I. ECONOMIC PERFORMANCE, PROBLEMS AND POLICIES-1971

1. INTRODUCTION

In 1971, economic growth suffered a set-back. The growth rate was only 0·9 per cent. Population grew by 2·0 per cent. Consequently, per capita real income showed a negative growth rate of 1·1 per cent. While output in domestic agriculture and construction declined, output in manufacturing and services rose. Private consumption expenditure at market prices declined while public consumption expenditure continued to increase. Investment declined in both public and private sectors.

The balance of payments situation was somewhat more comfortable than in previous years and an increase in external assets became possible. The terms of trade deteriorated further. Money supply increased by 9·3 per cent. Prices, as measured by the Colombo Consumers' Price Index recorded an increase of 2·7 per cent. The expansionary impact of the Budget was considerably lower than in the previous year.

2. ECONOMIC PERFORMANCE

(a) Gross National Product

According to provisional estimates Gross National Product at constant prices (real terms) rose by 0·9 per cent as against a rise of 4·1 per cent in 1970. In money terms (at current factor cost prices) Gross National Product rose by 1·8 per cent from Rs. 11,618 million to Rs. 11,828 million. It is estimated that the population of Ceylon rose by 2·0 per cent to 12·76 million in 1971. On per capita terms there was a decline in real product from Rs. 775 per head to Rs. 766 per head or a decline of 1·1 per cent.

As in previous years, the commodity terms of trade moved unfavourably and had a more severe effect in absolute terms than in any previous year. The loss in the purchasing power of exports was almost entirely due to high import prices reflecting inflationary conditions and currency disturbances abroad. This resulted in the terms of trade declining by 7·6 per cent thus reducing the capacity to import by Rs. 955 million as compared with 1959. The fall in real income by an equivalent amount would have had its repercussions on investment, consumption and employment.

Private consumption expenditure at market prices declined (by 1·1 per cent) for the first time since 1961; it was confined solely to imported goods and services due mainly to tight import restrictions. There was, however, a rise in the consumption of domestically produced goods and services but this increase of 4 per cent was less than that experienced in 1970. Public consumption rose (by 8·6 per cent) but the rate of increase was lower than in the previous year. The import content of private consumption expenditure, in money terms, declined from 15·9 per cent in 1970 to 10·6 per cent in 1971.

Total investment expenditure declined by 11·2 per cent. When allowance is made for an accumulation of stocks equivalent to 5 per cent of total investment, the decline in fixed investment was 14·9 per cent. In this decline, the Government accounted for nearly 38 per cent while private sector share was 42 per cent. Construction activity both in the private and public sectors was seriously affected by a shortage of building materials and a rise in their prices.

(b) Fiscal and Monetary Developments in 1971

(i) The Government Budget 1970/71

The original budget estimates for 1970/71 envisaged the collection of Rs. 2,878 million as total receipts from all sources. According to provisional data, total revenue collections in 1970/71 amounted to Rs. 2,815 million compared to Rs. 2,736 million in 1969/70. There was a shortfall of Rs. 63 million over the original estimate due largely to a decline in receipts from sale of FEECs and revenue from customs duties, particularly export duties, resulting from a lower level of imports and exports. Heavy utilisation of import credits coupled with a large programmed reduction in imports subject to FEECs reduced FEECs revenue by Rs. 61 million. As a proportion of GNP, total revenue, however, increased from 24·6 per cent in 1969/70 to 26·1 per cent in 1970/71.

Though the revenue collections from import duties declined by only Rs. 6 million, there was a substantial fall of Rs. 66 million in export duty collections. The rapid fall in rubber prices, particularly in the second half of 1971, resulted in a decline in export duty collections by Rs. 55 million. Tea duty collections which fell by Rs. 18 million were partly offset by an increase of Rs. 9 million in coconut duty collections. The relative weight of customs duties in total revenue declined from 23·2 per cent in 1969/70 to 19·5 per cent in 1970/71. Revenue from Business Turnover Tax and excise duties amounted to Rs. 643 million, having increased by Rs. 120 million or 23 per cent. Viewed against an increase of Rs. 134 million in 1969/70, this was a very satisfactory performance.

In contrast, direct tax revenues increased by only Rs. 3 million in 1970/71 as against an increase of Rs. 97 million in the previous year. The former increase stemmed mainly from better enforcement and collection, particularly through decentralisation rather than due to any enlargement of the tax base. The share of direct taxes in total revenue remained at 17 per cent as in 1969/70, while the share of the indirect taxes (including FEECs revenue) declined from 65·4 per cent to 63·0 per cent over the same period.

The Budget for 1970/71 provided for a total expenditure of Rs. 4,058 million; in the event, the actual expenditure amounted to Rs. 4,143 million and showed an increase of 2·1 per cent over the original estimate. Compared to the previous year when total expenditure grew by 12·8 per cent there was an increase of 6·6 per cent in the year under review. As a percentage of Gross National Product it was 35·0 per cent indicating a rise of 1·6 percentage points over 1969/70. In this total, recurrent expenditure (less debt repayments) constituted 72·0 per cent and formed an increasing proportion as compared to 68·4 per cent in 1969/70. The capital expenditure of the Government, which includes capital transfers to local authorities and public corporations, declined by Rs. 2 million in 1970/71. Capital expenditure registered an average annual rate of increase of 7·4 per cent in the last decade. The growth rate of recurrent expenditure out-stripped the growth of GNP.

The amounts absorbed on account of basic current expenditures are shown in the following Table.

TABLE I-1

Absorption of Increased Current Expenditures[1]

(Amounts in Rs. Million.)

Item	1968/69		1969/70		1970/71	
	Amount	Percent	Amount	Percent	Amount	Percent
Total increase over previous year ..	224·7	9·4	207·9	7·9	259·0	9·2
of which amount absorbed by:						
1· Administration ..	11·3	5·0	67·2	32·3	94·4	36·4
2· Social Services ..	46·1	20·5	90·0	43·3	13·7	5·3
2· Economic Services ..	11·1	4·9	10·2	4·9	21·6	8·3
4· Transfer Payments ..	143·2	63·7	51·2	24·6	151·9	58·6
5· Other[2] ..	13·0	5·8	– 10·7	– 5·1	– 22·6	– 8·6

1· Based on economic and functional classification.

2· Adjusted for unallocable FEECs amounting to Rs. 40·1 million in 1969/70 and Rs. 16·0 million in 1970/71.

Transfer payments which comprised 45·7 per cent of total current expenditures showed the highest increase over the previous year; it absorbed 58·6 per cent of the increase. A large amount of this increase (Rs. 83 2 million) was due to servicing of domestic debt. The unusually large increase in administration expenditure in 1970/71 was the result of defence expenditure almost doubling over the previous year in consequence of the operations against the insurgency. Gross food subsidy rose by Rs. 27·1 million in 1970/71 over the level of Rs. 574·3 million in 1969/70. When allowance is made for profits realised from the sale of sugar and flour, the net food subsidy rose sharply by Rs. 178·8 million or by 54·8 per cent. Although the cost of imported rice fell from Rs. 780 to Rs. 668 per long ton the effect of this price decrease was more than offset by increased issues of rice under the ration. The latter was the result of the decision to issue a second measure of rice at 75 cents per measure. Substantial price increases were experienced in respect of flour from Rs. 685 to Rs. 713 per long ton, and sugar from Rs. 727 to Rs. 887 per ton. Together with the decision to subject the import of sugar to FEECs, the higher import price resulted in an increase of Rs. 135 million in total cost of sugar. Besides, the distribution expenses in respect of rice alone went up by 50 per cent to Rs. 7·32 million on account of the increase in the ration.

One of the most disappointing features was a record decline in capital expenditures from the originally estimated level of Rs. 1,194·5 million to only Rs. 799·6 million or by 33·1 per cent provided for in the original estimates. In the past under-expenditure on capital accounts has been around 15 per cent. Perhaps the most important single cause of this decline was the fact that the targets of crash programme for employment were not realised. Disruption resulting from the insurgency coupled with administrative and financial problems resulted in only about 8000 persons being found employment though it was hoped to provide 100,000 jobs during the year. Only Rs. 8 million was spent on this account as against an estimate of Rs. 200 million.

The net expansionary impact of Governments fiscal operations is summarised in the following table.

TABLE I - 2

Financing of the Deficit 1968/69 - 1970/71

Rs. Million

	1968/69	1969/70	1970/71
1. Budget Deficit	947	1150	1327
2. Less: Sinking Fund contributions, etc. ..	160	214	244
3. Net Cash Deficit	788	936	1083
4. Financing			
(i) Total financing from non-bank sources ..	609	508	853
(a) Domestic non-market borrowing ..	52	16	140
(b) Domestic market borrowing from non-bank sources ..	203	266	479
(c) Foreign loans and grants ..	354	226	234
(ii) Domestic borrowing from the banking system	68	454	107
(iii) Use of Government cash balances and commodity aid counterpart funds ..	111	–26	123
(a) Cash balances	63	–31	– 3
(b) Foreign Aid Counterpart Funds ..	48	5	126*(a)*
5. Adjustment for change in U.S. Aid Counterpart Funds	...	...	1
6. Net expansionary impact of Government fiscal operations (4 ii, 4 iii & 5)	179	428	231

(a) The Central Bank Foreign Aid Counterpart Fund as at the end of September, 1971 was overdrawn by Rs. 112·8 million. This overdrawn position is the result of the delay in recording of commodity aid receipts. Also, please see footnote in page 155.

Evidently, the net expansionary impact of the budgetary operations has shown a sizeable decline in 1970/71 from that of the previous year. Recourse to the banking system which reached a record figure of Rs. 453·5 million in 1969/70 was Rs 106·8 million.[1] Reliance on foreign finance has decreased from 24·2 per cent of the total net cash deficit in 1968/69 to 21·6 per cent in 1970/71. Commodity loans comprised, the bulk of foreign finance and constituted 11 per cent of the net cash deficit.

Market borrowing from non-bank sources almost doubled between 1969/70 and 1970/71. Domestic public debt (gross) has been increasing at an annual rate of 13 per cent (compound) in the last decade; in 1970/71 it rose by 11 per cent over the domestic debt of the previous year. The domestic debt was 58 per cent of GDP in 1970/71 as against 54 per cent in 1965/66. Servicing of domestic debt has had a high growth rate of nearly 15 per cent per annum, during the last decade; as a ratio of total revenue it was 9·5 per cent in 1967/68 rising to 10·4 per cent in 1969/70 and reaching 11·8 per cent in 1970/71.

1. See footnote at page 155.

When the Budget for 1970/71 was presented to Parliament the anticipated Budget deficit was Rs. 1,180 million. It was to be financed through non-expansionary sources such as domestic non-bank borrowing (Rs. 445 million), commodity aid (Rs. 525 million) and project loans and grants (Rs. 113 million), leaving a gap requiring bank finance amounting to Rs. 97 million. The actual (provisional) budget deficit rose by Rs. 147 million to Rs. 1,327 million. At the same time, non-bank market sources provided Rs. 586 million or Rs. 141 million more than the amount budgeted, mainly due to larger subscriptions from savings institutions arising from the combined effect of the implementation of the demonetisation measure, higher interest rates and increased collections from EPF following an increase in the compulsory contribution of employers and employees. Sinking funds, too, greatly increased their contributions. Foreign finance fell short of expectations by Rs. 268 million to Rs. 370 million despite the use of Rs. 100 million of the cash loan from the Peoples Republic of China. When allowance is made for the use of Rs. 123 million of cash balances[1] the deficit requiring bank finance amounted to Rs. 106 million.

The Budget for 1971/72 was drawn up for a period of fifteen months with the aim of presenting the budget hereafter on a calender year basis. Thus, it ncluded the period October to December 1971 and the calender year of 1972.

As originally proposed, the total budget deficit was expected to be Rs. 1,513 million in 1971/72 (15 months). Revenue was estimated at Rs. 4,130 million, while expenditure was Rs. 5,643 million. The total expenditure was 9 per cent more than that of the previous year. It was noted earlier that there was a sharp fall in the utilisation of resources under the capital budget in 1970/71. Accordingly, the estimated capital expenditures in 1971/72 are very much higher than in the previous year.

The budgetary deficit was to be financed largely by non-inflationary sources leaving an unfinanced gap requiring bank finance of Rs. 161 million (Rs. 129 million for 12 months). But the withdrawal of the proposals to increase the sale price of flour from 33 cents to 48 cents per lb. and the raising of the proposed sugar ration from 2 lbs. to 3 lbs. per month per individual at 72 cents per pound (off ration sugar priced at Rs. 1·50 per pound remained unchanged) would raise the deficit further by Rs. 285 million to Rs. 446 million;[2] (Rs. 357 million for 12 months).

(ii) *Money and Credit*

The increase in money supply in 1971 was chiefly determined by the increase in net external banking assets. In contrast to a marginal contractionary influence in 1970 it generated the largest expansionary influence on money supply in 1971. Between end December 1970 and end December 1971 money supply increased by Rs. 183 million or 9·3 per cent compared to an increase of Rs. 84 million or 4·5 per cent in 1970. The rise in the monthly average level of money supply was 6·7 per cent in 1971 compared to 4 per cent in 1970. The income

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1. See footnote at page 155.
2. After allowing for the Rs. 100 million expected reduction in expenditure, from the proposal to increase the price of the second measure of rice to Re. 1/- per measure, which is not reflected in the estimates as approved by Parliament.

velocity of money as measured by the ratio of Gross National Product to money supply declined from 5·9 in 1970 to 5·5 in 1971. This was accompanied by a fall in the rate of turnover of demand deposits held by the public by 12·6 per cent over the same period.

The main factors responsible for the change in money supply are depicted in the following table:

TABLE I-3

Factors Affecting Money Supply (1969–1971)

Rs. Million

	1969	1970	1971
External Banking Assets (Net)	– 299·6	– 1·5	+200·5
Domestic Credit	+343·5	+497·3	+233·6
1. Government	+117·5	+349·8	+ 90·6
2. Private Sector	+226·0	+147·5	+143·0
(a) Government Corporations	+ 69·9	+ 43·2	+ 62·3
(b) Other	+156·1	+104·3	+ 80·7
Government Cash balances	+ 71·9	– 124·2	+ 68·0*
Time and Savings deposits of the private sector ..	– 158·1	– 178·8	– 137·7
(a) Government Corporations	– 10·8	+ 17·5	+ 6·2
(b) Other	– 147·3	– 196·3	– 143·9
Other items (Net) .. .	+ 12·1	– 109·1	– 181·3
Money Supply of which :	– 30·1	+ 83·5	+183·1*
Currency .. :	+ 17·7	– 148·8	+180·8*
Demand Deposits	– 47·8	+232·3	+ 2·3

* Provisional
Signs denote effect on Money Supply.

Government operations were less expansionary in 1971 than in 1970. Total credit to Government from the banking system increased in 1971 by Rs. 91 million compared to a much higher increase of Rs. 350 million in 1970. Of this increase in 1971, the Central Bank contributed Rs. 41 million, consisting of an increase of Rs. 61 million in provisional advances offset partly by a decrease of Rs. 20 million in the Bank's holdings of government paper. The net increase in the Government's indebtedness to the Central Bank was appreciably lower than the increase of Rs. 156 million in 1970. The increase of Rs. 49 million in commercial bank credit to Government in 1971 was also considerably lower than the increase of Rs. 194 million in the previous year.

Credit to the private sector including government corporations from commercial banks increased in 1971 by Rs. 152 million as against an increase of Rs. 168 million in 1970. Loans and overdrafts which rose by only 41 million in 1970 increased sharply in 1971 by Rs. 210 million. Overdrafts constituted the most important single component in the increase in credit to the private sector; nearly 52 per cent of this increase of Rs. 133 million was taken by corporations. Even though there was a large volume of bills discounted comprising mainly export bills, the increase on this account was only Rs. 5·4 million. One significant feature was a reduction in the goods receipt advances by Rs. 68·2 million compared to an increase of Rs. 144 million in the previous year. There was a fall in the gross volume of agricultural loans under the New Agricultural Credit Scheme to

Rs. 29 million in Maha 1970/71 and Yala 1971 seasons from Rs. 52 million in the previous two seasons mainly due to a large number of defaulters becoming ineligible for new loans.

TABLE I-4

Credit to Government & Private Sector

(Annual changes in Rupees Million)

	1969	1970	1971
Government	+ 117·4	+ 349·8	+ 90·6
From Central Bank			
1. Loans & Advances	− 7·6	+ 29·5	+ 61·0
2. Government securities & treasury bills ..	+ 112·0	+ 126·2	− 19·7
Sub-total	+ 104·4	+ 155·7	+ 41·3
From Commercial Banks			
1. Import bills	+ 87·9	− 141·8	+ 2·4
2. Government securities & treasury bills ..	− 83·1	+ 334·9	+ 50·6
3. Others	+ 8·2	+ 1·0	− 3·7
Sub-total	+ 13·0	+ 194·1	+ 49·3
Private Sector			
From Commercial Banks			
1. Government Corporations	+ 69·9	+ 43·2	+ 62·3
2. Other private sector	+ 156·2	+ 104·3	+ 80·7
3. Export bills	+ 5·7	+ 20·6	+ 9·1
Sub-total	+ 231·8	+ 168·1	+ 152·1
4. Adjusted for private securities held by commercial banks	+ 2·4	+ 0·4	− 0·2
Sub-total	+ 229·3	+ 167·8	+ 152·4
Total Credit from the Banking System.. ..	+ 346·7	+ 517·6	+ 242·9

Aggregate credit to the private sector including government corporations had been increasing at a decreasing rate since 1968; in 1971 the increase in its volume at Rs. 152 million was 91 per cent of the total expansion in the previous year. The smaller increase in the volume of credit to the private sector may be largely attributed to the stagnant economic conditions prevailing in the private sector (excluding government corporations). The time and savings deposits of the private sector expanded by Rs. 138 million, thereby reducing its expansionary impact on the money supply.

The absorption of credit by purpose is shown in the following table:

TABLE I-5

Increase in Credit classified by Purpose[1]

(Rs. Million)

	1969	1970	1971
Commercial	+ 40·0	− 24·8	+ 110·2
Financial	+ 2·1	− 1·3	− 13·2
Agricultural	+ 36·3	+ 26·4	+ 23·7
Industrial	+ 155·6	+ 28·7	+ 37·1
Consumption	+ 3·5	+ 0·3	+ 38·4
Other loans	+ 7·9	+ 1·5	+ 22·6
Total	+ 245·5	+ 30·6	+ 219·0

1. Cash items in the process of collection and a few miscellaneous items which could not be classified by purpose are excluded.

It can be seen that there has been a significant change in the pattern of credit from that of the previous year. In 1970 advances for commercial purposes declined by Rs. 24·8 million while in 1971 they increased by Rs. 110 million and its relative weight was more than 50 per cent of the total increase. A very large proportion of commercial loans (79 per cent) had maturites of up to one year, while 50 per cent of the industrial loans had the same maturity pattern. In contrast to a decline in credit for export and import trading in 1970 there was a substantial increase in credit for these purposes in this year. Loans for consumption purposes increased by Rs. 38 million and as to be expected the bulk of these (74 per cent) were medium and long term loans with maturities ranging from 1 year and over.

Unlike in 1969 when the increase in advances for industrial and agricultural purposes constituted the bulk of the total increase, the increase for these purposes in 1971 amounted to a little more than quarter of the total increase. Commercial bank had less recourse to refinance facilities than in 1970. The increase in 1971 was a little over 11 per cent of the increase in the previous year. Continuing increase in defaults rendered a large number of cultivators ineligible for loans under the New Agricultural Credit Scheme. Accordingly the demand for these loans declined sharply.

The importance of specialised long-term credit institutions decreased perceptibly. The volume of loans granted by these institutions in 1971 was only 54 per cent of the 1970 level. This could have been mainly due to uncertainties created by the insurgency coupled with the slow growth of investments opportunities.

(c) Balance of Payments 1971

The balance of payments position continued to be under strain despite a reduction in the current account deficit. There was an improvement in the net external assets position due to a number of factors. The slackening of demand for imported goods as a result of the slow growth of the economy, continuation of the system of deferred payments and accumulation of short term credit for imports, an appreciable increase in foreign finance including a cash loan from the People's Republic of China and a reduction in the import programme as a deliberate policy of cutting down imports through tight import restrictions were the main factors responsible for a rise in net foreign assets. Nevertheless, the balance of payments on current account indicated a deficit of Rs. 209 million, in 1971 compared to a deficit of Rs. 350 million in 1970. In fact the impact of this deficit on external assets was only forestalled by the increased availabilty of foreign finance.

According to Customs data nearly 67 per cent of the reduction in the imports of consumer goods was due to the reduced value of rice imports arising entirely from a reduction in volume by 39 per cent. There was a decline in the import value of investment goods by Rs. 127 million. The attitude of the private sector in the context of existing uncertainties combined with slow economic growth made this sector invest less. The increase in external assets occurred not only at the expense of domestic consumption but also at the expense of economic growth.

The terms of trade moved even more adversely than in the previous year mainly due to higher import prices reinforced by lower export prices, particularly for rubber exports. In fact the import price index for imported goods rose by 7·2 per cent while export prices fell by a small margin.

The value of total exports showed a decline of Rs. 53 million (from Rs. 2,017 million in 1970 to Rs. 1,964 million in 1971) and was mainly caused by low earnings from rubber. Though the price of tea practically remained unchanged the volume exported fell perhaps due to slow movement of exports during the insurgency. Progress has been made in the production and export of instant tea; instant tea exports rose from 26,000 pounds in 1965 to 399,200 pounds in 1971.

Though the world consumption of rubber including synthetics had been increasing at an annual rate of nearly 6 per cent, Ceylon's production failed to keep pace with world demand conditions. Besides a sharp fall in prices, adverse weather conditions reinforced by the effects of the April insurgency reduced supplies. A sharp drop in prices may have caused marginal estates to go out of production. The pressing problem today is that prices have reached a level even lower than that in 1967 mainly due to the releasing of the U.S. stockpile at the rate of almost 6,000 tons a month.

Coconuts however showed a marked improvement as its export volume rose by 11 per cent over that of the previous year. Better market conditions and higher prices because of a fall in output in the Philippines were the main reasons for this increase.

Minor exports of the non-traditional types did not perform as well as they did in the previous year. The reduced availability of imported raw materials, under capacity utilisation and the disruption of manufacturing output during curfew hours at the time of the insurgency, together with the greater attraction of the domestic market resulted in lower export earnings from this sector.

Merchandise imports fell by Rs. 135 million or 6 per cent from Rs. 2,332 million in the previous year. Imports of consumer goods were at a lower level than in 1970, while imports of capital goods also fell reflecting a slow-down in economic activity.

On the services account, the deficit was smaller due to an appreciable fall in the outward remittances of investment income and reduced expenditures on transportation, travel and other services. Tourist earnings remained static at Rs. 20 million.

Again in 1971, import capacity, as measured by export earnings adjusted for terms of trade and net factor movements, declined thus causing a greater strain on resources in the context of rising debt burden. Despite this there was a net accretion of Rs. 96 million to external assets. Total transactions generated a resource gap of Rs. 1,353 million. The following table depicts the method of financing this resource gap.

TABLE I-6

Ceylon's External Resource Gap and Modes of Financing (1968-1971)

Rupees Million

	1968	1969	1970	1971[1]
1. Exports ..	1,976	1,909	2,017	1,964
2. Imports ..	2,356	2,655	2,332	2,197
3. Trade balance ..	– 380	– 746	– 315	– 233
4. Investment income ..	– 23	– 51	– 42	– 29
5. Interest Payments ..	– 30	– 58	– 100	– 110
6. I.M.F. repurchases ..	– 48	– 87	– 161	– 145
7. Debt repayments including short-term and or repatriation of capital ..	– 218	– 305	– 495	– 904
8. Other current account transactions ..	+ 50	+ 12	+ 32	+ 68
Total (3 to 8) ..	– 649	– 1,235	– 1,081	– 1,353
Financed by:				
Commodity aid ..	255	272	263	260
Project aid ..	40	89	35	65
Other aid ..	—	—	—	152
Suppliers' Credits ..	—	176	85	55
I.M.F. purchases ..	213	77	57	83
Bank borrowings ..	—	227	123	—
Short term credits ..	84	185	434	646
Bilateral balances ..	42	18	– 75	– 57
External assets ..	– 14	86	– 25	– 96
Grants ..	28	46	75	95
Private Capital ..	8	9	8	13
Other ..	9	32	52	51
Special Drawing Rights ..	—	—	78	63
Errors and Omissions ..	– 16	18	– 29	23
Total ..	649	1,235	1,081	1,353

1. Provisional.

There was an increase in resources from Rs. 3,462 million in 1970 to Rs. 3,735 million in 1971, mainly because of a larger inflow of foreign resources. Merchandise exports added Rs. 1,964 million to resources in 1971 while, services contributed Rs. 266 million. The capital inflow of Rs. 1,483 million consisted of Rs. 95 million of grants, cash loans of Rs. 152 million, commodity aid and other loans amounting to Rs. 325 million, private capital inflows of Rs. 13 million and other short term credits amounting to Rs. 753 million. Purchases from the International Monetary Fund amounted to Rs. 83 million, while allocations of Special Drawing Rights added Rs. 63 million to resources. Repurchases from the I.M.F., however, amounted to Rs. 139 million.

One striking feature is the growing importance of short term trade credit as a source of finance for imports. From a small proportion of nearly 4 per cent of exports earnings in 1968 these short term credits increased to Rs. 185 million or 8 per cent in 1969, Rs. 434 million or 19 per cent in 1970 and Rs. 646 or 29 per cent in 1971. Heavy dependence on short term credits, whether in the form of suppliers' credits, deferred payments or bank borrowings, is a costly way of meeting import payments. Apart from the high rates of interest, the usual commissions and other concessions are seldom or never made available.

Debt servicing comprised 14 per cent of export earnings in 1970, while in 1971 it was 16 per cent. External public debt repayments (capital and interest) in 1971 amounted to Rs. 303 million (inclusive of IMF repurchases of Rs. 139 million).

The need for the Central Bank to incur a large volume of short term debt as in the previous year was forestalled by the cash loan already referred to. In fact there was a decline in the amount of short term credit owed by the Central Bank to foreign banks by Rs. 81 million.

(d) Prices

The year witnessed the continuation of gradually rising prices throughout the world. Consequently, the impact of import prices on the Colombo Consumers' Price Index would have been more marked than the rise of 6 per cent within the year between January and December 1971 but for the extension of price control of essential items (consumed mainly by the lower income groups) that have a high weightage in the index. Domestically produced goods experienced even larger increases in prices due to supply shortages, relatively lower yields of some of the agricultural commodities and a rise in production costs. These factors together with a rise in money supply by 9·3 per cent were offset to some extent by a slackening of consumption and investment demand.

There is, however, no reliable indicator of changes in the general level of prices. As mentioned in previous Annual Reports the Colombo Consumers' Price Index not only fails to cover all classes of consumers but the basket of goods used in the computation of the index has remained unchanged since 1950. Nevertheless, there is adequate evidence to indicate that price increases have been heavy in certain sectors of the economy.

(e) Wages and Employment

The available data on wages refer to a minimum wage rate of teachers, technical, clerical and minor employees of the Government, and of workers in agriculture, industry and commerce covered by the Wages Boards. There was a high degree of stability in these wage rates in 1971. The minimum wage rate of Central Government employees remained unchanged, while those in Wages Boards indicated a rise of 3 per cent during the year. Besides these minimum wages some employees may receive bonuses, exgratia payments and concessional grants.

Data on the overall level of wages or total earnings are fragmentary. An indirect assessment of the total earnings has been made by using contributions made to the Employees' Provident Fund. The total wages bill of employees covered by the EPF increased from Rs. 1,068 million in 1970 to Rs. 1,283 million in 1971 as against a contribution of Rs. 919 million in 1969. The average earnings per employee rose from Rs. 524 per annum in 1969 to Rs. 584 in 1970 or by 11 per cent. Judging by the slow growth of the economy, employment may have increased less fast than the rise in the wage bill in 1971. It is therefore reasonable to assume that total earnings rose as fast, if not faster, in 1971 as in the previous year.

In the manufacturing sector the average earnings per worker rose from Rs. 2,182 in 1970 to Rs. 2,492 in 1971 or by 14·2 per cent. The wage bill of the Central Government rose from Rs. 1,102.5 million in 1969/70 to Rs. 1,252.3 million in 1970/71 or by 13·6 per cent, while those employed in government service rose by 3 per cent thus giving an increase of earnings by over 10 per cent.

Wages in government and public enterprises are fixed by Government regulations and administrative regulations of Boards of Corporations.

For the private sector employees minimum wages are fixed by either Wages Boards, or remuneration tribunals (shops and offices). Collective agreements are in operation for 65 establishments covering employees in banks, the mercantile sector and similar trades and occupations. A few of these collective agreements were revised in 1971, while in a few others that fell due for renewal negotiations were in force.

Data on employment and unemployment are available from various surveys but because of the differences in concepts of unemployment used in different surveys, comparability of the data is limited. In 1969/70[1] about 3·8 million people were employed and some 557,000 were unemployed. The yearly addition to the work force is around 110,000 persons. In 1970 the numbers of paid employees amounted to 2·4 million or 63·2 per cent of the employed.

Nearly 14 per cent of the work force had been unemployed in 1969/70. Considering the fact that the real Gross National Product rose only marginally, unemployment would have increased at a faster rate than the rise in the work force. This figure excludes the under-employed for whom no reliable estimates are available. An estimate based on a survey of 1964[2] puts the figure at 13 per cent of the work force. The triple task of keeping up with the rapidly rising labour force, reduction of the backlog of unemployment and looking for avenues for employment for the under-employed places a heavy burden on the economy.

If the targets of the Five Year Plan announced in November, 1971 are realised unemployment will reduce to about 290,000 or less than 6 per cent of the work force by 1976. The Plan proposes to create employment for 800,000 persons distributed in agriculture (300,000); industry (165,000); construction (60,000) and services (285,000).

3. POLICIES AND MEASURES

(a) Monetary Policy

The Monetary Board continued to follow a policy of credit restraint during 1971. Given the balance of payments situation and the consequent severe restriction on imports, credit creation had to be kept at a low level. The ceilings on commercial bank credit which were in force were revised in November, 1971 with a view to broadening their scope and coverage.

1. Socio-Economic Survey 1969/70, First Round – Department of Census and Statistics.
2. I.L.O. Labour Force Survey, 1964.

(b) The Exchange Rate

The U. S. A. suspended the convertibility of the U. S. dollar in August 1971. For a while existing parities vis-a-vis foreign currencies were maintained, but with effect from November 6th it was decided to maintain, existing parity between the Ceylon Rupee and the U. S. dollar at 1 US$-Rs. 5.9524 and to vary the parities of other currencies on the basis of their values in international foreign exchange markets.

(c) The Five Year Plan, 1972-76

The most important policy announcement made by the Government in 1971 was the Five Year Plan, 1972-76.

The aims of the Plan are-

I. To achieve a rate of growth in Gross National Product at around 6 per cent annually during the five-year period, 1972 to 1976, and to increase per capita real income from Rs. 910 per annum to Rs. 1,150 per annum in 1976; and

II. To provide employment for 810,000 persons.

The strategy for achieving this rate of growth during this five-year period includes:

(i) raising investment rate to about 19 per cent of the Gross Domestic Product in 1976;

(ii) achievement of a savings ratio of 17 per cent of Gross Domestic Product (raising its level from its present rate of 12·5 per cent);

(iii) reducing the current account deficit of the balance of payments to Rs. 265 million by 1976 from the level of Rs. 468 million in 1970.

(iv) effective implementation of policies relating to the maximum use of labour, thereby reducing the capital intensity (and foreign exchange cost) of projects;

(v) import substitution, export diversification and promotion; and

(vi) the involvement of the people in the formulation, execution and implementation of development plans.

A growth rate of 6 per cent in real terms is attainable. Ceylon has had even higher rates of growth in the past. The achievement of such a rate of growth requires *inter alia*, the efficient mobilization of both external and domestic resources. The success of the Plan depends crucially on the ability to finance the required imports. The Plan involves a total investment expenditure of Rs. 15,000 million. In order to meet the foreign exchange requirements during the period, the Plan envisages an increase in export earnings of Rs. 700 million in 1976 as compared with 1970 and the availability of foreign aid and credits sufficient to produce a net average inflow of about Rs. 300 million per year. The achievement of these targets on the foreign exchange side will require substantial effort and changes of policy.

In the past, Ceylon's import capacity has been seriously impaired by a fall in real export earnings, increasing prices of imports and the growing burden of debt servicing. The medium-term outlook for prices of Ceylon's major exports is not encouraging. At the same time, prices of imports are likely to rise even further. The debt servicing burden has increased from 10 per cent of export earnings in 1968 to 16 per cent in 1971 (partly due to a fall in export earnings). In absolute terms, debt servicing, including capital and interest charges and repurchases from the IMF, has risen from Rs. 207 million in 1968 to Rs. 303 million in 1971. Current projections show that this figure would exceed Rs. 500 million by 1975, without taking into account the servicing of debts which would be incurred after 1972; thus the actual amount is likely to be even larger.

In this context, the Plan lays emphasis on increased export earnings and a reduction in imports of consumption goods. An increase in exports of Rs. 700 million is to be achieved as follows:

Existing minor exports	..	Rs. 105 million
New agricultural exports	..	Rs. 85 million
New industrial exports	..	Rs. 250 million
Fish	..	Rs. 16 million
Gems	..	Rs. 50 million
Others	..	Rs. 194 million
Total	..	Rs. 700 million

In comparison with past export perfomance, these are ambitious targets. In fact, exports grew at an annual rate of less than 0·5 per cent since 1965. Nevertheless, the success of the Plan depends so vitally on their achievement.

It is not impossible to achieve an increase in annual exports of the order of Rs. 700 million by 1976 but this would require an entirely new approach to the problems of the export sector.

Export policy as such has received very little attention in the past mainly because the major exports enjoyed buoyant market conditions for many years. But when there was a shift in the structure of that demand, Ceylon was not ready with new lines of exports. Even the major exports themselves were at a disadvantageous position in world markets; they were taxed more heavily than domestically produced and consumed goods.

Export promotion and growth are not matters to be treated with indifference nor should they be considered in isolation from the overall strategy. Problems of major exports include modernisation, sales promotion and accumulation of surpluses for re-investment. Lower costs and higher productivity are desiderata for growth and for increasing exports. In the case of minor exports there are other problems as well.

Clearly, with a limited domestic market the continued growth of output will depend largely on the degree of specialisation and the need to produce for export. Export orientation was adversely affected by the high prices obtainable in the local market. As long as rupee profits are high, there is little incentive to sell abroad. The table shown below indicates the slow rate of growth in industrial exports.

TABLE 1 - 7

Industrial Growth

	1960	1963	1966	1967	1968	1969	1970	1971
1. Industrial production at constant prices (Rs. Mn.) ..	728	853	1008	1052	1154	1221	1335	1379
2. Growth rate over previous year ..		7·1	7·6	4·4	9·7	5·8	9·3	3·3
3. Industrial exports at: (a) Constant prices (Rs Mn.) ..	73	73	70	80	88	89	122	128
(b) As % of Domestic exports at constant prices ..	4·1	3·8	3·7	4·0	4·3	4·5	5·9	6·3
(c) As % of industrial production at constant prices ..	10·0	8·6	6·9	7·6	7·6	7·3	9·1	9·3

Source: Central Bank of Ceylon and Ceylon Customs Return.

High domestic prices relative to world prices discourage exports. There still exists a large difference in the export and domestic prices for most industrial and minor agricultural products like pepper. The Foreign Exchange Entitlement Certificate Scheme has tended to reduce this difference, but more steps such as the levy of high turnover and excise taxes on domestic sales, combined with tax and other concessions on export sales appear to be necessary.

There is already some established capacity for increased production especially in the industrial sector. Public industrial corporations are being operated mostly well below capacity. In private industry too there is excess capacity as pointed out in later sections of the Report. In these cases, a quick increase in production for export would be possible given aggressive sales promotion and research in foreign markets and import allocations for raw materials.

The Plan envisages net capital inflows from abroad as follows:

	Net Capital Inflows (Rs. Million)
1972	309
1973	341
1974	327
1975	277
1976	226

Gross inflows would have to be substantially higher in order to meet the capital repayments due on debts already incurred. In fact, gross inflows would have to be higher than those of the past years.

Given the will and appropriate policies, it would not be impossible to achieve the export and capital inflow targets. If, however, there are shortfalls, the implementation of the investment programme would require additional cuts in imports of consumer goods. It may then become necessary to accelerate the pace of import substitution especially in agriculture if intolerable shortages are to be avoided.

Internally, the financing of the Plan depends on raising the average rate of savings from 12·5 per cent to 17 per cent of Gross Domestic Product. It is estimated that roughly 26 per cent of the increases in incomes during the Plan period should be saved if the investment targets are to be met.

To raise the level of resources required internally will require not only a massive Government effort but also a high degree of co-operation from the public. A marginal rate of savings of 26 per cent implies a substantial change in the community's current preferences between consumption and savings. In the sphere of public finances, it implies a shift of emphasis from current to capital expenditure. As stated in the Plan document, "A surplus on the current account of the dimensions needed will depend on the Government's ability to contain the increases in current expenditure within limits, eliminate waste, and effect strict economies in all branches of expenditure which are not directly productive".

The public corporations too are expected to contribute a total of Rs. 927 million, commencing with Rs. 120 million in 1972 and rising to Rs. 272 million in 1976. The profits before tax in 1970/71 of 35 corporations for which data are available amounted to Rs. 141 million or about 8 per cent of capital employed. The ability of the corporations to produce the surpluses for investment envisaged in the Plan would depend on efficient management and the adoption of more realistic pricing policies than in the past. The Auditor-General has had occasion to point out the inadequacy of cost and budgetary controls, lack of proper systems of costing and inefficient stock control methods in some of public corporations.

The Central Bank's own surveys have revealed that accounts of some corporations are not prepared promptly and the basic data required for efficient management are not readily and promptly available. These deficiencies will have to be identified and systematically remedied if the corporations are to play the vital role assigned to them in the financing and implementation of the Plan.

Private savings are expected to finance Rs. 11,307 million or 76 per cent of the total investment. Raising this volume of savings from the private sector will not only require provision of appropriate incentives and facilities, but also a complete re-orientation of the present attitude of the public towards consumption and savings. The success of the Plan thus depends on the public's willingness to understand the long-term strategy of the Plan, which is based on a period of continued austerity for the sake of building up of the infra-structure necessary for sustained growth in the future.

In sum, a massive effort at resource mobilisation will be required if the Plan targets are to be achieved. It will also require careful management of the balance of payments, the Government budget and the finances of public corporations. The public would have to support the Plan by increasing the rate of saving and assisting in its implementation.