demand for tea in lower income countries; (b) promoting tea consumption in the countries where coffee consumption is high; and (c) further processing of tea in Ceylon. Partly due to the change of government and partly due to lack of detailed agro-economic information on crop diversification (presently being gathered by the UNDP team), Ceylon has not yet been able to formulate a comprehensive tea policy including replanting and diversification. However, the basic problems of the tea industry and the policy implications seem to be generally recognized and are currently under active consideration by the government. The formulation and announcement of the long-term plans and policies re-

garding the tea industry and clarification of the government's position on important issues such as intended degree of government control of the industry, are strongly urged. An explicitly announced long-term tea policy will help stimulate the adjustment process of the tea industry by clearing away some of the concerns and uncertainties shared by the private tea estates in recent months. Since recent fiscal policy changes relating to taxation, price incentives and the FEEC system have resulted in a favorable net effect on domestic crops relative to export crops, and considering the heavy tax burden on the tea industry, a thorough review of policies in relation to tea industry should be undertaken. This would provide an opportunity to analyze what has been termed the "financial crisis of the tea industry in Ceylon", and to assess its current profit position. No private sector industry can be expected to survive in the long run without a reasonable return on investments.

Agricultural Statistics

Table 7.1

VALUE OF AGRICULTURAL OUTPUT - 1963 - 1969

AT CURRENT MARKET PRICES

(Rs. Millions)

Crop or Product	1963	1964	1965	1966	1967	1968	1969 *
Tea	916.7	910.4	924.7	837.7	791.1	915.6	818.4
Rubber	225.6	224.7	242.7	260.6	234.7	256.9	381.6
Coconut	255.4	307.5	347.1	327.6	317.8	424.1	437.0
Minor export crops	38.0	50.6	46.6	45.8	43.5	53.5	66.7
Rice	506.0	520.8	376.6	475.9	663.0	890.4	900.2
Other food crops	369.7	405.5	405.8	424.3	459.0	540.2	573.5
Tobacco	17.7	18.1	23.8	25.7	27.5	29.4	34.1
Betel & Arecanuts	35.3	32.8	29.6	28.4	29.7	29.9	34.3
Miscellaneous agricultural products	18.5	20.3	20.3	21.2	22.3	27.0	28.2
Livestock	181.7	192.1	193.5	198.9	223.0	254.7	258.5
Firewood & Forestry	88.6	95.7	102.3	103.0	109.9	123.2	151.2
Fish	130.5	127.1	148.0	164.0	187.4	224.7	245.5
Total:	2783.7	2905.6	2861.0	2913.1	3108.9	3769.6	3929.5

Source: Ministry of Planning and Employment,
Department of Census & Statistics.

* Provisional.

Table 7.2

VALUE OF AGRICULTURAL OUTPUT -1963 - 1969

AT CONSTANT (1963) MARKET PRICES

Crop or Product	1963	1964	1965	1966	1967	1968	1969 *
Tea	916.7	911.2	951.5	926.8	920.8	937.8	915.8
Rubber	225.6	263.6	279.2	309.6	307.6	319.5	324.0
Coconuts	255.4	284.3	267.2	243.0	235.1	243.6	234.3
Minor export crops	38.0	49.1	42.2	43.5	42.2	48.1	57.3
Rice	506.0	519.4	465.9	470.0	565.3	664.3	677.3
Other food crops	369.7	389.4	368.9	376.7	397.3	437.8	450.0
Tobacco	17.7	16.8	22.9	22.8	24.0	24.7	28.7
Betel & Areconuts	35.3	36.2	37.1	37.9	39.1	39.6	39.9
Misc. Agricultural Products	18.5	20.3	20.3	21.2	22.3	27.0	28.2
Livestocks	181.7	188.5	186.6	189.6	211.8	219.2	219.8
Firewood & Forestry	88.6	95.4	103.4	105.1	111.7	102.8	108.3
Fish	130.5	121.3	136.7	141.4	154.7	169.0	180.5
Total:	2783.7	2895.5	2881.9	2887.6	3031.9	3233.4	3264.1

Source: Ministry of Planning and Employment, Department of Census & Statistics.

* Provisional.

Table 7.3

VALUE OF MINOR CROPS AT CURRENT PRICES 1/

(Rs. Millions)

Crops	1965	1966	1967	1968	1969 2/
Kurakkan	6.5	7.2	9.0	7.5	9.9
Maize	4.1	4.7	5.0	6.5	9.3
Green Gram	2.7	1.6	1.8	2.4	2.9
Cow Pea	1.4	1.6	1.6	1.5	2.0
Gingelly	6.1	4.4	5.8	8.8	7.9
Ground Nuts	1.8	1.3	2.2	5.5	4.1
Manioc	41.3	41.7	65.3	89.4	87.5
Sweet Potatoes	8.6	11.6	19.3	22.5	18.6
Potatoes	1.3	2.8	7.9	26.7	32.4
Mustard	2.6	2.4	1.6	2.0	2.2
Pepper	33.5	33.7	30.7	31.5	41.1
Chillies Dried	1.0	1.5	5.7	8.9	10.3
Red Onions	16.6	19.3	19.2	19.9	22.7
Total:	127.5	133.8	175.1	233.1	250.9

Source: Ministry of Planning and Employment, Department of Census & Statistics.

1/ Excluding meneri, sorgham, ginger, tumeric, green chillies and coffee.

2/ Provisional.

Table 7.4

PRODUCERS' PRICES FOR PRINCIPAL AGRICULTURAL PRODUCTS

(Rupees)

Commodity	Unit	1958	1963	1964	1965	1966	1967	1968	1969*
Tea	Lb.	1.89	1.82	1.81	1.76	1.67	1.54	1.80	1.68
Rubber	Lb.	.96	.74	.70	.71	.71	.71	.72	.73
Coconuts	Per'000	-	116.00	124.00	145.00	152.00	152.00	190.00	202.00
Rice	Measure	-	.72	.72	.76	.78	.91	1.03	1.02
Other Crops									
Kurakkan	Bushel	7.59	10.85	9.77	9.54	10.29	12.98	14.05	15.18
Maize	"	11.66	10.32	9.56	10.88	12.65	12.63	14.43	14.39
Green Gram	"	25.00	20.92	20.65	19.98	17.34	22.29	27.17	29.87
Gingelly	"	19.80	22.17	25.56	25.38	18.99	22.56	27.54	22.58
Manioc	Cwt.	7.42	7.73	7.13	7.14	7.48	9.48	10.70	11.05
Sweet Potatoes	"	10.92	11.75	9.29	8.92	9.62	13.38	15.04	14.27
Mustard	"	106.30	95.20	105.28	114.24	110.42	75.05	67.20	92.50
Pepper	"	129.40	122.64	118.64	193.76	172.84	140.00	140.00	160.00
Chillies Dried	"	94.29	95.85	102.74	103.01	152.65	252.00	268.85	228.15
Red Onions	"	28.52	26.49	32.21	26.38	31.11	30.40	29.00	30.75
Cow Pea	"	-	15.96	17.64	17.90	19.01	16.51	17.00	17.43
Ground Nuts	"	-	14.73	14.13	14.36	12.51	16.33	19.51	18.66
Potatoes	"	-	-	-	-	-	52.16	74.20	61.15
Fish	"	66.61	72.49	75.98	78.47	84.05	87.82	96.38	98.57

Source: Ministry of Planning and Employment, Department of Census & Statistics

* Provisional

Table 7.5

RETAIL MARKET PRICES FOR SELECTED AGRICULTURAL PRODUCTS

(Rupees)

	1965		1966		1967		1968		1969		1970 Jan.-Oct.	
	C.[1/]	O.M.[2/]	C.	O.M.	C.	O.M.	C.	O.M.	C.	O.M.	C.	O.M.
Rice (raw & parboiled) (per measure of 2 lbs.)		.85		.82		1.11		1.19		1.20		1.21
Dried Chillies (per lb.)	1.26	1.41	1.47	1.90	1.63	3.27	1.60	4.00	1.60	3.02	1.60	3.86
Red Onions (per lb.)	.30	.35	.28	.29	.28	.34	.28	.42	.28	.35	.28	.44
Bombay Onions (per lb.)	.25	.28	.26	.29	.26	.32	.31	.41	.27	.31	.32	.37
Potatoes (per lb.)	.25	.32	.26	.32	.47	.71	-	1.01	.65	.86	.76	.85

1/ C. = Controlled price; a regulated price as at co-operative stores, etc.

2/ O.M. = Open market price

Source: Ministry of Planning and Employment, Department of Census & Statistics, Colombo, Ceylon.

Table 7.6

RICE: BASIC STATISTICS

Year	Rice Production (millions bushels)			Net Acreage Harvested 1/ (1,000 acres)			Average Yield Per Net Acre Harvested (bushels)	
	Maha	Yala	Total	Maha	Yala	Total	Maha	Yala
1959	21.9	14.5	36.4	645.1	398.7	1,043.8	34.1	36.4
1960	26.3	16.7	43.0	728.5	455.5	1,184.0	36.1	36.8
1961	27.1	16.0	43.1	754.4	441.4	1,195.8	35.9	36.5
1962	30.3	17.8	48.1	795.9	472.6	1,268.5	38.0	37.7
1963	31.6	17.6	49.2	834.5	462.1	1,296.6	37.8	38.0
1964	32.1	18.4	50.5	832.8	471.7	1,304.5	38.6	38.9
1965	23.1	13.2	36.3	676.3	379.9	1,056.2	34.1	34.7
1966	30.7	15.0	45.7	856.0	429.5	1,285.5	35.9	35.0
1967	34.9	20.1	55.0	855.4	476.5	1,331.9	40.9	42.0
1968	43.5	21.1	64.6	916.2	472.8	1,389.0	47.5	44.6
1969	46.9	18.9	65.8	916.7	460.9	1,308,512	51.2	48.2
1970	49.5	23.8 *	73.3 *	947.941	501.057 *	1,448,998	52.2	47.55 *
1971 **	53.91	25.56	79.47	992.590	514.556	1,507,146	54.31	49.68

1/ The net acreage harvested is estimated to be 85% of the gross area planted.

Sources: Annual Report 1968 Central Bank of Ceylon;
Statistical Abstract of Ceylon.
Ministry of Agriculture and Food.

* Provisional
** Targets

Table 7.7

BASIC STATISTICS - TEA

(i)	(ii)	(iii)	(iv)	(v)			(vi)		(vii)
				Seedling Area in Bearing			Clonal Area in Bearing		
Year	Total registered tea acreage	Acreage uprooted and immature tea	Acreage of tea in bearing (clonal and seedling)	(a) Yield per acre lbs.	(b) Acreage	(c) Output-lbs.	(a) Acreage	(b) Output - lbs.	Total Output lbs.
1965 ..	594,308	19,008	575,300	872	572,943	500,143,339	2,357	3,031,000	503,174,339
1966 ..	596,445	21,618	574,827	848	569,950	483,385,925	4,877	6,729,500	490,115,425
1967 ..	598,814	25,680	573,134	839	565,854	475,081,350	7,280	11,571,000	486,652,350
1968 ..	597,490	26,261	571,229	851	560,854	447,356,782	10,375	18,248,500	495,605,282
1969 ..	597,500	27,958	569,542	824	555,854	457,752,464	13,688	26,469,500	484,221,964
1970* ..	597,500	28,189	569,311	n.a.	550,354	n.a.	18,957	n.a.	476,000,000

* Estimated

Source: Ministry of Plantation Industries, Office of Tea Control.

Table 7.8

CHANGES IN LIVESTOCK POPULATION AND PRODUCTION

Population

Year	Cattle	Buffalo	Poultry	Pigs	Sheep
1965	1.903,576	1,051,009	6,089,933	116,945	34,586
1966	1,745,759	832,364	6,500,219	122,069	25,930
1967	1,659,226	764,543	6,255,774	128,189	24,593
1968	1,659,603	783,228	6,747,873	124,377	24,819
1969	1,584,462	765,437	6,578,032	108,313	28,260

Production
(numbers slaughtered)

Year	Cattle	Buffalo	Poultry	Pigs	Sheep Mutton Goat	Milk (mil. bottles)
1965	189,756	17,878	2,152,224	13,735	140,166	223.0
1966	224,647	18,500	2,342,924	17,162	139,282	233.2
1967	221,949	21,000	2,258,708	19,790	160,228	245.4
1968	227,082	23,500	2,409,938	18,926	160,622	257.8
1969	236,735	24,628	2,369,062	18,542	125,203	270.6

Source: Ministry of Planning and Employment,
Department of Census and Statistics.

Table 7.9

MAJOR EXPORT CROPS: PRODUCTION AND YIELDS

	1965	1966	1967	1968	1969	EST. 1970
Production						
Tea (m. lbs.)	503	490	487	496	484	476
Rubber (m. lbs.)	261	289	316	328	332	356
Coconut (m. nuts)	2,841	2,630	2,589	2,778	2,616	2,800
Yields						
Tea (lbs. per acre)	872	848	839	851	824	n.a.
Rubber (lbs. per acre)	590	618	643	671	n.a.	n.a.

Source: Ministry of Plantation Industries.

Table 7.10

EXPORTS OF MINOR AGRICULTURAL PRODUCTS

		1967	1968	1969
1.	Coir fiber mattress ('000 cwt.)	1,065	1,260	1,180
2.	Coir fiber bristle ('000 cwt.)	538	564	507
3.	Tobacco, unmfg. ('000 lbs.)	942	1,340	709
4.	Citronella oil ('000 lbs.)	338	298	403
5.	Cinnamon oil ('000 lbs.)	45.0	80.6	95.1
6.	Cinnamon quills ('000 cwt.)	52.8	61.8	65.9
7.	Cocoa beans ('000 cwt.)	23.2	34.8	25.4
8.	Cinnamon chips ('000 cwt.)	7.9	16.6	21.6
9.	Pepper ('000 cwt.)	2.0	16.2	17.9
10.	Leather ('000 cwt.)	10.2	13.4	11.9
11.	Coir yarn ('000 cwt.)	7.0	5.7	8.9
12.	Cloves ('000 cwt.)	0.85	0.95	4.6
13.	Chocolate & cocoa preps. ('000 lbs.)	0.49	4.6	n.a.
14.	Fruit, tinned or bottled ('000 cwt.)	0.8	4.5	3.7
15.	Cardamoms ('000 cwt.)	2.4	2.5	3.2
16.	Fish ('000 cwt.)	3.7	3.1	2.6
17.	Nutmeg ('000 cwt.)	0.76	2.1	2.5

Source: Ceylon Customs Returns and Annual Reports of the Central Bank of Ceylon for 1968 and 1969.

Table 7.11

FERTILIZER CONSUMPTION IN CEYLON: 1965 - 1969

	Fertilizer (tons of products)					Nutrients ('000 tons)		
	Sulphate of Ammonia	Urea	Rock Phosphate	Muriate of Potash	Others	N	P_2O_5	K_2O
1. Tea								
1965	107,605	125	22,054	27,332	4,046	22.2	6.1	15.0
1966	102,562	135	18,728	26,555	10,631	21.1	5.1	14.6
1967	106,111	625	16,689	20,824	5,244	21.9	4.6	11.4
1968	95,033	6,346	14,998	20,529	9,752	22.5	4.1	11.3
1969	71,755	10,209	13,727	18,545	7,493	19.3	3.8	10.2
2. Rubber								
1965	7,964	3	7,959	2,646	3,214	1.7	2.2	1.4
1966	8,405	4	8,291	2,927	3,088	1.7	2.3	1.6
1967	8,794	15	8,204	3,154	3,112	1.8	2.3	1.8
1968	8,655	-	6,422	3,183	2,774	1.8	1.8	1.7
1969	8,160	15	8,084	3,784	2,716	1.7	2.2	2.1
3. Coconut								
1965	16,143		16,142	16,142	-	3.3	4.4	8.9
1966	17,497		17,498	17,497	-	3.6	4.8	9.6
1967	16,529		16,529	16,529	-	3.4	4.5	9.1
1968	29,849		16,547	16,568	5	6.1	4.5	9.1
1969	29,850		14,950	14,929	-	6.2	4.1	8.2
4. Paddy								
1965	17,529	5,538	10,825	4,690	710	6.1	3.0	2.5
1966	19,181	8,780	10,369	6,094	1,379	8.0	2.8	3.3
1967	26,155	15,697	18,118	12,213	4,827	12.6	5.0	6.7
1968	26,701	25,684	11,250	8,106	15,790	17.3	3.1	4.5
1969	23,288	26,223	7,784	9,498	18,513	16.9	2.1	5.2
5. Others								
1965	11,724	20	7,311	3,746	11,568	2.4	2.0	2.0
1966	13,085	20	10,015	4,881	9,791	2.7	2.8	2.6
1967	16,874		9,381	8,031	7,223	3.5	2.6	4.4
1968	17,168	676	14,808	8,157	11,099	3.5	4.1	4.5
1969	18,657	1,112	118,278	7,403	10,515	4.3	5.0	4.1
6. Total								
1965	160,962	5,686	64,291	54,556	19,558	35.8	17.7	30.0
1966	160,730	8,939	64,901	57,954	24,889	37.2	17.8	31.8
1967	174,463	16,338	68,921	60,751	20,406	43.4	19.0	33.4
1968	177,406	32,706	64,025	56,543	39,420	51.3	17.6	31.1
1969	151,690	37,559	62,823	54,109	39,235	48.4	17.2	29.8

Source: Ministry of Plantation Industry.

Table 7.12

PLAN FOR SELF-SUFFICIENCEY IN RICE (1971-77)1/

Year	Population	Area laid out for paddy cultivation	Net Area Harvested			Yield per Acre		Production			Demand for Paddy	Self-sufficiency	Difference 11-12	
			Maha	Yala	Total	Maha	Yala	Maha	Yala	Total			Paddy	Rice
	Millions	Acres	Acres	Acres	Acres	Bushels		Million Bushels			Million Bushels	%	Million Bushels	Tons
	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1967-68	12,072	1,342,056	916,175	472,842	1,389,017	47.49	44.59	43.51	21.08	64.59	99.3	65.04	-34.71	-492,619
1968-69	12,341	1,386,709	916,760	391,752	1,308,512	51.23	48.24	46.96	18.89	65.85	99.9	65.85	-34.14	-484,530
1969-70	12,616	1,386,753	947,941	501,057*	1,448,998*	52.21	47.55*	49.49	23.82*	73.31*	102.22	71.71	-28.91	-410,303
1970-71	12,896	1,409,753	992,590*	514,556*	1,507,146*	54.31*	49.68*	53.91*	25.56*	79.47*	104.51	76.04	-25.04	-355,379
1971-72	13,185	1,429,753			1,540,373	56.71				87.35	106.83	81.76	-19.48	-276,468
1972-73	13,480	1,450,253			1,568,373	60.58				95.00	109.23	86.97	-14.23	-201,958
1973-74	13,758	1,469,253			1,592,373	64.33				102.43	111.48	91.88	- 9.05	-128,441
1974-75	14,043	1,487,253			1,621,943	68.24				110.67	113.78	97.26	- 3.11	- 44,138
1975-76	14,334	1,504,253			1,653,853	72.38				119.70	116.14	103.06	+ 3.56	+ 50,525
1976-77	14,630	1,514,253			1,686,403	75.59				127.47	118.54	107.53	+ 8.93	+ 126,732

1/ This table has been updated wherever necessary but in regard to columns 4,5,7,8,9 and 10 the figures are not furnished separately for the two seasons for the year 1971 to 1977 as no projections are available seasonwise. However, the average figures for both seasons are shown.

* Provisional.

Source: Ministry of Agriculture and Lands.

III. MANUFACTURING

A. RECENT STRUCTURAL CHANGES

91. In the decade 1960-69, Ceylon's industry was growing faster than most other economic sectors, its average annual growth rate being 5.9% as compared with 4.7% for GDP (at constant prices). The contribution of the manufacturing sector to the increase of GDP amounted, in the same period, to 15.4%. At the same time, its share in GDP increased from 11.5% to 13%. The pace of industrial growth has been slightly higher in the second half of the decade. In 1965-69, the output of industry, at constant prices rose by 30.3% as compared to 23.7% in 1960-64. This was due to easier procurement of imported materials under the Open General License scheme introduced in May 1968, as well as structural changes within the sector.

92. The analysis of structural shifts within industry is not an easy task given the absence or inadequacy of statistical information. Existing statistics understate the level of manufacturing to some extent since they do not include primary processing of rice and, more important, of tea and rubber. These items would amount, according to the estimate for 1968, to 5% of GDP, and one percent more should be ascribed to handloom textiles and other cottage industries. On the other hand, the proportion of manufacturing to total output is overstated in part because of under-evaluation of subsistence agriculture.

93. In addition, the major series of industrial statistics of Ceylon are confined to gross value of production figures at current prices. Bearing in mind that the import component of industrial output is quite high, and that the prices of imported materials have been steadily increasing, it is clear that the picture of changes in relative importance of individual industries may be distorted if based on non-value added figures only. 1/ In spite of these gaps, certain viable, if not always quantifiable, conclusions on structural changes can be drawn even from the existing statistical sources.

(a) Although the basic pattern of industry remained the same throughout the period 1965-69, certain important modifications became apparent towards the end of the period. First, several new industries were established, such as a 72,000 ton iron and steel plant, a tire plant, a petroleum refinery, manufacture of glass products, machinery, and some chemical and wood products. The value of output by units which began producing in 1967 or later, amounted in 1969 to Rs.178 million or 11% of total industrial production. Second, apart from new industries, the relative weight of several other industries rose sharply. The share of this

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1/ Between 1965 and 1969 industrial production increased by 92% in terms of gross value at current prices, and by 30% in terms of GDP at constant prices, the increases being differently distributed among the industries.

rapid grwoth group (food preparations and beverages, ceramics, cement, ilmenite, electrical machinery and appliances, and manufactures n.e.s.) increased from 22% to 30%, while the aggregate share of the slower growing industries (vegetable oils and fats, food confectionary, wearing apparel, leather products, rubber products other than tires, industrial and other chemicals) declined from 47% to 29%. Third, while the preponderant weight of food processing and textiles has gradually been reduced from 66.4% in 1965 to 53.5% in 1969, fabricated metal products and simple machinery (particularly machinery for tea and rubber processing, and sewing machines) and equipment, have emerged as a growing segment of industry (16% in 1969 as compared with 7% in 1965). More generally, a distinct shift in the pattern of industry towards somewhat more sophisticated lines of industrial activity, has become identifiable. 1/ By the same token, the share of investment goods almost doubled (from 9% to 17%) at the expense of both consumer goods (from 54% to 52%) and intermediate goods (from 37% to 31%). It is largely owing to these trends that the share of industries other than those engaged in tea, coconut and rubber processing, has for the first time become predominant in the second half of the sixties.

(b) These general trends have been reflected in changes in the size of firms and the distribution of work force within industry. This is shown in Table I below.

1/ For instance, out of 667 manufacturing units approved in 1965-67, about 250 were concerned with the manufacture of metal products, machinery and transport equipment.

Table I

DISTRIBUTION OF FIRMS AND EMPLOYEES, 1965 AND 1969
(In percent)

	Number of Firms 1965	Number of Firms 1969	Number of Employees 1965	Number of Employees 1969
Total Number	1,381	1,962	56,835	103,726
Percentage Distribution:				
Manufacture of Food, Beverages and Tobacco	52.7	33.3	36.4	30.7
Textiles, Wearing Apparel, and Leather Industries	16.5	27.4	31.9	24.6
Manufacture of Wood and Wood Products	0.1	0.7	1.1	3.3
Manufacture of Paper and Paper Products	4.3	4.8	4.1	4.7
Manufacture of Chemicals, Petroleum, Coal, Rubber and Plastic Products	13.8	14.1	13.6	12.0
Manufacture of Non-Metallic Mineral Products (except Petroleum and Coal)	1.0	3.8	3.9	7.5
Manufacture of Metal Products, Machinery and Equipment	9.0	14.5	7.9	16.4
Manufactured Products n.e.s.	2.6	1.4	1.1	0.8

Source: Central Bank of Ceylon, Annual Reports for 1965 and 1969.

Between 1965 and 1969, the total number of employees in the manufacturing sector almost doubled, and the number of enterprises rose substantially as well. 1/ The average size of a firm, measured by the number of employees, reached 53 employees, as compared with 41 at the beginning of the period. Also important are some changes in sectoral distribution of firms and employees, as indicated by the above table. Among them, three different trends are noticeable: (i) A group of industries can be identified, whose weight in terms of firm, employment and production figures, rose considerably. This applies to manufacture of metal products, machinery and equipment, non-metallic mineral products (other than petroleum and coal products),

1/ The Department of Census and Statistics has identified some 21,000 industrial units, in both manufacturing and primary processing sectors. The statistics of the Ministry of Industries and Scientific Affaires include some 2,600 enterprises, of which about 75 percent, accounting for nearly all manufacturing output, have been covered by statistical surveys.

paper and wood products. The share of these industries in total employment rose from 17% to 42%, much faster than in terms of firms (from 14% to 29%) and value of output (from 16% to 28%). These figures imply that the trend towards concentration has not been matched by a corresponding increase in productivity; (ii) The share of food processing and textile industries has clearly declined in all categories under consideration, except for the number of textile firms. This last phenomenon can be ascribed both to the expansion of the number of very small production units and to increased statistical coverage.

A condensed picture of the changes in size distribution of manufacturing firms is given in Table II below.

Table II

DISTRIBUTION BY SIZE OF MANUFACTURING FIRMS, 1965 AND 1969

	1965 1/		1969 2/	
	% of firms	% of Output/ Wage Bill	% of firms	% of Output/ Wage Bill
By value of output				
Less than Rs. 0.25 Mn.	69	8	72	6
Rs. 0.25 Mn - Rs. 2 Mn.	24	26	20	16
More than Rs. 2 Mn.	7	66	8	78
By wage bill				
Less than Rs. 50,000	78	16	72	10
Rs. 50,000 - Rs. 500,000	19	37	24	29
More than Rs. 500,000	3	47	4	61

1/ Number of firms covered: 782.
2/ Number of firms covered: 1,537 for output value, and 1,347 for wage bill distribution.

Source: Central Bank of Ceylon, Annual Reports for 1965 and 1969.

Enterprises falling into the categories of output of Rs. 2 million and above (in the case of output) and wage bills of Rs. 0.5 million and above, are clearly becoming more significant. The share of firms in the lowest categories (those below Rs. 250,000 and Rs. 50,000 respectively) would have been much greater had the coverage of productive units been more complete.

(c) Another outstanding feature of Ceylon's industrial development has been its heavy and growing reliance on imported raw materials (not to

speak of imported machinery, equipment, spare parts, accessories, and fuel). Table III offers some insight into this matter.

Table III

IMPORTED RAW MATERIALS USED IN INDUSTRIAL PRODUCTION, 1965 AND 1969
(as % of total raw material usage)

	1965	1969
Manufacture of Food, Beverages, and Tobacco	35	47
Textiles, Wearing Apparel and Leather Industries	79	72
Manufacture of Wood and Wood Products	15	13
Manufacture of Paper and Paper Products	70	68
Manufacture of Chemicals, Petroleum, Coal, Rubber and Plastic Products	53	74
Manufacture of Non-metallic Mineral Products (except Petroleum and Coal)	82	62
Basic Metal Products	-	94
Manufacture of Fabricated Metal Products, Machinery and Equipment	71	79
Manufactured Products n.e.s.	87	88
Total	57	66

Source: Central Bank of Ceylon, Annual Reports for 1965 and 1969.

Although the above figures are neither very accurate 1/ nor strictly comparable 2/, they provide an indication of the basic orders of magnitude. First of all, import content in raw material usage is less than 50% in only two sectors - food processing and manufacture of wood and wood products. Other industries were in 1965 in the range between 50 and 90 percent, and in 1969 between 60 and 95 percent. Several new industries which encompass the bulk of relatively sophisticated products, fall into the group with highest import content. As for the sharp decline in the import content of non-metallic mineral products, it can be explained by the expansion of cement production which has been increasingly based on local materials. Finally, since raw materials account for almost half of the total value of production (49% in 1965 and 47% in 1969), the import content of industrial production has attained the remarkable level of nearly one third of the value.

1/ The actual share of imported raw materials is greater, since many firms classify only raw materials directly imported by them as being of foreign origin.

2/ The number of reporting firms in food processing industry was 184 and 574 in 1969 and 1965, respectively, while in textiles it was 511 and 187, respectively. The difference in total firm coverage, however, was not beyond limits (1,385 firms in 1969, and 1,076 in 1965).

(d) As can be seen in Table 8.5 in the Statistical Appendix, the value of industrial exports virtually doubled in the years 1965 - 69. Given the tiny base however this still leaves their total very low. With an unchanged level of total exports the share of industrial products in total exports rose from 0.7% to 1.4%. At the same time the export component of total industrial production has hardly changed. The portion of industrial production sold abroad accounted for 1.7% in 1969, as compared with 1.6% in 1965. The bulk of exported industrial goods consists of semi-manufactures. Kapok fibre, hides and leathers, glycerol, alcohol phenol, glycerine and fatty acids, graphite, ilmenite and mica, accounted in 1965 for Rs. 12.4 million or 92% of total industrial exports and in 1969 for Rs. 19.1 million or 71% of total industrial exports. The group of non-metallic mineral products (graphite, ilmenite, mica) is responsible for about a half of the country's industrial exports. On the other hand, the value of manufactures exported (total industrial exports minus exports of semi-manufactures)[1/] rose between 1965 and 1969 from Rs. 1.1 million to Rs. 7.9 million. Their share in total industrial production reached 0.5% in 1969, as compared with 0.1% in 1965. They still comprise less than ½ percent of total exports.

(e) Ceylon's statistics lack systematic information on both the supply and demand aspects of the market for manufactured products. Nevertheless, some attempt can be made to assess the dimensions and dynamics of this market. An approximation is shown in the computation in Table IV below.

Table IV

MARKET FOR MANUFACTURED PRODUCTS
(Rs. million at Current Prices)

	1965	1969
Manufacturing output	847	1,627
Manufactured imports	853	1,540
Manufactured exports	14	27
Imported inputs	276	504
Balance	1,410	2,636

1/ Principal manufactures exported are: fruits canned or bottled, biscuits and other food processed; cotton made articles; clothing, footwear articles; articles made of rubber and of wood; soaps, spectacle frames; various metal ware; tea machinery driers, parts; electrical aparatus, batteries.

94. In four years, the domestic market for manufactures increased from Rs. 1,410 million to Rs. 2,636 million or by 87%.[1/] It is interesting to note that the amounts of manufactured imports and output remain comparable. While on the one hand this would suggest that the results of the long pursued import substitution policy have not been impressive, the aggregate data do not take into account the increasing sophistication of the newer products produced and shifts in the sector composition of output as rising incomes create demand for items with a relatively higher import content.

1/ Here again, the reservations deriving from combined effects of changes in domestic prices and terms of trade should be taken into account.

B. STATE INDUSTRIAL CORPORATIONS

General

95. Ceylon's first large scale industries were set up by the state in preindependence days. Several factories, under the then Department of Industries, were involved in manufacturing rolling steel, coir yarn, acetic acid, quinine and other drugs, paper, plywood, leather, glass and ceramics. By 1950, most of them had incurred considerable losses and were closed down; the last four listed survived. Subsequently, the government established new industries: textiles, cement, vegetable oils, caustic soda and, again, paper. In 1955 all state factories were converted into state corporations. At the same time, a policy statement delineated the areas reserved for public and private sectors. Iron and steel, cement, chemicals, fertilizers, salt, mineral sands, sugar and rayon were reserved for the public sector, while some 82 commodities (mostly consumer goods, but also some others like car assembly, pesticides, nuts and bolts) were earmarked for the private sector. Some important industries, like textiles, paper, plywood, tiles, bicycles, leather products, ceramics and glassware, were declared open to both sectors.

96. Today there are 26 public corporations established under the State Industrial Corporations Act. In the period under consideration (1965-1970), one public corporation - Ceylon Hardboard - was wound up (February 1966). For various reasons, six of them will not be dealt with in this report. State Engineering Corporation is engaged in construction, State Timber Corp. deals with timber extracting, not with its processing, Ceylon Fertilizer Corporation only mixes and sells imported materials. Industrial Estates Corporation has been little engaged in manufacturing, and the Industrial Development Board is in the course of being transformed into a small industry promotional agency. Out of twenty remaining corporations, thirteen were founded before 1965. These are: Ceylon Cement, Ceylon Plywoods, National Textile, National Small Industries, Ceylon Oils and Fats, National Milk Board, Ceylon Ceramics, Paranthan Chemicals, State Hardware, Ceylon Leather Products, Ceylon Mineral Sands, Eastern Paper Mills and Ceylon Fisheries Corp. Four corporations have begun to operate more recently: Ceylon Steel and Ceylon Tyre in 1967, Ceylon State Flour in 1968, and Ceylon Petroleum Corp. in 1969. Three more corporations have been founded since 1965, to take over operations from other public corporations or government bodies: National Salt and Sri Lanka Sugar in 1966, and Ceylon Ayurvedic Drugs in 1969.

Output trends

97. In 1969/70, the output of public corporations reached Rs. 561.7 million, as compared with Rs. 100.4 million in 1965/66. The larger part of the total increase derives from four new public corporations, whose output amounted to 1969/70 to Rs. 288.6 million or more than a half of total output in public industrial sector. Output of the sixteen "old" corporations rose in the same period to Rs. 273.1 million or 2.7 times. The share of public corporations in the total value of Ceylon's industrial output increased from 11.9% in 1965/66 to 34.5% in 1969/70. The share would fall to 20.4% if the four newly established public corporations are omitted. In the same period, the number of employees in the public sector more than doubled, increasing from 11,315 to 22,814.

98. It is very difficult to assess the performance of public corporations with any precision. In addition to general reservations with which any quantification of production in value terms must be approached, differences in pricing policies, which are very pronounced in some cases, have to be considered. One approach would be to group them into a few categories on the basis of trends in the period 1967/68-1969-70. The first group would then include corporations which have experienced a substantial increase in production - that is, whose output rose by more than 50% in two years. These are: Textile, Cement, Tyre, Milk, Mineral Sands, Salt and Fisheries. In the first four cases, the increase has clearly been due to the expansion of capacities or their coming into regular operation; in the remaining cases, a low starting point or seasonal variations proved to be of importance. In the second group are: Ceramics, Steel, Paper, Leather, Hardware, Oils and Fats, and Plywood. These have shown a low or moderate increase in production which in some cases, if computed in real terms, may be non-existent. Finally, Small Industries, Chemicals and Sugar are in the group, showing a distinct decrease in production.

99. In the year 1970, however, some important reversals occurred. Comparing physical output in 1970 and 1969, only the Cement, Tyre, Hardware, Small Industries and Paranthan Chemicals have had a clear-cut production increase. For cement, the increase was 13%, tyres 16.5%, tubes 124%, caustic soda 42%, mammoties 40% and chlorine 18.5%. In the case of Paper and Steel, the increase has been less than 5%. For six other corporations, among them some of the most important, output fell considerably. The output of the Textile Corporation was lower in spinning by 10% and in weaving by 29%. Salt output declined by 45%, tanned leather by 41%, dried fish by 45%, wet fish by 19.2%, cattle feed by 16.5% and ceramic-ware by 13%.

100. The overall view of state industrial corporations' performance in 1970 would be, of course, less unfavorable if some new manufacturing items were taken into account (cast iron, some chemicals and, particularly, petroleum products). On the other hand, it does not seem that Milk, Oils and Fats, and the Sugar Corporation, if they were available, would improve the general picture.

101. As can be seen from Table 8.3 the composition of the public industrial sector has changed considerably in the last two years. Petroleum refining and cement now account for 45% of the public sector's output, the share of the former being substantial. Of other corporations only the Milk, Mineral Sands and Textile Corporations have maintained or increased their share in public sector output. On the other hand the output of the Sugar, Hardware and Small Industries Corporation decreased even in absolute terms, reducing their combined share in public sector's output from 13.8% in 1967/68 to 3.2% in 1969/70. It is interesting to note that these three corporations account for almost one fourth (23%) of the total labor force in the public industrial sector. More generally, the ten most labor intensive enterprises account for 54% of the total labor force and 17% of total output of the public sector. This is partly a consequence of the Petroleum Corporation's position within the sector (35% of total output and only 2% of total employment).

Capacity utilization

102. A review of the capacity utilization in sixteen public corporations for the year 1969/70 is shown in Table 8.1. Five out of 16 corporations have operated at close to full capacity: Salt Corporation at over 100%, Paper 99%, Small Industries 98%, Cement 90-94%, and Leather at 82-97%. 1/ In three more enterprises the average degree of capacity utilization has attained 75% or more: in Flour Milling 82%, Ceramics 64-91% and Plywood 61% to over 100%. The performance of the other half of the corporations, however, lagged far behind. For the Textile Corporation it has been in the range of 31-78%, Chemicals 38-72%, Mineral Sands 13-64%, Oils and Fats 7-82%. In four remaining firms the degree of capacity utilisation has been well below 50% - in the case of Steel Corporation 35-41%, Fisheries 16-55%, Tyre 16-29% and Hardware 1-24%. Capacity utilization of the Sugar Corporation has been below 20%.

103. There are many causes of low capacity utilization in Ceylon's public industrial enterprises. Of particular weight seem to be: the high degree of absenteeism, labor unrest, scarcity of skills, inefficient management, competition of imports and private industries, lack of markets, irregularity in raw materials procurement

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1/ Installed capacity is based on 3-shift operations.

and power supply, and some structural and locational deficiencies. These phenomena are, of course, not limited to the public sector alone. Most of them appear to be much more pronounced in this sector, however. Performance and efficiency comparisons between public and private industries are substantially in the latter's favor. That is exemplified in Table V, containing a comparison in terms of value added per worker for the year 1968.

Table V

VALUE ADDED PER EMPLOYEE IN STATE AND PRIVATE INDUSTRIES, 1968
(in Rs. 1000)

	State Industries		Private Industries	
	No. of establishments	Value added per worker	No. of establishments	Value added per worker
Food processing	4	3.0	115	7.1
Beverage	1	7.5	16	14.7
Textiles	1	3.7	86	5.6
Leather Footwear	1	6.2	42	6.4
Wood and cork products	1	4.6	3	4.2
Paper and its products	1	2.3	68	7.3
Non-metallic mineral products	4	3.9	37	7.3
Industrial chemicals	1	1.3	10	4.7
Fabricated metal products	1	1.5	95	6.3

Source: Department of Census and Statistics, Survey of Industrial Production 1968

104. The above table is indicative only. Much better data and a good deal more analysis would be required to accurately compare value added per worker of state and private industries. Yet it is somewhat surprising that in all but two categories (leather footwear and wood products) the indicated value added per employee seems to be substantially higher in the private sector. Most private firms in Ceylon are small and relatively labor intensive whereas, the public corporations are generally much larger and more capital intensive.

Labor and management problems.

105. It is in the field of labor and management and their interrelationships that the main constraints on public corporations' performance are to be sought. The incidence of absenteeism is perhaps the most striking single constraint of this type. There are two sorts of absenteeism to be dealt with: the authorized and unauthorized. Apart from 14 days annual leave and 7 days casual leave, which employees are entitled to, they can claim additional leave of up to 21 days on the basis of easy-to-get medical certificates. In reality, what has been a possibility soon became a system. The average "authorized" leave approaches 42 days or about 14% of a working year. Another 25-50 days of unauthorized leave have become a common practice all over the industry, particularly in the public sector. If allowance is made for recognized vacation and casual leave, the number of absentee-days amounts to 15-25% of the total man-days. In some cases these percentages are even higher (Hardware, Plywoods, Tyre, Textile Corp.). They are understandably higher in the months of holidays, harvest, festivals and after paydays.

106. The consequences of absenteeism, naturally, go beyond the percentages indicated above. Being subject to sharp seasonal variations, absenteeism causes bottlenecks and expenses for overtime hiring. What is perhaps more important, it contributes immensely to a general lack of discipline and affects all kinds of operational programs of enterprises. Repeated failures of efforts to overcome the problem within the existing framework have led to a feeling of resignation rather than to positive steps to handle it. In order to fill the gap caused by arbitrary leaves, the public corporation managers have in most cases resorted to hiring excess labor on a permanent basis. Because of seasonal bottlenecks, the number of workers additionally hired usually exceeds the average number of absentees. Overemployment in the range from one fourth to one third of the total employment figure has become a recognized institution in Ceylon's public sector.

107. Labor disputes and strikes are the second major reason for the low capacity utilization. There are no statistics on strikes in public corporations. There is no question however, that most of the corporations have suffered sizable losses because of strikes and prolonged labor unrest. In other cases, frustration builds up when a corporation fails to keep its production running at the level of the existing work force. Labor unrest in the State Hardware Corp., for instance, multiplied when the corporation found itself forced to release 640 workers for many months after having run into serious market troubles.

108. The absenteeism, labor unrest, lack of discipline and low productivity of labor, are problems that cannot be solved only within and by the corporations themselves. Neither can they be solved through some isolated, across-the-board governmental measures. But so far, nothing

like serious effort has ever been made to deal with these problems. In this connection, two points of particular interest should be stressed. First, the wage system is uniform for the entire public sector. Any change in the wage or salary scheme has to be approved by the Ministry. The same applies to the hiring regulations and incentive schemes. As a matter of fact, in Ceylon's public corporations there are no production and labor incentives of any significance. Existing bonus schemes have mostly been converted into a recognized additional monthly payment. Attendance incentives do not exist beyond these bonus schemes, and their effects are hardly felt. Production incentives are extremely rare. Secondly, the managers of the public corporations have been put into a precarious position. Their responsibility is, in principle, split between the enterprise and the Ministry. Whenever a conflict between these two arises, it is usually settled in favor of the latter. Such situations are inevitable in a system where state industrial firms are asked to serve purposes in addition to their original commercial and economic functions. Managers who are able and anxious to introduce progressive reforms into the system are generally not permitted to do so. It is consistent with the system that, for instance, a general manager in a successful public corporation receives the same salary as the manager in a very inefficient one. 1/

Market and profit considerations

109. In 1969/70, the gross profit figure of eleven public corporations increased by 23% to Rs.47.7 million. At the same time, the aggregate loss figure of five other corporations virtually doubled, reaching Rs. 7.8 million. Thus the aggregate gross profit increased by 15% to Rs. 39.9 million. As can be seen from Table 8.2 (Statistical Appendix), these figures represent by and large a continuation of the trends prevailing since 1965/66. Compared with gross output figures, the profit increase has been considerably smaller during this period.

110. These global figures are to some extent misleading however. First, the trend would be very different if the Cement Corp. profit figures were deducted. This Corporation's share accounted for 56% of the aggregate net profit in the period 1965/66-1969/70. The net profit figure for 15 corporations other than Cement Corp. has fallen from Rs. 20.8 million in 1968/69 to Rs.13.9 million in 1969/70. It appears therefore that the high profit figure of the Cement Corp. is the first thing to be explained.

1/ The salary for general managers is around Rs. 2,500 a month.

Table VI

STRUCTURE OF CEMENT PRICES IN 1969/70
(Rs. per long ton)

	Kankesan factory	Ruhunu factory	Imported Cement
Cost of production/import	103.5	208.2	108.9 c.i.f.
Selling price	210.0	240.0	254.1
Net profit	106.5	31.8	- a)

a) The difference between the selling and import price covers the FEECS, duty, stevedoring, landing and transport charges.

Source: Ceylon Cement Corporation

111. It is clear from the above Table that the selling price at Kankesan cement works has been fixed at a level that provides for a level of net profit exceeding that of production cost itself. This has, of course, been made possible under the monopoly position of the Corporation. This is why the Corporation has been able to finance a large part of its expansion program from its own resources. 1/ The profit margin is much lower in the case of Ruhunu works (13% of the selling price). This is due to the use of the imported clinker or domestic clinker that has to be transported from the other distant factory. But even this profit margin would be non-existent had the Corporation not resorted to an increase in the selling price to above the Kankesan price level. The bulk of the profits the Corporation obtains through its larger capacity and lower cost Kankesan plant.

112. Global profit figures also raise some doubts due to the methodology applied. The profit amounts are related to the "capital employed in production" rather than to the total capital invested. Besides, the value of fixed assets is underestimated, being based on pre-devaluation prices. Both factors act in the same direction; without them, the rates of return would certainly be lower.

113. As can be taken from Table 8.2, the number of public corporations suffering losses increased in 1969/70 from three to five. Three permanent "losers" - the Fisheries, State Hardware and National Small Industries Corporations have been joined by the Paranthan Chemicals and Leather Corporation. The Flour Corporation has been on the edge of profitability.

114. The Cement, Salt and Ceramics Corporations have been particularly profitable, according to official estimates, and the remaining corporations have been moderately so. The 1970/71 budget estimates that the profits of the public corporations will be twice the 1969/70 level with most of the increase

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1/ Out of the corporation's after tax profits, only 20% went to the Consolidated Fund, the remaining 80% being used to expand capacity.

budgeted for the Cement, Textile, Steel and Tyre Corporations. To meet the budget estimate the last three would have to triple their combined profits in 1970/71, which hardly seems realistic. In any event, the measures to implement the Government's announced intention to raise prices and increase efficiency are as yet unspecified.

115. In the case of Ceylon's public corporations, profit is only of limited value in measuring economic results. This is even more so if the under-utilization of capacity and the burden of non-economic objectives are taken into account. To this, one more problem should be added: neglect of marketing considerations. Few corporations base their production decisions on market surveys. They are not even particularly interested in expanding the market for their products. Some of them have accumulated large stocks of unsold merchandise. 1/

116. What are the reasons for this attitude? First, the pricing policy that has traditionally been pursued in the public sector. With few exceptions (the most notable one is that of the Cement Corporation) state enterprises have been compelled to sell their products at low prices. This is true particularly for those engaged in production of consumer goods. Secondly, the organization of trading activities of public corporations lacks coherence in many respects. Some of the public corporations, having acquired a monopoly in both production and trading, have become more interested in trading activities than in manufacturing itself. Others, having passed all importing and selling activities to state trading organizations, have become completely indifferent to marketing, pricing, competition and similar matters. Thirdly, when faced with competition from imports, public corporations have usually been given an import monopoly or protected through an import ban, with the effect in both cases being the same. This has reduced the incentive to produce more efficiently.

1/ This has been the case in the Hardware, Leather, Steel, Paper and Tyre Corporations.

C. POLICY ISSUES

Introduction

117. The structure of Ceylon's economy has changed considerably since the country became independent 23 years ago. A new, important manufacturing sector has emerged. If the level of manufacturing output per capita is taken as a measure of industrial development, Ceylon ranks around the average among the South-East Asian countries. In addition, certain important changes in the structure of manufacturing sector are on the way. The factory-type of industrial production has finally outweighed the processing of traditional export crops and cottage industries. A number of new industries have emerged. shifting the balance in favor of more sophisticated products. Ceylon has become or is on the way to becoming selfsufficient in many food and related processing industries, and produces much of its consumption of textiles and footwear; tyres, plywood and paper; cement and other building materials; petroleum products, some chemicals and plastic products; and some agricultural implements and other metal products.

118. Volume I of this report concludes that a major structural transformation of Ceylon's economy is required over the next several years if she is to emerge with an economic base capable of sustaining growth at an acceptable pace. To accomplish this the first and crucial requirement is establishment of a policy framework for economic and social development which, although placing strong emphasis on agricultural development, should also provide a short and longer-term strategy for the industrial sector. Over the immediate future the central question regarding the sector is the availability of resources to operate existing capacities and, in view of the resource constraint, which plants should be operated and at what capacities, whether some plants should be closed down and what new industrial investment should be undertaken, given the large demands for imports associated with it.

119. Development of a strategy for the industrial sector is thus essential but it is even more essential that this be accomplished within the context of strategies for the economy as a whole, for other sectors and within a framework of assumptions regarding the growth of public and private savings, consumption. public expenditures, exchange resources, etc.

120. Given the sharp fall of private investment in 1970, the likelihood that it will continue in 1971 and, particularly the overall resource constraint, there is little possibility that public and private industrial investment will reach the 1969 level. Under these circumstances it must be emphasised that Ceylon needs rapid investment in areas which have a significant impact on the exchange situation and help achieve a structural balance in the economy. This suggests that resource allocations to manufacturing should be aimed in large part at expanding exports from existing capacities.

121. Some of the issues mentioned above have been given a certain amount of attention since the new Government took office. A number of policy changes have been made, but this has mainly been done within a short-term context and regardless of their interdependence. For the time being, a few single issues have become the prime concern of the Government in the industrial sector. These are: strengthening the public sector while controlling the private sector, development of the cottage industries, reorganization of the institutional set-up at the national and local levels, price controls and taking over the import and wholesale trade connected with manufacturing.

Public versus private sector issue

122. From the economic point of view, there is very little substance in what has become the major policy issue in the manufacturing sector. But to the extent to which the public-private controversy - a typical institutional problem - is fogging the real issues of industrial growth, it may have, and is having, adverse consequences upon the structure and pace of that growth.

123. Important changes in the function of the public sector are implied by present policies. Earlier, its role was to provide infrastructure for private industry, to prevent bottlenecks and to establish links between the industries. Now it is intended to take over responsibility for the development of the entire industrial sector. This implies a fundamental shift in the balance between the public and private sectors. "Heavy, basic and essential industry shall be under state management, if not under direct state ownership. That sector of industry, which for reasons of scale, technology and policy does not make state ownership vital in the national interest will be left for private enterprise but will be subject to regulation by the State." (Budget speech 1970-71).

124. What does this in practice mean? State monopolies have already been established for manufacturing paper, plywood, steel rolling, tyres, basic chemicals, petroleum, fertilizer, cement, mineral sands, ceramics, sugar, salt and flour. State corporations face competition from the private sector mainly in textiles, leather, timber, furniture, drugs, hardware, bricks and tiles, oils and fats and milk products. Private firms have been the only producers in several food processing sectors; beer, carbonated beverages, tobacco, garments, some chemical products, plastic products and some machinery and equipment. Although statements by officials suggest that new private investment may be confined to the smaller size firms, the Government thus far has not defined specifically the respective roles of public and private enterprise. This has contributed considerably to the general state of uncertainty and to the sharp drop in private investment.

125. A potentially important device for transferring private property into State ownership is the Business Undertakings (Acquisition) Act, which has already passed the House of Representatives. The Government may be given the

power to take over, by ministerial order, any private business undertaking "as it might deem appropriate". In the same manner, "any movable or immovable property" may be vested in the Government, if deemed necessary for the purposes of any business undertaking already taken over by the Government. A stipulation specifying the cases when the Act could be applied, which was requested by the Chambers of Commerce and Industries, has not been included. Each take-over is subject to the a posteriori approval of the Parliament.

126. The Government has given assurances that the Act is only intended to be used where major offenses have been committed against basic national interests. However, until the Act has been passed and tested, it adds to the general uncertainty prevailing in the private industrial community. Several other measures which effectively limit the activities of the private sector have been applied through industrial licencing, price controls and foreign exchange policies.

127. Under the circumstances prevailing in Ceylon, the consequences of these pressures have begun to be felt almost immediately. 1/ Many private investors and industrialists are reluctant to undertake new ventures or to expand existing ones. Although data for 1970 is not yet available, it can be safely assumed that private investment dropped by more than 25% in that year. 2/ Under present circumstances, it is impossible to see how the 1971 target for private investment can be achieved. That target (Rs.1,204 million) which is 10% lower than the 1969 figure is regarded as the level necessary to maintain the minimum acceptable rate of growth of domestic production and employment.

128. If the potential contribution of private sector industry to accelerating economic growth is doubtful, nothing very different can be said about the immediate prospects for the public sector. Both projected and actual investment figures in the public sector were lower in 1970 than in the preceding year. Net investment figures in state industrial corporations dropped from Rs. 255 million in 1968/69 to Rs. 168 million in 1969/70. But had the trend been the opposite, it would still be necessary to question the viability of the expansion of the public sector without

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1/ In the second half of 1970, no single new investment application was approved.

2/ Actual private sector investments in 1970 were well below the projected figure, which was in itself 24% below the 1969 level. These figures relate to private investment in all sectors.

simultaneously improving its efficiency. In any case, if the function of public sector industries remains that of providing employment and subsidized consumer goods, its contribution to the development effort might be questioned as well.

Price Controls

129. The officially declared purpose of the price control extensions undertaken by the new Government is to "combat the cost of living", but from the list of 17 manufactured products under price control, it is difficult to discern the rationale for the selection. 1/ Price controls are not, of course, confined to those 17 items only. Even more important are informal price controls, exercised through state corporation monopolies, state import and trading monopolies and rationing systems. Similar effects result from the near monopoly position of some Government agencies and enterprises. Nevertheless, there is a strong trend towards the institutionalization of price controls into a comprehensive system. 2/

130. In addition to its traditional function (furthering policies of income distribution), the price mechanism has been assigned a role in holding down profits. These policies have been pursued even in the cases where profit was brought down close to zero or was actually converted into loss. Needless to say the loss to the Treasury is imminent in such cases. Price and profit controls of this kind are unmistakably leading to distortions of the price structure, making them unrealistic in relation to costs. Even major changes in cost structure and level are, if at all, followed by price changes with a considerable time lag. These controls are likely to have more straightforward consequences too. Through the minimization of profit incentives, they may bring about production restriction and affect the generation of resources for expansion.

Promotion of small industries

131. "The development and promotion of small industries, based primarily on local raw materials and established under a regional development program to solve the problems of unemployment and underemployment in rural areas will

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1/ Among the price controlled items are also umbrellas, barbed wire, toothpaste, drawing books, slate pencils.

2/ Price Control Division under the Commerce Department has recently been set up, while the establishment of the Price Control Courts is under way.

receive the highest possible priority in the industrial sector" (Budget speech 1970/71). With this end in mind, a series of organizational and promotional measures have been announced or undertaken. The Department of Small Industries is to take a leading part in establishing new industrial units, and the Industrial Development Board has been reconstituted into the Small Industries Development Board, an agency for the research, planning and promotion of small industries. A legislative motion for setting up Divisional Development Councils, as well as People's Committees, has been launched. The creation of 50 powerloom centers is under way. It is hoped that a network of industrial estates, technical service centers and local development banks will emerge. Several supporting measures are being applied, including tax incentives, credit facilities and FEEC exemptions (when the turnover is less than Rs.75,000).

132. The idea of easing the unemployment problem through the expansion of small industries deserves attention, and so do its underlying elements-mobilization of local savings and their productive use, and transforming seasonal employment into permanent employment. Nevertheless, there are difficulties in carrying this through into viable projects. In the absence of a longer-term strategy for industrial growth, the Government has decided to begin with a set of small industry projects which could be brought about in the near future. The selection of projects is based on several general principles, in addition to "practical experience and common sense". These principles (or criteria) are: potential for generating employment, comparatively low level of capital employed, use of indigenous resources, suitability for location in non-urban areas, capacity of saving or earning foreign exchange, relatively low level of technical and managerial skills involved, ability to sub-contract for large-scale industries, and other social benefits created. On this basis, a list of 105 small scale candidate industries has been drawn up. The problem arises from the omission of one major criterion - the economic viability of the projects selected. Are they to operate economically, that is, at least without incurring losses? Should the demand and marketing outlooks not be regarded as equally important criteria on which decisions must be based?

Institutional changes

133. Some changes within the existing institutional framework that are relevant to the industrial sector, have already been mentioned. A fresh addition is the attempt to organize the coordinating and regulatory activities of the state in the industrial field on a new basis. This is to be achieved through industrial development corporations, to be established for all (presumably 8 to 10) manufacturing sectors. Each sectoral development corporation (or board) would be responsible for:

(1) the development planning and coordination of production programs,
(2) allocation of resources within the sector,
(3) research work in the field,
(4) management of state industries,
(5) investment in selected private industries, and
(6) regulation of private industries.

134. Much remains to be clarified and defined, before the real implications of this major institutional change become clear. The idea contains both possibilities for sectoral development boards: to become an effective device

for rational coordination and purposeful direction and development efforts, or a new, superimposed administrative structure which would tend to reduce the autonomy of production units even more. Through setting up specific sectoral development targets, the new scheme might eliminate some of the gaps in the existing planning mechanism. But it will certainly not solve the problem of coordination between the sectors, in fact it may accentuate this problem even more.

135. It is in this field - planning at the level of the manufacturing sector as a whole - where an effective change is badly needed. There is nothing resembling an integrated system of industrial planning at present. The Government's concern in planning has traditionally been with the public sector. Processing of traditional export crops, manufacturing, public and private industries are in many respects differently treated. 1/

Foreign trade policies related to industry

(1) Foreign exchange allocation

136. After abolishing OGL imports in mid 1970, a new system was created. Its starting point was amounts of foreign exchange "actually used" in 1969, corrected for the "estimated raw material requirements" where deemed necessary. Since foreign exchange available was insufficient to match the 1969 allocation, the industries were given a reduced percentage of it. For this purpose, all industries were classified in three groups depending on their importance. Industries producing articles considered as essential were given 70% of their estimated foreign exchange requirements (Group A); those producing less essential articles, 60% (Group B); and those producing non-essential articles, 40% (Group C). All the articles under price control (17 items) were given 100% of their estimated requirements. The allocation for 22 so called "regulated industries" was made equal to their 1969 allocation.

137. The same system has been extended through 1971. As before, the Ministry of Industries is given the foreign exchange allocation for the private sector en bloc. There is also a reserve fund for increases during the year. Import licences are obligatory. The allocation procedure is as time consuming for the applicants as it used to be. Some delays are due to the procedure of determining foreign exchange requirements. 2/ Since importing

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1/ For example, labor problems are under the Ministry of Industries for the public corporations, and under the Ministry of Labor for private industries.

2/ Definite estimates of those requirements for each individual firm in 1971 are expected to be completed by the middle of the year.

of trade quota items is being taken over by state trading organizations, a number of private businessmen will have to stop engaging in import and foreign exchange transactions. 1/

(2) Export promotion policies

138. The incentives for encouraging exports of manufactured products are the following:

(a) Rebate on exports (a 100% drawback of customs duty paid on raw materials for the manufacture of industrial products for exports);

(b) Fiscal incentives: (i) Three year tax holiday on export products, and (ii) Income tax rebate on industrial exports; and

(c) The FEEC premium of 55% on exports of nontraditional items.

In addition, more favorable treatment is accorded to producers of exportable goods in the allocation of imported raw materials.

139. The existing set of incentives has proved to be ineffective. The export rebate scheme has failed in its objectives, in part due to the cumbersome procedures involved. 2/ For this reason, a new scheme with an all-inclusive flat rate of rebate of 10% of the f.o.b. value of goods has been introduced as a temporary measure. The three year tax holiday period may be too short. The 55% FEEC premium will not solve the problem either, unless it is integrated into a broader policy framework. These inducements are of little importance in countries at the very beginning of industrialization. What is needed is a more powerful impetus to be applied in selected industries. Export promotion in a narrower sense should be introduced and given an active part in organizing export activities on a growing scale (market research, marketing, advertising, technical assistance, personnel training, manufacturers' representatives abroad). 3/

1/ Out of Rs.200 million allocated for raw material imports in the first quarter of 1971, almost Rs.100 million is earmarked for the National Textile Corporation and Salu Sala, and the remainder for private sector industries other than textile.

2/ Delays of over 24 months have become customary in the procedure for settling the rebate amounts between the Customs, Ministry of Industry and exporting firm.

3/ At the moment, there are only 14 commercial counselors with Ceylon's embassies, and they are dealing mainly with traditional export items.

(3) Longer-term strategy

140. Probably the main feature of Ceylon's industrialization effort has been its inward-looking, import substitution orientation. At earlier stages,the regime of import restrictions was intended to eliminate less essential goods from imports, while the relatively permissive investment approvals policy lead to the setting up of precisely the same, highly protected industries. Later on, the imports liberalization within the exchange reform of May 1968 induced a growth acceleration of a temporary nature, based on better capacity utilization and capacity extension. The import restrictions which were introduced again in mid 1970, being non-selective, affected the efficient and inefficient producers alike. The new system of exchange allocation clearly has inherent defficiencies. one. The lack of flexibility in rationing imports on the basis of the previous year's shares of individual firms in the exchange allocation, tends to fix shares in the market, and in the long run, to freeze the existing structure of production, with little discrimination between more and less efficient entrepreneurs. In the field of industrial exports, the system does very little to make production for export at least as attractive as for the home market.

141. Considering the existing foreign exchange constraint on industrial growth, a development strategy aiming at a high import substitution priority would seem to be natural. But what kind and degree of import substitution, in which manufacturing sectors and how much - if at all - interconnected with export oriented sectors?

142. The first effect of import substitution policy in any country is, in the short run, likely to increase the foreign exchange deficit. In the case of Ceylon, this effect has been intensified due to certain specific circumstances. Ceylon's manufacturing sector has had a very high import coefficient from the outset. The import coefficient of investment is even higher, which is quite understandable when the consumption oriented structure of industry is taken into account. The policy neglecting the development of interindustrial relations has tended to make the import content high even in industries relying on domestic raw materials (because of machinery and intermediate products inputs, costs of infrastructure and packing, etc.). Finally, by moving from simple to more sophisticated production lines, a shift is taking place in the pattern of imports, in favor of intermediate and capital goods. 1/ In other words, the cost of import substitution tends to become higher the further along the way the process of industrialization goes.

143. Regardless of such built-in difficulties, the import substitution process may, under circumstances, yield substantial benefits both in terms of diversifying and augmenting domestic production, and maintaining external balance. This depends, of course, on whether appropriate strategy and policies are pursued. Ceylon needs in the future to ensure that the selection of

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1/ The relationship between imported consumption goods and intermediate plus capital goods was reversed from 60:40 in 1964 to 40:60 in 1969.

industries (and of firms within the industries) gives preference to undertakings with a higher proportion of local value added. In addition, much more use has to be made of the potential for developing domestic sources of raw material supplies both in import substituting and exporting activities.

144. These policies are essential if the industrial sector in Ceylon is to realise its potential contribution to growth.

Industrial Statistics

Table 8.1

STATE INDUSTRIAL CORPORATIONS
CAPACITY, PRODUCTION AND EMPLOYMENT
1969/70 AND 1970/71 (ESTIMATED)

Corporation	Installed Capacity (3 shifts)	% Utilisation 1969/70	Production 1969/70	Production 1970/71 (Est)	Employment 1969/70	Employment 1970/71 (Est)
National Textile					2,424	4,022
Spinning (Mn. lbs.)	3.4	77.7	2,643,942	3,200,000		
Weaving (Mn. yds.)	14.0	61.8	8,663,953	12,090,000		
Finishing (Mn. yds.)	34.0	31.3	10,651,603	8,000,000		
Ceylon Cement					2,379	n.a.
Cement (tons)	285,000	94.2	268,635	447,500		
Clinker (tons)	270,000	90.4	244,096	n.a.		
Ceylon Ceramics					998	1,184
Crockery (tons)	2,540	79	2,003	2,040		
Kaolin (tons)	5,000	64	3,235	3,600		
Sanitaryware (tons)	500	91	453	500		
Wall tiles (tons)	300	67	201	340		
Ceylon Steel					960	1,010
Rolled Sections (tons)	60,000	34.5	20,688.64	36,800		
Wire (tons)	12,000	41	4,925.15	9,625		
National Small Industries					1,880	2,029
Tiles and bricks (000)	17,726	98	17,286	n.a.		
Eastern Paper Mills					1,492	2,007
Paper (tons)	9,000	99	8,912	8,660		
Ceylon Tire					1,302	1,483
Tires (nos.)	250,000	29	71,403	60,500		
Tubes (nos.)	250,000	16	38,946	130,700		
Flaps (nos.)	88,000	29	25,297	40,000		
State Hardware					1,064	1,110
Agricultural Implements (pieces)	573,000	3	15,592	46,022		
Builders hardware (pieces)	3,635,000	18	652,099	443,661		
Water Fitting (nos.)	269,000	13	34,331	81,324		
Cutlery (nos.)	600,000	24	143,667	171,805		
Engineering Tools (nos.)	600,000	8	48,903	109,409		
Miscellaneous Items (nos.)	800,000	0.7	5,907	5,000		
Paranthan Chemicals					309	629
Caustic Soda (tons)	1,500	57	853	1,400		
Chlorine (tons)	1,320	38	505	500		
Table Salt (tons)	400	72	288	400		
Ceylon Leather Products					715	n.a.
Footwear (pairs)	345,000	82	281,200	n.a.		
Chrome Leather (Sq. ft.)	720,000	97	697,887	n.a.		
Bark Leather (lbs.)	420,000	85	356,722	n.a.		
Ceylon Mineral Sands					437	456
Ilmenite (tons)	120,000	64	77,357	95,000		
Rutile (tons)	10,800	14	1,549	3,000		
Zircon	9,500	13	1,200	n.a.		
Ceylon Oils & Fats					773	868
Provender (tons)	60,000	82	51,234	61,500		
Oil Expeller (tons)	51,000	21	10,535	16,090		
Fatty Acid (tons)	5,100	13	660	200		
Refinery (tons)	9,000	6.5	591	n.a.		
National Salt					1,099	1,599
Salt (tons)	97,450	115	112,352	91,100		
Ceylon Plywoods					1,182	1,624
Plyboards (sq. ft.)	1,800,000	133	2,396,604	2,100,000		
Tea chests (sets)	1,262,456	72	903,650	1,208,000		
Flush doors (nos.)	12,000	86.4	10,369	18,000		
Veneer (sq. ft.)	300,000	169	509,330	1,390,000		
Block boards (nos.)	33,000	61	20,060	49,800		
State Flour Milling					425	464
Flour (tons)	50,700	82	41,756	n.a.		
By-products (tons)	18,830	81	15,309	n.a.		
Ceylon Fisheries					1,308[a]	n.a.
Fish meal (tons)	320	22	69	n.a.		
Shark liver oil (gallons)	10,000	18	1,762	n.a.		
Ice (tons)	17,280	54.5	9,412	n.a.		
Fish cans (000)	933	16	149	n.a.		

[a] 1968/69

Source: Ministry of Industries and Scientific Affairs and Central Bank of Ceylon.

Table 8.2

STATE INDUSTRIAL CORPORATIONS

CAPITAL, PROFITS/LOSSES AND RETURN ON INVESTMENTS[1]

Public Corporations[2]	Capital Employed in Production 1969/70 (in Rs. 000)	Profit/Loss (in Rs. 000) 1965/66	1966/67	1967/68	1968/69	1969/70	1970/71[3]	Return on Investment before Tax (in %) 1968/69	1969/70	1970/71[4]
National Textile	42,600	1,482	667	2,894	2,734	2,126	9,280	7	5	22
Ceylon Cement	96,355	9,628	8,285	13,875	13,897	26,009	36,033	22	27	37.5
Ceylon Ceramics	19,852	442	765	3,000	4,000	3,502	3,502	20	16	18
Ceylon Steel	117,923	-	-	2,018	2,350	4,132	9,433	2	3.5	8
National Small Industries	18,960	-1,000	-660	-645	-454	-1,406	358	Loss	Loss	2
Eastern Paper Mills	29,000	3,565	5,882	3,919	6,641	3,150	2,098	23	11	7
Ceylon Tyre	67,525	-	-	805	1,000	3,335	8,823	1.5	5	13
Ceylon State Hardware	18,725	-	-878	-379	-706[5]	-1,922	828	Loss	Loss	4
Paranthan Chemicals	11,802	-265	203	667	398	-853	823	3	Loss	7
Ceylon Mineral Sands	15,225	-203	54	192	688	1,284	2,064	5	8.4	13.5
Ceylon Leather Products	6,245	293	391	187	335	-206	n.a.	5	Loss	n.a.
Ceylon Oils and Fats	22,695	568	248	1,600	2,188	1,173	1,493	11	5	6
National Salt	10,149	618[5]	860	1,713	2,074	2,200	2,271	26	21.6	21.7
Ceylon Plywoods	5,772	14	600	557	2,386	565	1,598	41	9.7	26
Ceylon Fisheries	36,095	-1,285	-4,610	-3,600	-2,800	-3,440	n.a.	Loss	Loss	n.a.
State Flour Milling	26,396	-	-	-	n.a.	213	n.a.	n.a.	0.8	n.a.
Total (net)	545,319	13,853	11,807	26,803	34,731	39,862	78,604	7.5	7.3	14.4

1/Profits from trading activities are excluded. Profits are before taxes.
2/There are about ten more public corporations engaged in industrial processing, assembling or servicing activities. Some of them are of minor importance, and the others are not included due to lack of information.
3/Budgeted.
4/Budgeted profit expressed as percentages of invested capital.
5/Annual Report of the Central Bank of Ceylon, 1969.

Source: Ministry of Industries and Scientific Affaires.

Table 8.3

STATE INDUSTRIAL CORPORATIONS

VALUE OF PRODUCTION AND SHARES IN PRODUCTION AND EMPLOYMENT

	Value of Production, 1969/70 (Rs 000, at sale prices)	Shares in Production (in %) 1967/68	1968/69	1969/70	Shares in increase between 1967/68 and 1969/70 (in %)	Shares in Employment (in %) 1969/70
National Textile	34,471	6.1	5.6	6.1	6.2	10.6
Ceylon Cement	58,754	17.2	14.7	10.5	6.0	10.4
Ceylon Ceramics	14,913	4.8	4.4	2.7	1.3	4.4
Ceylon Steel	34,569	13.6	9.7	6.2	1.2	4.2
National Small Industries	8,399	3.9	2.3	1.5	-0.1	8.2
Eastern Paper Mills	25,223	8.5	5.9	4.5	1.8	6.5
Ceylon Tyre	28,624	7.0	5.6	5.1	3.9	5.7
State Hardware	2,468	2.3	1.3	0.4	-0.8	4.7
Ceylon Mineral Sands	5,862	0.7	1.8	1.0	1.3	1.9
Paranthan Chemicals	2,487	1.1	0.6	0.4	-0.0	1.4
Ceylon Leather Products	9,808	3.4	2.2	1.7	0.6	3.1
Ceylon Oils and Fats	30,604	9.6	9.1	5.4	2.7	3.4
National Salt	11,235	3.0	2.6	2.0	1.3	4.8
Ceylon Plywoods	8,656	3.3	2.8	1.5	0.4	5.2
Ceylon Fisheries	11,550	3.1	4.3	2.1	1.3	5.8[a]
Ceylon Ayurvedic Drugs	1,248	-	-	0.2	0.4	0.7
State Flour Milling	30,581	-	1.1	5.4	9.0	1.9
Sri Lanka Sugar	7,286	7.6	4.4	1.3	-2.9	9.8
National Milk Board	40,117	4.8	6.0	7.1	8.7	5.1
Ceylon Petroleum Refinery	194,809	-	15.6	34.7	57.7	2.2
Total	561,665	100.0	100.0	100.0	100.0	100.0

[a]Based on employment in 1968/69.

Source: Ministry of Industries and Scientific Affaires and Central Bank of Ceylon.

Table 8.4

STATE INDUSTRIAL CORPORATIONS

FOREIGN TRADE COMPONENT OF PRODUCTION IN 1969/70

	Imported material as % of Total raw material usage	Imported material as % of Value of Production	Exports as % of Value of Production
National Textile	91.2	29.7	-
Ceylon Cement	31.1	2.2	-
Ceylon Ceramics	20.8	7.0	0.2
Ceylon Steel	89.1	35.4	-
National Small Industries	10.5	2.6	-
Eastern Paper Mills	63.5	23.5	-
Ceylon Tyre	72.0	26.3	-
State Hardware	70.0	51.9	2.0
Ceylon Mineral Sands	-	-	77.1
Paranthan Chemicals	-	-	-
Ceylon Leather Products	39.3	16.8	n.a.
Ceylon Oils and Fats	13.7	11.0	8.7
National Salt	-	-	
Ceylon Plywoods	15.4	5.6	0.9
Ceylon Fisheries	n.a.	1.6	4.5
State Flour Milling	n.a.	71.6	6.5[a]
Total	50.3[b]	21.2[b]	1.8[c]

[a]Estimated
[b]Of the corporations listed.
[c]Of 20 corporations listed in Table 8.3. For the corporations listed above, the percentage is 3.1.

Source: Ministry of Industries and Scientific Affaires and Central Bank of Ceylon.

Table 8.5

EXPORTS OF INDUSTRIAL GOODS*, 1965-1969
(In Rs. 000)

	1965	1966	1967	1968	1969
Food, Beverages & Tobacco	498	636	641	668	410
Textiles & Wearing Apparel	1,166	629	1,416	5,325	4,245
Leather & Rubber Products	2,724	3,285	2,770	3,461	5,378
Manufacture of Wood	221	267	226	326	717
Pulp and Paper	18	1	10	2	-
Chemicals & Chemical Products	1,271	1,313	2,061	4,022	2,201
Plastic Products	-	-	-	-	252
Non-metallic Mineral Products	7,203	7,283	8,250	10,489	12,430
Metal Products other than Machinery	-	700	705	1,234	1,098
Machinery other than Electrical	-	177	150	528	-
Electrical Machinery & Appliances	388	162	204	30	330
Total	13,489	14,453	16,433	26,085	27,061

* Manufactures and semi-manufactures.

Source: Ministry of Industries and Scientific Affaires.