1. ECONOMIC PROBLEMS AND POLICIES—1965

Introduction

In 1965 Ceylon's economic performance, as measured in terms of Gross National Product showed a decline. Whereas in 1964, the Gross National Product at current factor prices increased by 5·8 per cent, in 1965 the increase was only 4·0 per cent. In real terms, that is at constant (1959) prices, this means an increase in 1965 of only 2·0 per cent, in contrast to the increase of 4·4 per cent in 1964. When account is taken of the increase in population by 2·4 per cent, the Gross National Product per capita increased only by 1·7 per cent at current prices; in real terms it actually fell by 0·4 per cent.

This rather disappointing performance of the economy in 1965 was, however, due substantially to factors beyond the country's control. Adverse weather conditions resulted in a drastic fall in the output of paddy and coconuts by 29·5 per cent and 10·6 per cent, respectively. In fact, even the modest improvement in Gross National Product was made possible only by improved performance in other sectors of the economy.

The pressure on external payments, which has been a feature of the Ceylon economy in recent years, continued in 1965 although the year ended with an increase of Rs. 89 million in external assets. While the terms of trade improved by 1·2 per cent in contrast to a 2·6 per cent deterioration in the previous year, the inadequacy of external reserves forced the country to curtail imports severely. As this happened at a time when domestic production in general was not expanding sufficiently and, owing to fortuitous circumstances paddy production in particular declined, foreign exchange expenditure on the import of essential foodstuffs had to be increased. It became necessary, therefore, to curtail even more drastically the import of consumer goods other than essential foodstuffs. While the imports of capital goods were also lower, raw material imports were maintained at a somewhat higher, though inadequate, level.

Despite the slight favourable movement in the terms of trade and the severe curtailment of imports, it became necessary to resort to drawings from the International Monetary Fund. In the event, the cautious import policy and the increase in foreign indebtedness resulted in an increase in foreign assets in 1965 of Rs. 88·9 million, as against a decline of Rs. 111 million in 1964 and continuous declines in previous years.

In the domestic sphere monetary expansion was held down to a comparatively modest level by a sharp reduction in the expansionary impact of the Government Budget and by a reduction of credit to the private sector. The expansionary deficit in the Government Budget for 1964/65 was only Rs. 40·0 million in marked contrast to an expansionary deficit of Rs. 162·9 million in the financial year 1963/64. Gross commercial bank credit to the private sector expanded by only Rs. 4·2 million. The increase in money supply was also less than in 1964, the increase being Rs. 93·8 million in 1965 as compared with an increase of Rs. 115·8 million in the preceding year.

The shortage of supplies, arising both from an inadequate level of domestic production and from the reduction in imports combined with a certain degree of monetary expansion, resulted in continued pressure on the domestic price level. While subsidies helped to restrain the prices of the basic or essential goods, there were marked shortages in a wide range of semi-essential commodities. Vigorous administrative action to bring out hoarded goods and to control prices tended to relieve the pressure. Since these steps involved a de-stocking of goods, the year 1965 ended with a serious need both to replenish stocks and to make a continuous flow of consumer goods available to the economy.

Commodity aid on a substantial scale, negotiated in the latter half of 1965, might relieve to some extent the immediate pressures on supplies. Nevertheless, expansion of the import capacity, to which attention was drawn in the last year's Annual Report, can at best be only a means to the goal of achieving a rapid rate of economic growth. In this respect, past performance of the economy has not been sufficient to cope with the problem of increasing at an adequate rate the per capita income of a rapidly rising population. The immediate tasks ahead consist of identifying the high priority areas of development, and implementing a suitable plan of development designed to increase as rapidly as possible the productive capacity of the economy. In this process it is very likely that certain bottlenecks will appear in the effective utilization of resources; elsewhere in this Report some comments will be made on this problem.

(1) Economic Growth in 1965

In 1965, Ceylon's Gross National Product, at current factor cost prices, is provisionally estimated to have increased by 4·0 per cent, to Rs. 7388·4 million. In 1964 the increase was 5·8 per cent.

The increase in the Gross National Product in real terms, that is, at constant (1959) prices, was only 2·0 per cent which was one of the lowest rates of increase in recent years. In the export sector, exports in real terms showed an increase of 2·1 per cent. Export stocks are, however, estimated to have declined and the net output at constant prices of the export sector during 1965 declined by 0·8 per cent, in sharp contrast to an increase of 6·4 per cent in 1964. In the domestic sector, the expansion was less than in 1964, chiefly due to the sharp fall in paddy production by 29·5 per cent. Livestock and industrial production, transport and Government services continued to increase. The net result was a smaller rise of 1·7 per cent in the net real output of the domestic sector as compared with 4·1 per cent in 1964.

Provisional estimates of increase in population show that the rate of increase continued at the 1964 level of 2·4 per cent. Consequently, in per capita terms, the product per person increased by 1·7 per cent in money terms and declined by 0·4 per cent in real terms. In other words, the increase in Gross National Product in real terms in 1965 was inadequate to cope with the increase in population.

In 1965, Gross National Expenditure at current market prices increased by 3·2 per cent. Private consumption expenditure increased slightly by 1·1 per cent, reflecting the reduced availabilty of supplies. Capital formation in the private sector, inclusive of public Corporations, was lower by 20.3 per cent reflecting mainly the reduced imports of capital goods. These declines were offset by an increase in Government expenditure on consumption by 2·4 per cent as well as on capital formation by 21·6 per cent. The net result was the increase in Gross National Expenditure by 3·2 per cent, compared to a figure of 7·2 per cent in 1964.

(2) Fiscal and Monetary Developments in 1965

The 1964 Report stressed the need to curtail monetary expansion in order to secure a closer correspondence between aggregate demand and aggregate supply. The pressure exerted by a high level of purchasing power unmatched by adequate supplies continued in 1965. While the monetary expansion was held in check by a sharp reduction of the inflationary impact of the Government Budget as well as by a substantial reduction of the rate of expansion of bank credit to the private sector, supplies (both domestic and imported) failed to meet even this reduced rate of monetary expansion.

The disequilibrium in the economy in 1965 was thus more on the supply side than on the demand side. While there certainly were demand pressures arising from the latent effects of continued monetary expansion over several years as well as from the comparatively mild monetary expansion during the year, the poor performance of the economy and the paucity of foreign exchange reduced the total available supplies; and there was consequently some pressure on the domestic price level.

Prices, as measured by the Colombo Consumer Price Index, showed only a rather mild increase from 112:2 in 1964 to 112·5 in 1965, but during the year the Index went up to 113. This Index, however, is not a good indicator of price changes, as it is designed to measure changes in the cost of living of only working class families in Colombo. Even for this purpose the Index is known to be deficient, yet recourse to it must be had as a rough indicator of price changes. The Index showed some increase in prices and this was borne out by other evidence of shortages and high prices throughout 1965. Towards the latter part of the year the position seemed so intolerable that the Government carried through a vigorous campaign against hoarding of consumer goods and excessive prices. Whilst successful in themselves, these steps were inadequate to tackle the more fundamental problem of a shortage of supplies in relation to demand.

The problems confronting the Ceylon economy in 1965, and in years past, are capable of solution only by a vigorous and properly planned production drive. While foreign aid, price controls and other administrative action designed to increase supplies and keep prices in check can help in the short-run, the basic solution lies in so organising and directing the productive capacity of the economy as to enable an increasing flow of domestically produced goods to provide a rising level of per capita income to an increasing population. The establishment of a separate Ministry of Planning and Economic Affairs is in keeping with the priority that needs to be given to planned economic growth.

In the following paragraphs the developments in the monetary-fiscal situation in 1965 will be traced.

(a) The Government Budget

The Budget for 1964/65 set out to eliminate completely the inflationary financing gap which had been a feature of past Budgets. The inflationary gap which was Rs. 251·1 million in 1959/60 had fallen progressively to Rs. 162·0 million in 1962/63, and remained substantially at the same level in 1963/64 at Rs. 162·9 million. In the 1964/65 Budget it was expected that the inflationary gap will be altogether eliminated. In actual performance, however, this did not materialise and there was a reduced inflationary gap of Rs. 40·0 million; even this reduction was made possible by certain fortuitous circumstances rather than by the close implementation of the Budget measures.

The actual revenue collections were substantially the same as anticipated. Actual revenue in 1964/65 is estimated at Rs. 1816·4 million, as against the original estimate of Rs. 1821·3 million. This figure of revenue was an improvement on the actual revenue of Rs. 1759·0 million in 1963/64.

Actual expendtiure in 1964/65, according to provisional estimates, was Rs. 2311·3 million or Rs. 81·4 million less than the original estimate. The shortfall in actual expenditure was the result of a shortfall of Rs. 7·4 million in current expenditure and of Rs. 74·0 million in capital expenditure. Despite this shortfall, capital expenditure at Rs. 573·6 million was only Rs. 12 million lower than the peak level of Rs. 585·6 million achieved in 1961/62. In fact, the performance of the Budget in terms of the "Acquisition, construction and maintenance of real assets"[1] at Rs. 547·1 million was the highest level ever reached and was higher than the level of Rs. 499·4 million in 1961/62 and exceeded also the actual expenditure in 1963/64 by Rs. 58·6 million.

Current expenditure was not only below the originally estimated figure but was also less by Rs. 15·9 million than the current expenditure in 1963/64. This reverses a ten-year trend since 1954/55 for current expenditures to rise continuosly. It is, however, rather misleading to read too much into this fall in current expenditure between 1963/64 and 1964/65. In the former year, current expenditure had been very high due mainly to an increase in the food subsidy bill

1 See Table II (E) 3

consequent on a sharp increase in the world price of sugar. In 1964/65 there was a sharp decline in the world price of sugar. The average landed cost of sugar had risen from Rs. 637 per long ton in 1962/63 to Rs. 1135 in 1963/64. The average landed cost per long ton fell to Rs. 601 in 1964/65 and consequently Government's profits on the import and sale of sugar alone increased by almost Rs. 100 million. It is clear that but for this favourable and sharp movement in sugar prices, current expenditure would have followed the usual trend and recorded an increase above the 1963/64 level because there were increases in the other major expenditure categories such as Health, Education and Government enterprises.

The overall budget deficit for the financial year 1964/65 was Rs. 523·3 million. The net cash deficit after adjusting for Sinking Fund contributions and operations on advance accounts was Rs. 442·5 million, as compared with Rs. 461·7 million in 1963/64 and Rs. 391·7 million in 1962/63. Table I—1 shows the financing of the deficit in 1964/65 and previous years. While in 1964/65 the net cash deficit itself was lower than in 1963/64 by Rs. 17·8 million, there were significant differences in the manner of financing the cash deficit. Reliance on the banking system and other inflationary sources of financing was minimised, and at Rs. 40·0 million the inflationary gap was the lowest in recent years. The downward trend in the net expansionary impact of the Budget from its peak level in 1958/59 was commented on in previous Reports. In 1963/64 the expansionary impact was contained at the 1962/63 level despite a sharp increase in the net cash deficit. The performance in 1964/65 in this respect marked a distinct departure from the past, and merits closer examination.

TABLE I—1

Financing of the Deficit 1960/61 to 1964/65

Rupees Million

Source	1960/61	1961/62	1962/63	1963/64	1964/65
1. Financing from non-bank sources (Total) ..	212·2	269·7	213·2	301·1	400·0
of which (a) Administrative borrowing	29·4	104·5	–33·8	–1·9	56·7
(b) Domestic market borrowing from non-bank sources	165·2	109·4	153·5	207·6	243·2
(c) Foreign loans and grants	26·6	55·8	93·5	95·4	100·1
2. Domestic borrowing from the banking system	241·4	226·6	178·1	115·2	17·7
3. Use of Government cash balances ..	nil	–40·2	0·4	45·4	24·8
4. Total net cash deficit	462·5	456·1	391·7	461·7	442·5
5. Adjustment for change in U.S Aid Counter-part Fund account	–7·5	4·0	–16·5	2·3	–2·5
6. Net expansionary impact of Budget (2+3+5)	233·9	190·4	162·0	162·9	40·0

Goverment was able to hold down the expansionary impact of its financial operations to Rs. 40.0 million as a result of several factors. As already explained, the net cash deficit in 1964/65 was smaller than might have been expected, due to lower expenditure and higher revenue; yet, it was not significantly lower than in 1963/64. In the financing of the deficit, Government was able to obtain from non-bank sources Rs. 98.9 million more than in the preceding year. The chief causes for this were higher administrative borrowings and, more significantly, higher net borrowings from domestic non-bank sources. Receipts from the latter source have shown a rising trend since 1961/62 due mainly to larger receipts by the Insurance Corporation, the Employees' Provident Fund, Savings Institutions and other Provident and Pension Funds.

At the time the 1964/65 Budget was presented, it was expected that of the total deficit, Rs 225 million would be financed through Foreign Aid. The actual receipts were however, much lower and amounted to only Rs. 100·1 million, an amount not significantly different from the levels reached in the two previous financial years. It would have been possible to reduce even the modest expansionary impact of the Budget if foreign aid receipts were anywhere close to the estimated figure.

The Budget estimates for 1965/66, as presented in Parliament, envisaged a deficit of Rs. 558·6 million, which was to be financed by domestic non-bank borrowings of Rs. 275 million, foreign aid of Rs 175 million and administrative borrowings of Rs. 25 million, leaving a gap of Rs. 83·6 million which would, if realised, represent the expansionary content of the Budget deficit. There are indications that a higher level of domestic non-market borrowing will be possible especially in view of the substantial tax incentives for savings given in the 1965/66 Budget. Further, the yield on the tax amnesty has also been better than expected. Administrative borrowings also might be higher. It might, therefore, be possible to contain the expansionary impact of the deficit at or around a level of Rs. 80 million as expected in the Budget if foreign aid receipts as anticipated materialise.

The point must be made here that in attempting to maintain the inflationary impact of the 1965/66 at or around Rs. 80 million level, it would be extremely important to see that under-expenditure on capital votes should be minimised, if not eliminated, altogether. Estimated current expenditure for 1965/66 is only marginally above the actual current expenditure in 1964/65. It would be desirable to hold down current expenditure at or below the estimated level. If these objectives are strictly adhered to, the inflationary impact of the 1965/66 Budget can be contained at a desirable level while increasing capital expenditure.

(b) Commercial Bank credit to the private sector

In 1965, there was an increase of Rs. 4·2 million in gross commercial bank credit to the private sector.[1] This was in sharp contrast to the experience of the past three years when substantial increases in bank credit to the private sector were major causes of monetary expansion. The general economic situation, as revealed by data on Gross National Product, was one of inadequate growth. There was a severe curtailment of imports especially those by the private sector. Capital formation in the private sector including Government Corporations fell substantially. The increase in output was also lower than in previous years. As a consequence there was little expansion in commercial bank credit to the private sector during the year as a whole.

Table I–2 summarises the increases in commercial bank advances to the private sector. In 1965, loans and overdrafts increased by only Rs. 13 million in contrast to the increase of Rs. 106·8 million recorded in 1964. Even this small increase was channelled to Government Corporations (Rs. 7·8 million) and to Co-operative institutions (Rs. 5·6 million). Loans and overdrafts to the rest of the private sector remained almost at the 1964 level.

Table I – 2

Commercial Bank advances to the private sector

Rupees Million

	End of December			Change 1964/65
	1963	1964	1965	
(a) Cash items in process of collection ..	82·1	74·5	71·1	— 3·4
(b) Local Bills	—	...	...	...
(c) Import Bills	65·8	48·6†	49·7	+ 1·1
(d) Export Bills	72·8	53·6	47·1	— 6·5
(e) Overdrafts	331·9	372·3	383·0	+10·7
(f) Loans	213·0	279·4	281·7	+ 2·3
Total	765·6	828·5	832·7	+ 4·2

† Figure given in 1964 Annual Report has been revised.

The expanding trend in commercial bank credit to the private sector which was a major feature of the monetary situation in 1963 and in 1964 continued into 1965 and reached a peak in February, declined in March but increased again in April and May. In May1965 the Central Bank took action to restrain credit expansion by an increase in the Bank Rate from 4 to 5 per cent; this was supplemented by ceilings on credit expension by commercial banks and by applying, for the first time, a special reserve requirement of 28 per cent to the People's Bank.[2] These

1. Defined to include Government Corporations.
2. The Special Reserve Requirement of 38 per cent of any increase in demand deposits above the level of such deposits as at close of business on February 1, 1961 was imposed on all Banks on February 10, 1961. The People's Bank which commenced business only on July 1 1961 was not brought within this requirement until June 18, 1965 because the Central Bank, felt that such a restriction should not be applied to the People's Bank in its formative years.

policy measures attempted to re-orient the pattern of credit in favour of production and against consumption within the overall ceilings. Yet, there was some expansion of credit for consumption purposes, as revealed by the Central Bank's survey of bank deposits and advances. The attempt to re-orient the pattern of bank credit in favour of essential developmental needs of trade and production will however be sustained.

(c) Money supply

The money supply increased by Rs. 93·8 million in 1965 to Rs. 1715·7 million. The increase in 1965 was less than in 1964, when money supply increased by Rs. 115·8 million. Table I-3 shows the factors responsible for the increase in money supply in 1965.

Table I-3

Change in money supply (end December 1964 to end December 1965)

		Rupees Million
Expansionary factors		
(a)	Government borrowing from the banking system	81·6
(b)	Commercial bank credit to the private sector	11·0[1]
(c)	Increase in external banking assets (net)	79·7[2]
(d)	Adjustments	3·2
	Total	175·5
Contractionary factors		
(a)	Increase in time and savings deposits	46·9
(b)	Government cash balances	10·0
(c)	Increase in other liabilities (net) of commercial banks	20·2
(d)	Increase in other liabilities and accounts (net) of Central Bank	4·5
	Total	81·6
	Increase in money supply	93·8

1. Excluding export bills which are included under external banking assets. If export bills (which declined in 1965) are included gross bank credit to the private sector increased only by Rs. 4·2 million.
2. Includes foreign assets with a face value of Rs. 30·1 million purchased by the Central Bank from Government institutions in May, 1965.

The causal factors leading to the increase in money supply in 1965 showed some significant departures from the previous year. In that year the major determinants of the increase in money supply had been Government borrowing from the banking system and expansion of credit to the private sector by commercial banks, with changes in external banking assets playing only a minor role. In

1965, while Government borrowing from the banking system continued to be a major determinant of monetary expansion, commercial bank credit to the private sector played only a minor role and the increase in external banking assets became a major determinant.

Time and savings deposits continued to expand in 1965 but the expansion at Rs. 46·9 million was lower than the increase of Rs. 52·5 million in 1964, which was itself lower than the increase of Rs. 63.4 million in 1963. This increase in time and savings deposits was a major factor offsetting the increase in monetary expansion.

(3) External Payments in 1965

Part II of the Report contains a detailed discussion of the external payments position in 1965. In this Section, the main features of the balance of payments position in 1965 will be outlined.

In the Annual Report for 1964 much stress was laid on the problem of import capacity. The year 1965 commenced with Ceylon's external assets (net of Sterling Loan Sinking Funds) at the low level of Rs. 304·7 million. The International Reserve of the Central Bank was only Rs. 135·9, million of which the really liquid assets including clearing account balances amounted to only Rs. 67·6 million· The situation continued to deteriorate in the first quarter of 1965, when external assets declined further by Rs. 9·7 million despite foreign short-term borrowings of Rs. 51.2 million. This fall in reserves in the first quarter was made good towards the end of the second quarter and short-term liabilities were also reduced. The improved position in the second quarter of 1965 was made possible only by purchasing foreign exchange valued at Rs. 38·2 million from the International Monetary Fund and the reduction of import payments through import restrictions.

The International Reserve of the Central Bank stood at Rs. 163·2 million at the end of June 1965, showing an improvement of Rs. 27·3 million over the end December 1964 level. Included in the end-June figure, however, were the drawing of Rs. 38·2 million from the International Monetary Fund and a purchase by the Central Bank of foreign assets with a face value of Rs. 30·1 million from Government institutions. It is clear that but for these extraordinary accretions of foreign reserves to the Central Bank, its International Reserve would have declined by the end of June, 1965 to below Rs. 100 million. In fact, despite these extraordinary accretions, the liquid portion of the International Reserve including clearing account balances was only Rs. 65·7 million at the end of June 1965–no different from the position as at the end of 1964.

Ceylon's balance of payments situation reached an extremely critical level during the first half of 1965 despite severe import curbs. In dealing with the situation, as a first step, the issue of import allocations for the second half of the year was suspended, and arrangements were made with certain foreign commercial banks for short term accommodation. Secondly, in consultation with the International Monetary Fund, Ceylon entered into a standby arrangement with the Fund under which she obtained the facility of drawing, in instalments a total of Rs. 142·8 million of foreign exchange. Thirdly, with the help of the International Bank for Reconstruction and Development, Ceylon was able to obtain $ 50 million of pledges of foreign commodity aid from a group of donor countries in order to alleviate the acute shortage of goods of all kinds in the economy and to build up the foreign reserves of the country. Ceylon immediately entered into bilateral negotiations with individual donor countries and by the end of the year some negotiations had been completed while the details of some others were being worked out.

The standby arrangement with the International Monetary Fund is for a period of one year from June 15, 1965. Under its terms, Ceylon obtained the right to purchase from the Fund currencies of other members in exchange for Ceylon Rupees in an amount equivalent to $ 30 million in instalments. Purchases were not to exceed the equivalent of $ 15 million in the first six months and $ 22·5 million in the first nine months. In pursuance of this arrangement Ceylon purchased the first instalment of Rs. 15 million (equivalent to Rs. 71·3 million) in July 1965. At the same time, the Central Bank took certain monetary measures, as outlined in a previous section, as part of a stabilisation programme designed to secure domestic and external balance at rising levels of output and economic activity.

The delay in import licensing combined with the purchase of Rs. 71·3 million of foreign exchange from the International Monetary Fund helped to improve gross external assets by Rs. 164·9 million in the third quarter of 1965. The Central Bank's International Reserve also moved up in sympathy to Rs. 304·8 million by the end of September 1965. During the third quarter import licencing was resumed in view of the pledges of foreign aid and the improvement in the balance of payments consequent on the several remedial steps taken. The fourth quarter witnessed a fall in external assets once again due to repayment of a Sterling loan amounting to Rs. 24·6 million, a repurchase of Rs. 17·9 million from the International Monetary Fund and somewhat enhanced import payments consequent on the resumption of import licencing.

Table I-4 depicts in outline the balance of payments position in 1965 compared with previous years. The data reveal that for the first time in recent years Ceylon had a current account surplus in 1965. A small deficit of Rs. 5·0 million in the merchandise account was more than offset by a surplus on Invisibles resulting in a surplus of Rs. 47·0 million in the current account. This current account surplus together with an increase of Rs. 50·0 million in net external liabilities helped to finance an increase of Rs. 89·0 million in external assets and an outflow of Rs. 17·0 million of private capital.

TABLE I—4

Ceylon's Balance of Payments 1960–1965

Rupees Million

	1960	1961	1962	1963	1964	1965 Provi-sional
1· Merchandise						
Exports f.o.b.	+1,796	+1,707	+1,763	+1,708	+1,767	+1,911
Imports, c. i. f.	—2,006	—1,794	—1,906	—1,869	—1,960	—1,916
Trade balance	— 210	— 87	— 143	— 161	— 193	— 5
2· Services	— 32	— 18	— 4	— 20	— 7	+ 16
3· Donations	+ 22	+ 11	+ 7	+ 13	+ 40	+ 36
4· Current account balance ..	— 220	— 94	— 140	— 168	— 160	+ 47
Method of Financing						
5· Private capital						
Long-term	+ 2	— 8	— 2	+ 5	+ 1	— 3
Short-term	— 7	+ 14	—	— 4	— 9	— 14
6· Official and banking capital ✱						
(i) Change in net external long-term liabilities ..	+ 20	+ 19	+ 40	+ 75	+ 7	+ 36
(ii) Change in net external short-term liabilities ..	— 17	+ 81	+ 44	+ 46	+ 59	+ 14
(iii) Change in external assets ..	+ 193	+ 10	+ 28	+ 42	+ 111	— 89
(iv) Other ..	—	— 2	—	—	—	—
7· Errors and omissions	+ 29	— 19	+ 31	+ 4	— 8	+ 9

✱ Plus sign represents a decrease in assets or an increase in liabilities.

This comparatively satisfactory position in the balance of payments was achieved, as discussed earlier, due to several factors. There was a conscious effort to remove the imbalance in the merchandise account by a curtailment of imports. This effort was also helped by a slight improvement in the terms of trade by 1 per cent in Ceylon's favour. While the total import payments were reduced from Rs. 1960·0 million in 1964 to Rs. 1916·0 million in 1965, export earnings showed a marked improvement from Rs. 1767·0 million in 1964 to Rs. 1911·0 million in 1965. Imports of consumer goods including textiles were reduced, imports of capital goods were also substantially lower while those of intermediate goods were higher though inadequate. The curtailment of imports is not immediately apparent from the figure of aggregate imports; for concealed within this figure is the fact that due to enhanced imports of essential food-stuffs (the Food Commissioner's allocations alone were increased by Rs. 102 million) the reduction in imports of other commodities was substantial. In other words, in 1965 Ceylon achieved a satisfactory balance of payments position only at considerable sacrifice and social costs.

The second factor responsible for the improvement in the balance of payments situation was the several transactions entered into with the International Monetary Fund resulting in a net accretion of Rs. 53·4 million to Ceylon's foreign reserves. These transactions impose a relatively short-term burden of repayment on the economy. Ceylon has to make arrangements for repurchasing these obligations within 3 to 5 years and this would mean that it becomes extremely important to increase her repayment capacity within the shortest possible time if she is to meet these obligations without further sacrificing her import capacity.

The enhanced flow of foreign aid also casts special responsibilities on the country. Some of this aid is on a long term basis while some of it is on a medium to short--term basis. These liabilities together with the increase in the drawings from the Fund and any short-term liabilities which Ceylon might have to incur in order to tide over her immediate foreign exchange problems must result sooner or later in heavy repayment and servicing liabilities in foreign exchange. These commitments can be met only if the aid receipts together with Ceylon's own resources are utilized in such a manner as to enhance in the shortest possible time the productive capacity of the economy. This raises the crucial question of resource-utilization in a programme of development. In the next section some observations will be made on this problem.

(4) Perspectives of Economic Growth—the problem of resource - utilization

In the Annual Report for 1964 attention was drawn to the problem of import capacity. The experience of the economy in the last few years has brought this problem into sharp relief. It now appears that while the problem of import capacity could continue to hamper economic growth, certain critical bottlenecks of a different kind are likely to appear. The inflow of foreign aid on a larger scale has by itself served to underline some of these problems which have existed in the economy for many years. These problems can compendiously be grouped under the general heading of resource-utilization.

The basic requirement for utilizing the enhanced flow of foreign aid and domestic resources to the best advantage is planning. It is necessary to identify both the resources of capital and manpower available and the areas of development in which the resources can be utilized in order to achieve the fastest possible rate of growth. For when population is increasing rapidly and when the country is acquiring a load of foreign indebtedness time is of the essence.

There is no argument about the vital need to identify the available resources of men and material and the spheres in which they can be used to best advantage. This is, perhaps, in certain ways, the relatively simple aspect of the problem. The more difficult question is that of channelling these resources as expeditiously as possible to the actual projects that have been indentified as deserving high priority. The obstacles in this regard are likely to arise in several spheres, but for purposes of discussion they might be grouped under (a) manpower problems; and (b) the institutional framework. It is proposed to discuss each of these problems in outline in the rest of this section.

(a) Manpower problems

The need to identify the existing resources of manpower was earlier mentioned. The country already has a widespread Government administration and some quantum of managerial and technical capacity. It has been the considered view of several persons, who have looked into this problem, that there are big shortages of trained personnel in the country. The conclusion of a a manpower survey conducted by the I. L. O. for the labour Department in 1951 was that there was a "shortage of professional and technical personnel in the engineering as well as the biological, agricultural and social sciences". More recently, in 1963, the Commission of Inquiry into Technical Education found that shortages were not limited to the fields of technology and science but affected those of management and commerce. Nor was the short-supply limited to any particular grade of skill but extended to the grades of technologist technician and craftsman.

There is evidence both in the Government and in the private sector of a shortage of administrative and managerial skills. Government has never in the past been able to achieve targets of capital expenditure envisaged in its Budgets. Under-expenditure has in some years been as high as 36 per cent of anticipated capital expenditure and even in the last financial year only about 88 per cent of voted capital expenditure was actually spent. In the Government and semi-Government sector, administrative personnel have in recent times been called upon to shoulder heavy managerial and entrepreneurial responsibilities. There is no doubt that while some of them have done well there is a record of failure in certain Government Corporations which is attributable in part to deficiencies in management. Hence the need for training suitable personnel to run the several corporations in the public sector cannot be over-emphasised.

There is less evidence of a failure of managerial capacity in the private sector. Importers of a variety of consumer goods who had acquired experience and skill as traders have recently become manufacturers under a special framework of industrial incentives. These persons have achieved some success in running their small scale industries but it must be realised that they have been doing so in a sheltered market in which high unit profits are possible with the additional assistance of widespread tax and duty concessions. Without questioning the need for protecting import-substituting industries, it would seem doubtful whether despite some years of existence all those industries would remain financially viable without continued protection and fiscal concessions. For this, there might however, be several factors other than managerial capacity.

The scarcity of trained personnel in sphere other than top-management is also evident. There is a shortage of all types of technical personnel but, in a developing economy a shortage which generally appears is in the construction industry. There is some evidence to show that in Ceylon there are heavy pressures on the limited construction capacity available. While this may be due to some extent to the lack of adequate equipment, there is little doubt that particular skills are also in short supply. For example, even the limited supply of masons, carpenters etc. that is available is of a type suitable for construction of houses and the making of furniture, rather than for employment in heavy construction engineering works. In the few large construction works which Ceylon has so far undertaken there has been delay in completion and in some cases, a high degree of deficiency in completed ptojects. While this may have been due also to inadequate supervision and some dishonest practices, this is no doubt that the shortage of technical personnel was a major factor. This is therefore, an aspect of resource utilization in which an assessment of available capacities and requirements must be made and steps taken to remedy the imbalance.

(b) The institutional framework

The more provision of capital resources will not lead to their proper utilization unless there is a suitable institutional framework to channel these resources and to ensure that they are utilized in the best interest of the country. In the public sector, this involves the careful planning of devlopment projects and the use of the various Government Departments and public corporations to channel resources to the selected projects. The need for continuing control of the progress of development projects has to be emphasised. Apart from the maintenance of progress control, this would also involve for example, the speedy unloading at the Ports, the provision of adequate storage facilities and the quick despatch of imported materials to project sites. These problems are raised here purely to focus attention on the need to re-organise and re-orient the institutional framework of the country to handle the increasing availabilities of materials arising from foreign aid programmes in particular.

A word about the banking system would also be pertinent. The rationale behind the aid programme is to make possible a higher tempo of development than has been achieved in the past. In this process, the availability of domestic financial resources on a medium and long-term basis would have to be enhanced. The commercial banking system in Ceylon is not one designed for development financing. It has been designed and oriented to perform the more traditional commercial banking functions in an import-export economy. There is, nevertheless, some possibility of utilizing it to play a more active role in development financing.

The long-term lending institutions, which have been set up on Government initiative, have so far not been able to play the dynamic role expected of such institutions in a developing economy. This is, perhaps, due in some extent to the inadequacy of legal powers, the lack of experience and the paucity of projects coming up from the private sector. These, however, are not problems peculiar to Ceylon; they are, to varying degrees, present in every developing country. The real problem appears to be one of a mis-conception of the rôle of development financing institutions in developing economies like Ceylon. A Development Bank should not wait until entrepreneurs come up with finance-worthy projects. It has, on the other hand, to seek out finance-worthy projects which it would be prepared to back with its resources and which it would then proceed to hand over to likely entrepreneurs for implementation with its assistance. Mortgage lending, however necessary it might be, is not development lending. The latter involves lending not against an existing security but against a potential security in the form of a viable venture which the borrower hopes to create with the very finances so lent.

This type of development banking involves the creation of expertise in project evaluation, a type of expertise that is almost non-existent in the development financing institutions now functioning in Ceylon. It also requires the close supervision of loan-projects and the supply of constant advice and guidance to the borrower either by the lending institutions itself or by some other associated institution. The Central Bank has been giving active consideration to these problems. Now that the need for a proper stabilisation programme and an effective plan has been accepted and foreign aid on a substantial scale is likely to be available, the Central Bank proposes to initiate certain changes in the banking and development financing system with a view to gearing it to the developmental efforts of the country.

(5) Conclusion

Economic growth in the year 1965 was inadequate. While monetary expanion was kept within reasonable limits, supplies failed to respond to aggregate demand due, on the one hand, to inadequate foreign exchange reserves for obtaining supplies from abroad and, on the other hand, to the failure of domestic production to expand adequately. Consequently, there was considerable pressure on the domestic price level. Remedial measures designed to enhance the import capacity of the economy and stabilisation measures designed to secure domestic and external balance at rising levels of output and economic activity were initated in several directions during the year. These very policies serve to focus attention on the need to gear the manpower capacity and the institutional framework of the country to the achievement of the most efficient utilization of resources of men and material as an immediate and urgent policy objective.