I. ECONOMIC PERFORMANCE, PROBLEMS AND POLICIES—1974

I. INTRODUCTION

In real terms the economy grew at 3.4 per cent in 1974, which is slightly less than the rate achieved in the previous year (3.5 per cent). However, it is an improvement on the growth rates of 0.9 and 2.5 per cent in 1971 and 1972 respectively. With the lower rate of population increase of 1.6 per cent[1] in 1974, the increase in the real product at constant prices is 1.8 per cent. The latter, however, is higher than the increase in the real product in 1972 and is almost the same as the figure for 1973. During the year, the growth rate remained depressed due mainly to a sharp fall in production in the plantation sector which has considerable weightage in the country's national accounts and to a lesser extent in manufacturing and in mining. Within the agricultural sector paddy production, however, showed a very substantial increase and was instrumental in offsetting the decline in the output of tea and rubber.

The most significant economic event in 1974 was the severe price inflation which hamstrung the economy, seriously affecting several areas of economic activity and preventing the acceleration of the pace of devolopment. Inflation continued unabated throughout the year making heavy inroads into consumer real incomes. The public were also affected at various times by shortages of a wide variety of consumer goods. The only indicator of the magnitude of the price increase, the Colombo Consumers' Price Index, rose by a modest 12.3 per cent in 1974. In practical terms, a properly computed price index would have given a more accurate indication of the severe inflationary pressures in 1974. Inflation was caused by very high prices for imported foodstuffs, other essential consumer goods and industrial raw materials. Although the end year increase in the money supply was far less significant than in the previous year, its increase alone is inadequate to explain why prices rose very sharply in 1974. Whereas the money supply rose by 6 per cent the rate of inflation shown by the Colombo Consumers' Price Index was 12.3 per cent. The government Budget did not contribute to the inflation, its overall effect being contractionary.

The deficit in the balance of payments is the highest recorded so far and is attributable to the very large increase in the import bill resulting from very sharp price increases in the world commodity markets. This resulted in a considerably higher level of expenditure on imports of essential foodstuffs and raw materials. The prices for the main traditional exports tea, rubber and coconut were the highest recorded for more than a decade. Increased export earnings from the plantation crops, however, made only a very limited contribution to ease the pressure on the import bill. The traditional export industries could not fully benefit from the commodity boom because production, particularly of tea and rubber, fell appreciably, The foreign trade deficit was financed by the increasing use of bank borrowings and short term credits from several different sources. Imports of essential goods were

1. The rate of 1.6 per cent has taken into account net emigration which is now an important factor that has tended to reduce the rate of increase in population. If net emigration is excluded the population growth rate is higher. Please see table 1—2 for the adjusted rates of population growth excluding emigration which reflects the true position.

drastically reduced and foreign aid, although higher than in preceding years, was inadequate to maintain the import volume at earlier levels. Thus at the end of the year, short term liabilities which would fall due in less than one year had reached the highest level so far.

2. ECONOMIC PERFORMANCE

(a) Gross National Product

At current prices, although gross national product increased by 30 per cent in 1974 as against 19.6 per cent in 1973, the increase in 1974 at constant prices was only 3.4 per cent as against 3.5 per cent in the preceding year. The significant difference between the values at money and constant prices is a reflection of the magnitude of the price increases during the year.

As already indicated although in relation to the growth rates in 1971 and 1972, the growth rates in 1973 and 1974 are higher, these must be evaluated in the light of the performance required under the current Five Year Plan which came into operation in 1972. The rate of increase in 1974 in the gross national product is far below the target rate of growth of 6 per cent in the Plan. The average growth rate for the first three years of the Five Year Plan is about 3.1 per cent, which of course, falls short of the target levels. If a comparison is made with the performnce of the economy in the sixties, in more recent years economic growth rates have decidedly received a set-back.

TABLE I—I

Sectoral Growth—Gross National Product at Constant (1959) Prices

(Rs. Million)

	1972	1973	1974	Percentage Change 1973	Percentage Change 1974
1. Agriculture, Forestry, Hunting and Fishing. ..	3,478.4	3,387.6	3,558.3	— 2.6	+ 5.0
2. Mining & Quarrying. ..	67.5	266.2	190.9	+ 294.4	— 28.3
3. Manufacturing. ..	1,400.5	1,417.2	1,359.4	+ 1.2	— 4.1
4. Construction. ..	505.0	516.2	552.8	+ 2.2	+ 7.1
5. Electricity, Gas, Water & Sanitary Services. ..	31.0	31.3	31.5	+ 0.6	+ 1.6
6. Transport, Storage and Communication..	987.6	1,018.7	1,053.7	+ 3.1	+ 3.4
7. Wholesale & Retail Trade. ..	1,327.2	1,383.2	1,449.8	+ 4.2	+ 4.8
8. Banking, Insurance and Real Estate. ..	135.6	141.9	164.9	+ 13.8	+ 16.2
9. Ownership of Dwellings. ..	312.6	318.1	344.4	+ 1.8	+ 8.3
10. Public Administration & Defence. ..	522.2	566.6	609.1	+ 8.5	+ 7.5
11. Services. ..	1,334.0	1,379.4	1,440.6	+ 3.4	+ 4.4
12. Gross Domestic Product ..	10,101.6	10,426.4	10,755.4	+ 3.2	+ 3.2
13. Net Factor Income from Abroad. ..	— 71.9	— 43.9	— 24.9		
14. Gross National Product. ..	10,029.7	10,382.5	10,730.5	+ 3.5	+ 3.4

Between 1973 and 1974 there have been fairly substantial changes in the relative contributions made by certain vital production sectors in the economy. In the mining and quarrying sector where production increased by 294 per cent in 1973 there was a decline of 28.3 per cent in 1974. In 1973, the sharp increase in growth in the mining sector was due to the fact that the increase in production in 1973 was very high against the base year figure of Rs. 67.5 million in 1972. The fall in the growth rate in mining in 1974 has, therefore, been due to a very high growth rate in the previous year. Presumably recorded production in 1974 was also lower because the incentives offered to the gem industry in 1973 were slightly more advantageous from the tax point of view than those given to the industry in 1974.

The decline in manufacturing has been mainly due to the increase in the price of raw materials which sharply curtailed the physical volume of inputs to private sector industries and also due to the reduced consumer demand for certain categories of industrial goods on account of high prices. The performance of the agricultural sector showed a marked improvement over the previous year and was entirely due to the substantial increase in the production of paddy and subsidiary food crops. But despite this there was a marked decline in output in the plantation sector. The latter was the main reason for the failure of the gross national product to increase further in a year when the performance of other sectors other than mining and manufacturing were better than in 1973.

In 1974 the terms of trade fell less sharply than in 1973 because export prices also rose significantly. However, the purchasing power of the country's exports fell considerably because import prices rose much faster than export prices. The terms of trade declined by 10.7 per cent in the year as against 13.3 per cent in 1973 At (constant) 1959 prices the loss in import capacity resulting from the fall in the terms of trade alone is Rs 1,143 million.

TABLE 1—2

Growth Rates and Rates of Population Increase

Year	Growth rate	Increase in rate of population growth	Growth rate making allowance for increase in population	Increase in population adjusted for net emigration	Per Capita income at constant prices
1965 ..	2.5	2.4	0.1	2.4	676
1966 ..	3.5	2.5	1.0	2.4	683
1967 ..	5.0	2.3	2.7	2.4	702
1968 ..	8.4	2.5	5.9	2.4	742
1969 ..	4.5	2.2	2.3	2.2	759
1970 ..	4.2	2.1	2.1	2.1	774
1971 ..	0.9	1.5	— 0.6	2.2	766
1972 ..	2.5	2.0	0.5	2.2	770
1973 ..	3.5	1.8	1.7	2.0	784
1974 ..	3.4	1.6	1.8	1.8	801

As the table above shows, in 1973 and 1974, there has been an improvement in per capita income at constant prices. Per capita income in real terms rose from Rs. 784 in 1973 to Rs. 801 in 1974. This is in the context of relatively low growth rates in recent years and the inflationary pressures that have affected the economy. In the last few years the stabilisation of real per capita income around Rs. 780 indicates that price increases have been compensated for by a slight increase in incomes on the one hand and by a substantial fall in the rate of population growth resulting partly from the repatriation of Indian labour. In sustaining the level of real per capita income the fall in the population growth rate has been the more important factor. The table above shows the significant decline in the rate of population growth since 1968. Since 1972 the population growth rate has dipped below 2 per cent and has not risen above this level . Recent surveys undertaken by the Central Bank show a very favourable response among the community to the present population control policies. Even making allowance for repatriation of Indian labour which have been about 35,000 per year since 1970 there are indications that the rate of population growth will continue to decline. The low growth rates of 1.8 and 1.6 per cent in 1973 and 1974 respectively are in part due to this factor. If these rates are adjusted for the emigration of Indian labour the actual rates as seen in table I—2 are higher.

(b) Monetary Developments

Money and Credit

The monetary expansion of 6 per cent in 1974 when compared to the expansion of 12 per cent in 1973 may seem to be of little significance. Yet the price increases during the year were of a considerably higher magnitude than in any known preceding year. Since the price increases originated outside the country and came in via imports the causes for the inflation cannot be found simply in the expansion in the domestic money supply.

TABLE I—3

Changes in Money Supply and the Cost of Living Index 1965—1974

Year	Monthly Average level of Money Supply		Percentage increase in Money Supply-end of year	Percentage increase in Cost of Living Index
	Rs Mn.	Percentage increase over previous year		
1965	1,650	+ 6.8	+ 5.8	+ 0.3
1966	1,686	+ 2.2	— 3.3	— 0.2
1967	1,732	+ 2.7	+ 9.0	+ 2.2
1968	1,851	+ 6.9	+ 5.8	+ 5.8
1969	1,893	+ 2.3	— 1.6	+ 7.4
1970	1,969	+ 4.0	+ 4.5	+ 5.9
1971	2,102	+ 6.7	+ 9.3	+ 2.7
1972	2,183	+ 4.4	+15.4	+ 6.3
1973	2,496	+13.0	+12.0	+ 9.7
1974	2,949	+18.1	+ 6.0	+12.3

In 1974 the money supply on the average exceeded the level in 1973 by as much as Rs. 453 million or 18 per cent. In 1973 the average level was Rs. 2,496 million whereas in 1974 it was Rs. 2,949 million. Even so the average level of the money supply remaining at 18 per cent above the level in the previous year is inadequate in itself to explain the very high price levels that prevailed during the year. Moreover, other than very essential goods a large number of consumer items do not fall within the cost of living index. If the money supply was the major factor in the inflationary process a very much larger increase in the money supply would have been necessary for the very sharp price increase that took place during the year.

In the absence of more appropriate indicators of the relationship between the money supply and the price level some evidence of the role that money played in the inflation is found in the increase in bank clearings. The latter rose from a monthly average of Rs. 1,158.6 million in 1972 to Rs. 1,601.4 million in 1973 and to Rs. 2,063.6 million in 1974. Similarly, there was also an increase in the rate of turnover of demand deposits from 2.17 in 1972 to 2.20 in 1973 and to 2.27 in 1974. Despite these indications, since cash transactions are still very important in the economy and as the larger volume of transactions do not flow through the banking system other indicators of inflation are the increase in currency notes and coins. The notes of larger denominations, particularly Rs. 100 and Rs. 50 notes increased sharply. It would appear that the issue of these notes increased not on account of the motivation to hoard money, but out of sheer necessity to meet the higher costs of goods and services. The five and ten rupee notes were no longer convenient means of payment for some transactions. Even Re 1 and 50 cents coins which had remained relatively stable in the preceding years rose substantially in 1974 because these had to take over transactions which used to be affected earlier by coins of lower denominations.

One of the factors that prevented the level of the money supply from more fully reflecting the magnitude of the inflation was the decline in net external assets by Rs. 179.2 million resulting from a very large deficit in the balance of payments. The largest fall in the foreign assets of the banking system amounting to Rs. 278.9 million was in the holdings of the Central Bank.

The major factor behind the monetary expansion has been increased commercial bank lending to government corporations and to the co-operatives. Credit to the private sector as a whole, which includes government corporations, rose by Rs. 1,071.7 million as compared to the contraction of Rs. 22.6 million in 1973. Government corporations alone increased their borrowings by as much as Rs. 641.5 million during the year only to be offset by a negligible increase in their time and savings deposits of Rs. 21.1 million. Credit to private business concerns rose by Rs. 241.1 million mainly on account of the higher cost of imports. But this was largely offset by an equally large increase in private sector savings. The increase in bank credit to co-operatives was primarily to finance purchases of paddy and for cultivation loans. Moreover, the credit ceiling which was operative from 24th May 1974 prevented the flow of credit for non essential purposes. Apart from this the credit needs of private business concerns were lower because with their reduced foreign exchange allocations and high import prices they were able to obtain smaller amounts of raw materials. The high prices of final goods and increasing consumer resistance also limited the volume of sales. Furthermore, due to these and other uncertainties the business psychology in certain areas in the private sector was inimical to further investment. Many individuals and business concerns whose avenues of investment had dried up for these reasons found it advantageous to put their money in time and savings deposits in banks.

Transactions in the government sector also contributed towards restraining the monetary expansion because government budgetary operations had an overall contractionary effect. Government was able to finance its net cash operating deficit largely from public savings. The reduction in accommodation from commercial banks and the substantial increase in government deposits with the banks and cash balances with the Treasury helped to contain the monetary expansion during the year.

Credit to Government Corporations

On the other hand, the credit requirements of government corporations went up sharply with the increase in the price of imported raw materials and the need to finance the operating losses of a number of these enterprises. Bank credit to government corporations reached an all time high and amounted to Rs. 1060.1 million at the end of 1974 which represents an increase of Rs. 641.5 million over the level in 1973. The largest borrowers were primarily those which were almost entirely dependent on imports. These details are given in table I—4. In some cases even though the physical volume of imported raw material and other products fell, increased credit requirements arose as a result of the sharp increase in import prices that took place in 1974. In the case of the Ceylon Fertilizer Corporation its credit requirements increased by Rs. 256.2 million above the 1973 level because of the 400 per cent increase in the import prices of fertilizer following the very sharp increase in crude oil prices. Total advances to the Fertilizer Corporation

TABLE I—4

Total Advances to Government Corporations (Rs. million) by Commercial Banks

	Total Advances						
	Dec. 1973 Amt.	March 1974 Change	June 1974 Change	Sept. 1974 Change	Oct. 1974 Change	Dec. 1974 Amt.	Dec. 1974 Change
1. Ceylon Electricity Board	20.8	+ 0.5	— 2.4	+ 1.3	— 2.0	22.3	+ 1.5
2. Ceylon Transport Board	39.7	+ 2.3	— 0.4	— 3.0	— 4.3	44.2	+ 4.5
3. Petroleum Corporation	23.4	+ 31.6	+ 12.0	— 4.6	+ 16.8	75.0	+ 51.6
4. Eastern Paper Mills Corpn.	14.3	—	+ 13.8	— 0.5	+ 18.5	30.9	+ 16.6
5. National Milk Board	73.8	+ 4.2	+ 8.9	+ 5.6	+ 4.1	54.9	— 18.9
6. Ceylon Fertilizer Corpn.	32.5	+ 55.2	+123.8	+188.3	+203.4	288.7	+256.2
7. National Textile Corpn.	15.4	+ 8.1	+ 72.9	+ 43.9	+ 39.9	98.6	+ 83.2
8. Weaving Supplies Corpn.	6.6	+ 50.9	+ 74.5	+ 57.1	+ 59.4	81.2	+ 74.6
9. Co-operative Wholesale Establishment	10.8	+ 5.3	— 9.0	+ 0.3	+ 1.9	19.7	+ 8.9
10. State Engineering Corpn.	20.0	— 1.3	+ 6.3	+ 6.1	+ 6.8	26.6	+ 6.6
11. State Trading Corpn. General	3.8	+ 5.3	+ 12.5	+ 9.3	+ 13.0	27.2	+ 23.4
12. State Trading Corpn. Tractors	3.6	+ 6.2	+ 6.4	+ 10.5	+ 6.9	2.6	— 1.0
13. State Trading Corpn. Consolidated Exports	3.3	— 1.4	+ 2.0	+ 16.1	+ 14.9	16.6	+ 13.3
14. State Trading Corpn. Textiles	0.5	+ 18.5	— 0.4	+ 7.2	+ 22.2	30.8	+ 30.3
15. Other Corporations	149.5	+ 11.4	+ 26.1	+ 59.8	+ 62.2	240.3	+ 90.8
Total	418.0	+196.8	+347.0	+397.4	+469.3	1060.1	+641.5

at the end of 1974 was Rs. 288.7 million. To some extent this is an indication of the accumulation of fertilizer stocks due to the sharp fall in fertilizer issues for paddy cultivation. Similarly the increase in the price of cotton and yarn in international markets resulted in higher price being paid by the National Textile Corporation for its imports of cotton, pushing up the credit needs of the National Textile Corporation by Rs. 83.2 million and of the Weaving Supplies Corporation by Rs. 74.6 million in 1974. In the case of the Ceylon Petroleum Corporation, which imports its entire requirements of crude oil, credit needs increased by Rs. 51.6 million partly because with the increase in price of crude oil credits extended by suppliers have been more restrictive and partly because the corporation was not able to fully recover its costs from the sale of some of its major products in the domestic market and because bunkers were less profitable. The State Trading Corporation dealing with textiles Salu Sala, also needed an additional Rs. 30.3 million by way of credit mainly because of the accumulation of stocks of locally produced textiles. Service corporations like the State Engineering Corporation, the State Trading Corporation (General) and the Ceylon Electricity Board had credits outstanding which exceeded Rs. 20 million in each case.

Out of total commercial bank credit, advances to state corporations at the end of 1974 amounted to more than 30 per cent. Although most of the corporations are engaged in the manufacture of basic goods and the provision of essential services and their products saleable, yet they seem to have made liberal use of credit facilities from banks because they have had access to credit facilities with relative ease. To some extent the liberal extension of credit to government corporations has had the effect of restricting the supply of credit to other essential activities in the private sector and has considerably reduced the liquidity of the banking system.

The conclusion is inescapable that a ceiling is necessary not only on the total volume of bank credit to the corporations sector but also in respect of individual corporations. The management of money and credit would be increasingly difficult if corporations continue to finance their business out of bank credit on the scale they have done in 1974. However, the total volume of credit could have been maintained at a much lower level with realistic import programmes and a better coordination among institutions dealing with production and sales. Unrealistic import policies, inefficient management and consumer resistance to higher prices have been mainly responsible for the financial plight of many of these corporations.

(c) Prices

The price increases that took place in 1974 were much sharper than in 1973 and affected almost all imported and domestically produced goods in equal measure. In 1973, while prices of essential imported foodstuffs were at a very high level, in 1974 they rose even further to the highest levels recorded so far. Imported inflation fundamentally affected the entire price structure and was responsible for pushing up the prices of locally produced goods and services. Apart from foodstuffs, the cost of transport and other personal services rose very sharply and were instrumental in transmitting the higher price effect to all forms of economic activity.

In the above context the Colombo Consumers' Price Index does not fully reflect the actual intensity of the price rise. The index shows a relatively conservative price increase of 12.3 per cent. In real terms the consumer has had to face price increases of a very much higher order and this greatly reduced the purchasing power of money in his hands. Prices of several categories of consumer goods that did not fall into the index rose to higher levels than those included in the index. Since the quantities of some of the goods that were distributed on the ration were inadequate for purposes of consumption additional quantities of these goods were only obtainable at higher prices outside the ration. Thus there were two price levels for foods-tuffs like rice, sugar and chillies. For certain other consumer items, such as beef, the controlled prices were not operative at all.

Sri Lanka's heavy dependence on imports brought the economy into close touch with unprecedented inflationary pressures in the outside world. The price increases during the year were very largely the outcome of sharp price increases in the international commodity markets for foodstuffs and raw materials. The latter price increases were in turn given considerable momentum by the decision in January 1974 of the oil producing countries to more than quadruple the price of oil in one move. An additional factor was the rise in freight rates following the oil price hike. Very high prices for rice, flour, sugar and other essential goods and services were directly responsible for the increases in the prices of a variety of goods produced at home. The cumulative effect of these price increases gave added strength to inflationary pressures and gave further momentum to inflation and affected the prices of the entire range of manufactured goods and transportation in the country.

The high cost of living resulting from price increases of essential goods and services in turn pushed up wages. The higher wage rates and high prices for inputs also affected the cost of production of paddy and other agricultural produce. The latter explains why prices of locally produced goods and foodstuffs also increased at about the same rate as imported goods. Moreover, agricultural production in Sri Lanka is heavily dependent on imported fertilizer, insecticides and spares for machinery and equipment. The high yielding domestic agricultural crops particularly paddy thus have a high import content. In fact, according to data from the Land and Labour Utilization and other surveys of the Central Bank there is evidence that the cost of labour especially for work in paddy and other agricultural lands has gone up by almost 50 per cent in the last two years. In the fourth quarter of 1974 the average daily wage of a male worker in agriculture without meals was Rs. 7.38 and with meals Rs, 6.37. This all island average conceals the regional variation in the wage rates. In the Kandy, Matale, Kurunegala and Polonnaruwa districts the daily wage without meals averaged slightly less than Rs. 5.00. On the other hand, in the Colombo, Amparai, Jaffna, Vavuniya and Nuwara Eliya districts it exceeded Rs. 8.00. The organised working class and government employees sought relief on account of the high cost of living and as a result in April 1974 wages of certain categories of government employees and private sector employees were increased.

Pricing Policy

In its counter inflation strategy the government followed a policy of making available very essential commodities like sugar, flour and rice at subsidised rates. Although the prices of rationed rice, over and above the free half measure and off ration sugar were raised, these increases were kept to the minimum possible levels taking into account the implications of an increasing subsidy bill on government finances. For instance, the free half measure of rice alone cost the government more than Rs. 900 million in 1974. On the other hand, in the case of semi essential and manufactured goods produced by the state corporations and the private sector cost increases were passed onto the consumer. Most industrial corporations and others providing services such as the C.T.B. and the railway were compelled to raise the prices of their goods and services

The measures taken in the previous year in October 1973, to provide the consumer with goods at more realistic prices were in pursuance of the policy of eliminating as far as possible the subsidies on consumption and of relieving further strains on the budget. The attitude of government to pricing policy was essentially the same in 1974, however, on account of the sharp price increase this policy could not be pursued further with the object of achieving the maximum results. While pricing policy was formulated on a rational basis the arrangements for the distribution of essential consumer goods were less satisfactory because of the overdependence of the distribution system on the wholesale and retail co-operatives. However an equitable distribution of rationed goods was achieved, but due to deep-seated deficiencies in the co-operatives the distribution of other goods was less satisfactory

(d) The Balance of Payments

The deficit in the current account of the balance of payments has been the highest that the country has witnessed so far. As emphasised before, this was the outcome of an unprecedented increase in the expenditure on imports resulting purely from a phenomenal increase in commodity prices. Despite the fact that imports even of basic essentials were cut down to the barest minimum levels, yet the import bill could not be fully met out of current export earnings, and out of supplementary finance from traditional sources like assistance from the International Monetary Fund and countries in the aid consortium. In fact, the cuts imposed on consumer goods distributed to the public on ration have been the most severe and extensive in recent years. Per capita cereal consumption of rice and flour was at a low level. Allocations of sugar were cut to the bone. In 1973 when sugar was available off ration the country's imports were in the region of 193,000 tons; in 1974 the quantity was sharply reduced and total requirements are now confined to some 67,000 tons. The country would not have had the foreign exchange resources to maintain sugar imports anywhere near the former levels in view of the phenomenally high price of sugar in world markets in 1974.

The year 1974 saw an increase in the country's gross foreign assets. These assets averaged nearly Rs. 950 million during the year as against Rs. 650 million in the previous year and exceeded the Rs. 1,000 million mark during four months of the year. It would appear that this tends to distort the true picture of the country's balance of payments position. External assets were allowed to increase because an adequate reserve of assets in the form of working balances was necessary in order to meet the inflated import bills. The country could not have managed with a considerably reduced level of external assets because import prices were at phenomenally high levels in 1974 and corresponding increases in the total amount of disposable foreign exchange in the form of foreign balances were desirable. Furthermore the procurement of rice, flour and sugar on suppliers' credit terms meant that there was no immediate charge on the foreign exchange reserves of the country. At the high prices prevailing in 1974 the average level of external assets during the year would have represented approximately two months import requirements.

External Liabilities

External credit transactions have in recent years resulted in the progressive increase in Sri Lanka's total indebtedness. Both the domestic and the foreign component of the public debt have risen very sharply. In the case of the gross external debt the increase has been from Rs. 1,596.4 million in 1970 to Rs. 2,926.4 million in 1974. Thus in a matter of four years the foreign debt has almost doubled. Compared to the level of the gross external debt in 1965 at Rs. 472.8 million its present level represents an increase of over 500 per cent. However, the domestic debt has risen less sharply by about 40 per cent from Rs. 6,307.1 million in 1970 to Rs. 9,406.6 million in 1974. The total figure of the gross public debt including foreign and domestic components at Rs. 12,333 million at the end of 1974, does not reflect the short term liabilities which government has incurred in the last few years. The addition of these to the respective end of year figures would increase the gross debt by Rs. 1,000 million in 1973 and by Rs. 1,200 million in 1974.

Perhaps, the most disquieting feature in 1974 was the increasing rate at which short term foreign liabilities were incurred for balance of payments reasons. As indicated in table 1-5, during the year over Rs. 400 million in quick maturing short term liabilities and bank borrowings were utilised to maintain imports mainly of foodstuffs.

TABLE 1—5

Certain Categories of External Liabilities

	1971	1972	1973	1974
Short term Credit				
Amount outstanding (Rs. Mn) ..	250.4	290.0	444.8	492.1
Maturity period ..	less than 1 year	less than 1 year	less than 1 year	less than 1 year
Suppliers' Credit				
Amount outstanding (Rs. Mn) ..	104.9	94.0	329.0	517.8
Maturity period	1-10 years	1-10 years	1-10 years	1-10years
Rate of Interest ..	6—8%	6—8%	7—12%	9—14%
Borrowings from banks abroad (Central bank)				
Amount outstanding (Rs. Mn) ..	333.8	352.2	245.2	261.9
Maturity period ..	1 to 3 years	1 to 3 years	1 to 3 years	1 to 3 years
Rate of Interest ..	7½—9%	7½—9%	8—14%	9—14%

Table I—5 gives details of certain categories of external liabilities according to maturity and rate of interest during the last few years. Between 1971 and 1974 short term credits have almost doubled from Rs. 250.4 million to Rs. 492.1 million while suppliers' credits have increased fivefold from Rs. 104.9 million in 1971 to Rs. 517.8 million in 1974. Although borrowings from banks abroad have decreased slightly they still remain at a fairly high level of Rs. 261.9 million, having risen since 1973. The high interest rates payable on these short term credits were partly offset by equally high earnings which the country realised on its short term investments of foreign reserves in international monetary centres.

Although short term borrowings greatly contributed to ease the payments difficulties during the year and ensured the minimum requirements of essential foodstuffs, raw materials and other goods yet it is likely to create problems in the immediate future. As shown in table I—5 a good part of these short term credits are due to mature within the next year. In order to meet the repayment obligations the country must be in a position to rapidly generate adequate foreign exchange earnings. In the immediate future, Sri Lanka is going to be confronted with the situation of a further decline in the import capacity due to the fall in earnings from the main plantation crops other than tea. In the present circumstance the easiest way of increasing export earnings would be to increase output in the traditional export crops. There is no problem in selling more tea, rubber and coconut and it does not require export promotion and the elaborate infrastructure that is necessary to push non traditional goods in overseas export markets. Non traditional exports specially tourism and industrial goods, other than gems, are not likely to bring in substantial net foreign exchange earnings on account of the high import content of the products of such industries. Moreover, imports of foodstuffs, raw materials and other essential goods have now been drastically reduced and the scope for further curtailment of imports of these commodities do not seem to exist. Further inroads into the cereal content of the diet could impair the health of the population. Import capacity must be progressively increased to accommodate the import requirements of an increasing population. Apart from these considerations, in a situation of continuing inflation there is every reason to ensure that more goods are allowed to come in in order to stabilise prices. In the light of these issues the country would have to take measures to improve its export capacity in order to accommodate the increasing volume of external payments.

The only element of relief at the moment appears to be that the prices of essential foodstuffs such as flour, sugar and raw materials are falling fairly rapidly in world markets. But at the same time, there is no assurance that the coming recession in commodity markets will not affect Sri Lanka's major traditional exports to an even greater extent. This has already happened for rubber and to some extent for coconut.

From a sound foreign debt management standpoint it would be best, if it is possible, to refrain from incurring short term liabilities of the type that has been made available in 1974. The scope for such a policy will exist if an effort is made in a more fundmental manner to increase the production of essential imports particularly rice, fish and sugar in the coming seasons.

(e) Production

Domestic Agriculture

The statistics prepared by the Department of Census and Statistics show a very large increase in paddy production in 1974 as against the previous year. Output increased by 22 per cent; rising from 62.9 million bushels in 1973 to 76.8 million bushels in 1974. A very large increase in the extent under cultivation, about 20 per cent and a lower incidence of crop failure contributed to increased output. In addition the issue of fertilizer for paddy cultivation increased by about 20 per cent while credit increased by 285 per cent due to the upward revision of credit ceilings on account of higher production costs. The level of paddy production in 1974 was the highest since 1970, but per acre yields fell very substantially from 51.21 bushels per acre in 1969/70 to 45.66 bushels in 1973/74.

This large increase in paddy output in 1974 should be appraised in terms of the sharp increase in the price of both paddy and rice in the producing districts and on the supply, availability and the cost of ration and off ration (open market) rice. Data collected from recent Central Bank surveys show that the free market price of paddy and rice throughout 1974 has been at higher levels than at any time before. In the second half of 1974, while the guaranteed price of paddy was Rs. 33 per bushel, the free market price of paddy varied from Rs. 39 in the Batticaloa district to Rs. 53 per bushel in the Colombo and Kalutara districts. The all island average was Rs. 49 per bushel. Similarly, the price of rice in the open market varied from Rs. 3.70 per measure in the Amparai and Hambantota districts to Rs. 7.25 in the Jaffna district. The all island average was Rs. 4.46 per measure. While domestic production rose very substantially on account of the higher guaranteed price, the cost of producton also rose sharply on acount of the high cost of inputs particularly fertilizer. When the 1974/75 Maha season commenced it was found that because of the high price of fertilizer as well as the drought farmers had considerably reduced the levels of application and fertilizer tended to pile up in the godowns of the Fertilizer Corporation.

The total production of paddy in 1973/74 which is 76.8 million bushels making allowance for seed paddy and wastage represents 929,000 tons of rice and the availability of rice in 1974 from local production was thus at a higher level than at any time except in 1970. With the cut in the ration and higher domestic production in 1974, imports of rice were 297,000 tons which was higher than the import level in 1972. The lower quantity of rice distributed on the ration meant that the per capita availability of rice fell from 2.18 lbs per person per week in 1973 to 1.77 lbs in 1974. As seen in table 1-6 the per capita availability of ration rice in 1974 was lower than in any preceding year. Despite the very high level of domestic production, the open market price of rice rose because on the one hand, the price of the additional measure of rice on ration was raised from Re 1 in December 1973 to an average Rs. 1.15 in 1974 and on the other the guaranteed price for locally grown paddy was raised to Rs. 33 per bushel. In addition, the per capita availability of flour at 1.34 lbs per person was also lower than in the two preceding years although higher than in 1970 and 1971. The total availability of all cereals at 3.11 lbs per person per week in

1974 was lower by 16 per cent than the quantity available in 1973 which was 3.68 lbs The increase in the price of rice in the open market in 1974 was in the region of 300 per cent taking into account the price level in 1972.

TABLE I—6

Per Capita Availability of Cereals on Ration

Year	Mid—year population ('000)	Total quantity of rice given on ration ('000 tons)	Per capita availability of rationed rice per week (lbs.)	Total flour availability ('000 tons)	Per capita availability of flour per week (lbs.)	Per capita availability of cereals (wheat & rice) per week (lbs.)
1968 ..	11,992	505	1.81	422	1.51	3.32
1969 ..	12,252	542	1.90	440	1.54	3.44
1970 ..	12,514	532	1.83	381	1.30	3.13
1971 ..	12,768	925	3.12	370	1.24	4.36
1972 ..	13,020	1,018	2.73	531	1.53	4.26
1973 ..	13,249	673	2.18	462	1.50	3.68
1974 ..	13,393	553	1.77	419	1.34	3.11

Note: All figures are on a financial year basis. However, figures for financial years 1973 and 1974 will coincide with the calender year.

1. Divided by 64 weeks as the figure relates to a 15 month fiscal year.

Paddy Marketing

The scarcity of rice and the high price prevailing in 1974 and the government objective of ensuring the equitable distribution of available supplies has focused increasing attention on the Paddy Marketing Board. Although when the Paddy Marketing Board commenced operations in early 1972 it was meant to be the sole local outlet for paddy, it was only in February 1974 that its monopoly purchase of rice was rendered significantly more effective by regulations which prohibited the private transport of rice or paddy in large quantities. In February 1974, all transport or removal of paddy or rice without a permit was prohibited. Simultaneously stocks already held by producers were limited to quantities produced by them and all producers were required to confine sales of paddy or rice to the closest situated purchasing centre of the Paddy Marketing Board. These regulations were issued on account of the increasing divergence between the guaranteed price and the open market price which had provided an incentive for the increased flow of paddy into the "illegal" market.

Notwithstanding the regulations which came into operation in 1974, the Paddy Marketing Board was only able to purchase 20.8 million bushels or about 27 per cent of the 1973/74 crop. In the previous year, when the total cereal availability was 16 per cent more at 3.68 lbs per person per week approximately 36 per cent of the paddy crop had been chanelled through the Paddy Marketing Board and that without the assistance of the regulations which came into effect in February 1974 and despite a lower guaranteed price varying from Rs. 18 to Rs. 25 per bushel. The reduced quantity of paddy purchased by the Board could have been partly due to the shrinkage in the marketable surplus of paddy due to increased family consumption. Survey data for two districts, Hambantota and Kandy, have shown that on an average between 37 and 48 per cent of the paddy produced is retained by the farmer for domestic consumption as well as seed material. However, since only about 27 per cent of the 1973/74 output appears to have been purchased by the Paddy Marketing Board, the question remains whether the farm family requirements have increased by 25 per cent or even more in one year as a result of the reduced quantities available on the ration and the total reduced availability of cereals. The fact that only 27 per cent of the 1974 crop was purchased by the Board in the face of a bumper harvest needs to be re-examined very carefully as against the previous year's purchases amounting to 36 per cent. Purchases by the Board have declined progressively since it was given the monopoly purchasing rights over paddy. The fall in the level of procurement is, therefore, not confined to the year 1974 when exceptional circumstances have prevailed due to the reduction of the amount of rice given on the ration. At the same time, the very sharp increase in the guaranteed price of paddy in July 1974 to Rs. 33 per bushel from Rs. 25 per bushel should have given the Board more leeway to procure a greater part of the production despite higher consumption requirements of the producer.

There is evidence that the restrictions on the movement of rice and paddy in bulk from district to district have caused prices to move up very sharply in deficit areas and resulted in shortages. Given the level of rice availability indicated in the production statistics, there is little doubt that had the free transportation of rice been permitted the sharp differences in the price levels indicated earlier between areas would have been less. The forces of supply and demand operating freely would have tended to lower the price of paddy and rice and to ensure a better island-wide distribution. The restrictions on transport did not, in fact help to bring down the open market price of paddy which has throughout remained above the guaranteed price. As long as the free market price was higher than the guaranteed price of Rs. 33 per bushel the regulations were not effective in stopping the sale and disposal of paddy and rice in the open market.

Plantation Crops

As against the satisfactory overall performance of domestic agriculture that of the main plantation industries was disappointing. The figures given in table I—7 show the progressive secular decline in the production of tea, rubber and coconut. In the case of tea, production in 1974 declined to 449 million lbs from the peak production figure of 503 million lbs in 1965. Upto 1971, the average level of production was approximately 480 million lbs while in the last three years this has dropped to about 450 million lbs; the general indications are that production will continue to decline even further. Although rupee export earnings from tea have progressively increased, despite the fall in production from Rs. 1,210 million in 1965 to Rs. 1,360 million in 1974, the equivalent foreign exchange earnings in Special Drawing Rights have shown a marked fall from SDR 203 million in 1965 to SDR 168 million in 1974. This has

TABLE 1—7

Production and Earnings of Main Export Crops

Year	Tea			Rubber			Coconut			Total Ex. Values	
	Production (Mn. lbs.)	Export Earnings (Rs. Mn.)	SDR Value (Million)	Production (Mn. lbs.)	Export Earnings (Rs. Mn)	SDR Value (Million)	Production (Mn. Nuts)	Export Earnings (Rs. Mn)	SDR Value (Million)	Total Export Value (Rs. Mn)	Total SDR Value (Million)
1965 ..	503.2	1,210	203.36	260.8	303	50.92	2,676	275	46.21	1,949	327.56
1966 ..	490.3	1,027	172.61	288.8	337	56.63	2,461	196	32.94	1,700	285.71
1967 ..	486.7	1,061	178.32	315.7	282	47.39	2,416	167	28.07	1,690	284.03
1968 ..	495.5	1,162	195.29	328.0	330	55.46	2,601	334	56.13	2,035	342.02
1969 ..	484.2	1,061	178.32	332.7	431	72.44	2,440	225	37.81	1,916	322.01
1970 ..	467.9	1,120	188.16	350.9	440	73.92	2,510	240	40.32	2,033	341.54
1971 ..	480.1	1,144	192.19	311.2	307	51.58	2,617	280	47.04	1,947	327.10
1972 ..	470.6	1,162	171.39	309.4	265	39.08	2,963	266	39.23	2,009	296.31
1973 ..	465.8	1,261	165.27	341.0	592	77.59	1,935	145	19.00	2,617	342.99
1974 ..	449.8	1,360	168.94	301.0	738	91.68	2,031	397	49.32	3,472	309.94

Sources: Customs, Tea and Rubber Controller, Central Bank of Ceylon happened despite very favourble prices for tea during the year and is mainly due, among other factors, to the progressive depreciation in the value of the rupee due to currency realignments in the last few years.

Rubber production reached a peak in 1970 with an output of 350 million lbs and thereafter production declined to 309 million lbs in 1972. In 1974 rubber production at 301 million lbs was at a lower level than at any time since 1966. Despite the fall in production of 40 million lbs in 1974 export earnings rose by nearly Rs. 147 million. In terms of SDR, earnings however, have increased by nearly 250 per cent since 1972 when production was only marginally above the level achieved in 1974. In the coconut industry too production has improved only very marginally in 1974 since the fall in production by 38 per cent in 1973. At the 1974 level, coconut output is still some 33 per cent short of the record production of 2,963 million nuts in 1972. Despite the marginal increase in production in 1974, the very high prices fetched for coconuts in 1974, however, enabled the industry to more than double its rupee earnings and earnings in SDR terms. The decline in coconut production has implications not only for the balance of payments but also for the cost of living because a very large proportion of the output enters the domestic market. Both coconut oil and fresh coconuts are items which have an important place among the commodities in the Cost of Living Index. A significant decline in levels of production, therefore are bound to keep prices in the domestic market at fairly high levels. In the case of coconut, had the production in 1974 been at the 1972 level, export earnings from coconut alone would have been higher by about Rs. 670 million in view of the very high prices realised during the year.

The impact of the fall in the traditional major crops could be quantified only in terms of the foreign exchange that the country has lost as a result of the sharp fall in production. At the 1974 level of prices for tea, rubber and coconut and assuming that these three industries were able to maintain the same level of production as in 1970 the additional foreign exchange earnings would have been in the region of Rs. 790 million. With regard to the traditional export sector as a whole, although a rare opportunity arose in 1974 to maximise foreign earnings, it was unable to significantly augment the country's foreign reserves which had been at very low levels for a long period. Had this been possible the country need not have had recourse to the utilisation of bank borrowings and other short term liabilities on the scale that it did in 1974.

The decline in output in the plantation sector is a matter that needs urgent consideration. It could have very serious long term implications for the availability of foreign exchange in particular and for economic growth, because at present the most serious hindrance to a higher rate of growth is the shortage of foreign exchange. There is no doubt that the major plantations will continue to be the largest potential net earner of the foreign exchange for a very long time to come. There are no indications that non traditional exports, even gems, will effectively displace tea, rubber and coconut as the three major sources of foreign exchange. The country has had no problem in selling all the tea, rubber and coconut that it can produce. The difficulty is that it has not been able to produce more.

The factors that contributed to the decline in production recently needs to be carefully studied and reviewed in the shortest possible time. Although it is difficult at this stage to clearly determine all these factors some of them are quite obvious. What is even more significant is that the major factors that have affected the fall in productivity have been strictly outside the purview of the industry and the industry itself has been relatively helpless. Since the early seventies a climate of considerable uncertainty has prevailed in the plantation sector with threats of nationalisation and to add to this, commodity prices have also been in a depressed state. As a result of this, there has been an element of neglect in most plantation properties because the level of investment to maintain these properties in good condition has declined. When prices rose in 1974, the industries were not in a position to step up production very sharply in order to maximise the benefits from the boom. In the light of this, the implementation of the Land Reform programme over a short period of time of two years has had the most adverse repercussions from the point of view of export earnings. With the announcement of land reform estate proprietors who were aware that their lands would be taken over began to neglect them and due to the lack of expenditure on maintenance it has not been possible subsequently to step up production.

The data elsewhere in the report shows that the fall in the tea crop has taken place mainly in properties that belong to the category of low grown teas. Apart from a depressed price level for this elevational category of tea before 1973, the bulk of the low grown tea lands were non company properties that came under the land reform. In regard to rubber and coconut the same could be said. A large number of coconut small holdings and rubber properties that have come under land reform are not being managed properly and production has continued to decline. In the case of coconut some 115,000 acres of coconut lands have come under land reform and the position appears to be least satisfactory in respect of these properties because coconut unlike rubber, requires regular application of fertilizer and maintenance.

The overall decline in the plantation crop sector could, therefore, be attributed to the sharp curtailment in expenditure and the climate of uncertainty that has prevailed in the last three years since the implementation of the Land Reform Scheme. All this resulted in a sharp cut back in expenditure on replanting, manuring and maintaining properties in the best possible condition. In the context of the country's present economic difficulties, improvement of the quality of tea, rubber and coconut plantations need not be emphasised. In the case of the tea industry in particular, production is still dependent on very old plantations which do not have high yielding vegetatively propagated plants. The substantial gains in productivity in tea are largely dependent on replanting with high yielding clones. Despite the incentives offered in the form of a replanting subsidy the rate of replanting has slowed down considerably. At the same time, the machinery and equipment used in the manufacture of tea has not kept pace with technological change in the industry. Sri Lanka in this respect has had to face the challenge from technologically superior tea industries in the African countries. For investment to be maintained at a high level in the plantation industry, the most important consideration appears to be an assurance that irrespective of ownership, the efficient running and maintenance of plantations would continue for a long time. The productivity in the plantation industries in the past has been very largely due to good management and there was little doubt about the quality of management of these estates in earlier years. Furthermore, it is in a climate confidence and certainty that the plantation industry would be in a position to plough back profits or increase their capital investments through credits from lending agencies.

Land Reform

The Central Bank has undertaken a study of lands that have come under land reform. The purpose of these field studies has been primarily to obtain an overall picture of how these properties are being managed and the contribution that production on these lands are now making to economic growth. Many of these agricultural lands have valuable crops on them, mainly tea, rubber, coconut and also a wide range of minor crops. These crops are important from the point of view of the country's capacity to earn foreign exchange. If productivity on the lands that have come under land reform could be increased appreciably it would no doubt make a significant contribution towards easing the balance of payments problem.

Only about 50 per cent of the land that has been vested in the Land Reform Commission has been alienated to separate bodies specifically set up to manage lands such as the USAWASAMA, Multi-purpose Co-operative Societies, Co-operative Settlements, The State Plantations Corporation and the Live-stock Development Board. These lands represent about 270,000 acres of the total acreage vested. Some 288,000 acres are still being managed by the Land Reform Commission and by the Land Commissioner. The definite form of management of these lands have not yet been decided. These comments apply largely to the lands that have been managed by the specific bodies that have been set up for this purpose rather than to those properties that directly come under the Land Commissioner and the Land Reform Commission.

The Sri Lanka State Plantations Corporation was entrusted with the management of 38 estates covering about 32,000 acres. Most of these estates are being fairly well run, though in some properties an element of neglect was evident mainly due to the reduced application of fertilizer and the lack of weeding; but production and management on most of these properties have improved considerably. The previous superintendents and assistant superintendents have been retained and where new staff has been taken they have invariably been with planting experience.

The decision making authority of the superintendent on the estates managed by the State Plantations Corporation appears to have been curtailed. This has resulted in delays in repairing machinery or incurring expenditure to maintain production at a high level. The system of visiting agents has not been operating as satisfactorily as under the agency houses. In some cases, visiting agents have not visited the estates and in others, where reports have been submitted action has been slow.

Many estates that were vested in the Land Reform Commission and now managed by USAWASAMA[1] and other agencies were in a state of neglect before the take over. Those properties managed by agency houses were in a much better condition

1. The USAWASAMA was designed to manage a small number of estate holdings on a cooperative basis with a Board of Management consisting of 8 members. It managed about 13 estates in 1972. By the end of 1974, it was entrusted with the management of about 241 estate holdings covering 87,000 acres. These are mostly in the administrative districts of Kandy, Matale and Nuwara Eliya.

than those that belonged to proprietory planters. However, it has been difficult to determine the exact number of years of neglect, but the condition of many of them seem to have deteriorated in the wake of land reform. In a large number of the estates, the services of the former managers have been discontinued. Many of those who have been newly placed in charge of these estates have very little experience in planting although they displayed considerable enthusiasm for their jobs. Given the run down condition of the estates, a considerable amount of investment is now required to increase their productive capacity, but this has not been possible because the estates have been run on the principle that they should not spend an amount exceeding their current income. Since productivity has declined and incomes have been low, adequate resources for capital development have not been available. Equipment, spare parts for factories and lack of transport facilities are serious impediments to increasing production on most estates. There is little evidence that timely action has been taken to supply these inputs.

The programme of crop diversification has been rather hastily goneinto. In several estates, existing tea has been uprooted but the new crops planted have been unsuccessful. The choice of crops in many cases has been unsatisfactory. For instance, it is uneconomical to grow a wide variety of crops on tea estates. Tea production is probably best under large scale operation when cultivated as a mono crop. There appears to be an overall decision to indiscriminately diversify rather than plan diversification with a view to increasing production. There is a lack of decentralisation in decision making and project managers have little discretional authority. In nearly all estates, the accounts have been very poorly and unsystematically maintained and they have not been kept in a manner that will enable economic decisions to be taken.

The Samupakara Janawasas (Co-operative Settlements) have been allotted about 39,000 acres. It is likely that further extents of land may be allotted to this form of farm management in the future. This is the most extensive experiment in collective farming attempted in this country so far and the experience of these farms will be an important influence in the formulation of future land reform policies. Most of the lands that fall into this category are under the Co-operative Settlements Division of the Land Reform Commission. A conscious attempt seems to have been made to systematically plan each of these Janawasas. The development of a collective consciousness and a commitment to this form of organisation are important considerations in the organisation of these settlements.

Several problems have, however, surfaced. The low allowance paid to each settler has been a cause for dissatisfaction. In many cases the payment of a low allowance has been necessitated by the need to spend significant sums of money on improving the land and on growing new crops. As in the case of the USAWASAMA the number of settlers per acre under the Janawasas is considerably higher than the number of employees per acre when these properties were under the previous management. With the absorption of a much larger number of workers the per capita current productivity has not been adequate to pay the higher allowances. Furthermore, since some of the new crops grown have not turned out to be successful, the losses resulting therefrom have created financial difficulties.

For the successful operation of these enterprises increased investment, the availability of agricultural implements, careful selection of crops and an adequate training in agriculture for the settlers is vitally necessary. It is only by the provision of the latter that these units can become economically viable as intensively exploited high labour absorptive units. The development of technical know-how on these settlements will be an important determinant of the success of diversified agriculture. As in the case of the properties under the USAWASAMA the accounting systems in these schemes are in an unsatisfactory state. Settlers should be given a suitable training to maintain proper accounts so that a correct financial picture of the operations of these properties is readily available.

Industry

Considering the balance of payments difficulties, allocations of foreign exchange to industry were maintained at satisfactory levels; but 1974 was a difficult year for the industrial sector. The amount of raw materials that could be procured out of the foreign exchange allocated was considerably less than in the preceding year on account of the very sharp increases in the prices of all types of industrial raw materials ranging from plastics and cotton yarn, to chemicals and fuel. Purely in value terms, industrial production has shown an increase of 48.4 per cent over the level in 1973; production rising from Rs. 2759 million in 1973 to Rs. 4094 million in 1974. These figures of course, do not give an accurate picture of the actual level of physical production. The increase in the value of production in 1974 has been very largely due to the high prices of raw materials which in turn resulted in substantial increases in the prices of all manufactured goods. Apart from this, the coverage in the 1974 Central Bank industrial survey has increased by approximately 5 per cent, bringing in several enterprises from which data had not been obtained on earlier occasions. From the standpoint of physical output, when allowance is made for the very sharp increases in prices, production in 1974 has been below the level in the previous year. For the manufacturing sector as a whole the national accounts show a decline in output in real terms by 4.1 per cent.

In particular, the factor that tends to inflate industrial production very sharply has been the higher prices, in the region of 300 per cent, for petroleum inputs. In 1974 in value terms, petroleum production increased by 151 per cent whereas the volume actually declined by 15 per cent. If the inflated value of petroleum products is excluded from the increase in value of production at current prices the increase in the value of output from other sectors amounts to 32 per cent.

In private sector industry, capacity utilization was low and averaged about 40 per cent. The latter was primarily due to the continuing excessive dependence of most of the industries that were set up after 1960 on imported raw materials. Greater capacity utilization, therefore, is very much dependent on the foreign exchange allocations that are given. This has created a permanent problem for the industrial sector as a whole. Since industrial raw materials get second priority over foodstuffs, drugs and other essential goods the country's foreign exchange earnings in relation to import requirements will not permit adequate allocations to be made for industry except for those industries which are entirely export oriented and are in a position to earn foreign exchange. On account of this, it is not likely that in the future all these industries will have the opportunity of utilizing capacity to a greater extent unless they can become more export oriented. Furthermore, due to the very high prices for many categories of finished industrial goods there has been a certain amount of consumer resistance. Goods have been priced out of the market which in turn has kept industrial units working below capacity. During 1974, many industries that could not get foreign exchange for certain categories of raw materials were able to do so by using funds in Convertible Rupee Accounts.

In the case of most public sector industrial corporations production has not shown significant increases. This was especially true of industrial corporations producing foodstuffs (with the exception of the Sugar Corporation) and other goods which directly or indirectly affect supplies of consumer goods and the cost of living. Notable examples are the Milk Board where there was a marked decline in the production of milk, the Fisheries Corporation and the Oils and Fats Corporation which is the major supplier of animal foodstuffs. This decline in production has had adverse affects on the poultry and livestock industries resulting in higher prices for essential food.

Despite the fact that foreign exchange allocations for industries in the public sector have been available on a relatively more liberal basis than to private sector industry, capacity utilization continues to remain low and this cannot be attributed entirely to the shortage of foreign exchange and the non availability of inputs but rather to a large number of industries being unable to export profitably. Several public sector enterprises were given relatively liberal foreign exchange allocations in 1974 and some of them ran very high rupee bank credits to finance their stocks which were sufficient for several months. For instance in the Oils and Fats Corporation capacity utilization was only 61.5 per cent when the prices of poultry and cattle feeds were at a very high level in 1974. In the textile mills of the National Textile Corporation capacity utilization averaged about 40 per cent at a time when retail prices were high and there was an islandwide shortage of textiles. At the Salawa factory of the Plywoods Corporation, which is the principal supplier of plywood for the tea chest industry, capacity utilization was as low as 30.3 per cent. The latter has at least in part been responsible for the progressive increase in the price of locally manufactured tea chest panels. In the Ceylon Steel Corporation capacity utilization was about 40 per cent. Industrial units showing high rates of capacity utilization in 1974 were a few and among these were the Ceylon Tyre Corporation, which was able to use 90.7 per cent of its capacity and the Kankesanturai cement plant which utilized 76 per cent of its installed capacity.

In 1974, the prices of most of the products of the public sector industrial corporations were raised substantially. Among these were the price of milk, provender, textiles, tea chests, paper, tyres, hardware, steel, petroleum products and cement. Most of these price increases varied from 50 to 75 per cent of the prices prevailing in 1973 and in some cases exceeded 100 per cent. While there were fairly sound reasons for increases in prices in 1974, yet from the point of view of the consumer, certain other aspects have to be given due consideration. Apart from the price increases which were necessitated by the high cost of raw materials some of these price increases were effected to eliminate the losses which several industrial corporations have had to face in the last few years, or in other instances to increase the level of profits. Despite price increases, some corporations such as the Milk Board and the Oils and Fats Corporation have continued to run at a loss. This is because the fundamental factors behind the recurring losses of these corporations have not been rectified. In this context a mere adjustment of the price level would not help. A determined effort should be made to erradicate these shortcomings.

Despite the efforts that have been made to improve the quality of industrial goods there is yet considerable scope for achieving even more positive results in this direction. It is significant that industrial and service corporations have not looked at production from the point of view of the consumer. Although prices have been increased, often by as much as 50 to 75 per cent, the quality and durability of products have not shown similar improvement. It is important, therefore, that in production planning more attention should be given towards improving the quality of the product so that the consumer would feel that he is getting his money's worth although he is compelled to spend more.