A REVIEW OF THE ECONOMY OF SRI LANKA, 1950 - 1975

Fairly rapid social and economic changes have taken place in Sri Lanka in the last twenty five years and this process has gathered considerable momentum in the last ten years. Furthermore, the benefits of economic development are now increasingly seeping down to the bulk of the population. Whereas in the pre-war years only a small segment of the community benefited from economic growth, today it is the conscious policy of government to ensure that its impact is far more widespread. Economic progress in the period 1950—1975 is not only reflected in the various statistical indicators, but is now outwardly seen in the improved living standards of the majority of people and in the product mix of the economy as a whole. The country today produces a much wider range of goods, enjoys a higher standard of living, a more equal income distribution, is not bereft of skilled manpower in most fields and has a more diversified pattern of production and exports than at any time before in its history. All this is not fully reflected in the national income data. However, in the period 1950—1960, the average growth rate was 4.6 per cent; it was 3.9 per cent in 1960—1970 and 2.6 per cent in 1971—1974. The estimated gross national product at constant prices was Rs. 3,958 million in 1950, whereas in 1974 it had more than doubled and had risen to Rs. 10,781 million.

THE PRE-INDEPENDENCE ECONOMY

Economic advancement in the modern sense, that is development outside the plantation sector, started soon after independence in 1948 when steps were taken to diversify the economy. A comparative quantitative assessment of the progress achieved in the previous decades with the period under review is not easy to make on account of the non-availability of data on key indicators such as employment, per capita income, prices and production in all sectors. National income estimates were prepared systematically for the first time in the late fifties and have been the principal indicator, since then, of the relative changes that have taken place in the different sectors of the economy.

In 1948, when Sri Lanka attained independence the structure of the economy was essentially the same as it was some 25 years before. The principal economic activity continued to be centered around the plantations producing three main products, tea, rubber and coconut. The services sector, particularly banking, trade, insurance, transportation and district administration, was also closely linked to the plantation sector. In the rural sector, subsistence agriculture prevailed with considerable emphasis on paddy production, in addition to a few other agricultural crops grown for domestic consumption. The bulk of the crops which fell into the latter category were cultivated in the chenas. (Chenas are patches of jungle cleared by "slash and burn" methods). Within this rudimentary and undiversified economic framework, the country could sustain itself, because the foreign exchange earnings of these few plantation products were sufficient to provide the population with an adequate level of imported foodstuffs and other manufactured goods. This was true not only of the pre-war years, but of the period 1945 to 1950 as well; manufacturing industry was virtually non-existent and the country was almost wholly dependent on imports for food. The rural peasant was less dependent on imports of manufactured goods; his needs were limited and the little food that he produced was heavily supplemented by imported rice, flour, sugar and subsidiary foodstuffs.

A fundamental characteristic of the economy of Sri Lanka in the pre-independence period was the existence of two clearly demarcated agricultural sectors, the rural economy and the plantations. At that time the latter represented the modernized sector of the economy, while the rural sector was under-developed. This cleavage in the levels of development was created by the rapid rise of the plantations mainly in the first two decades of this century. The plantation economy had very little influence on the traditional agricultural sector where the peasantry were primarily engaged in the raising of subsistence food crops. As against this, the production of commercial crops was the mainstay of the plantation economy. Production was mainly for export; other than coconut, the main products of the plantation sector did not have a substantial internal market. The bulk of the labour employed on the plantations did not belong to the indigenous population, but consisted of immigrant workers from South India. This tended to isolate the rural community from the plantations and the benefits that the rural economy derived from the advancement and rapid growth of the plantation economy were negligible. The owners of plantations were motivated by purely commercial considerations and of maximising both production and profit. A major portion of the national resources was directed towards achieving these objectives, while the rural sector was primarily concerned with subsistence agriculture, with self-sustenance as the prime motivation.

Since the British administration was not very much concerned with investment in new areas outside the primary export sector, but with the provision of essential services for the sustenance of the population, the rupee budget did not present many problems. In fact, throughout the period of British administration, it was possible to budget for a surplus, partly because the population was small and partly because the level of revenue and expenditure could be easily regulated. The rupee revenue to the government accrued mainly from duties on exports and imports and from a few other taxes. There was no pressure on resources for accelerated economic development. The expenditure on a wide range of welfare services, which is a hallmark of budgetary policy today, did not exist. In this period, the bulk of the country's trade was with Britain and more than 90 per cent of Sri Lanka's exports were plantation products, the most important being tea, rubber and coconut. The principal imports consisted almost entirely of consumer goods, mainly food, drink, tobacco, raw materials and manufactured goods. Even intermediate goods were less important. In this background, the extent of diversification and structural change in the economy today is reflected in both the changing pattern of imports and exports and in the direction of foreign trade.

STRUCTURAL CHANGE

In the post-war years, the overall strategy of economic development has been to reduce the disparities between the plantation and rural sectors and to promote the rapid development of domestic agriculture. Low incomes were not confined to the rural sector; even in the urban areas, there were large numbers who had not benefited from economic growth in the pre-war years. The urban population was either directly or indirectly concerned with administration, trade, banking, transport or other services closely linked to the plantation sector. In relation to a population of less than six million in the twenties and thirties, and the then prevailing low levels of income, the expansion and growth in the plantation sector was generally found adequate to sustain the then existing living standards and to provide employment for the population. However, after the end of the war, with the rapid increase in population from 5 million in 1939 to 6.6 million in 1946, and subsequent further increases, the pattern of development in the earlier period, which was essentially based on the plantation sector, was no longer adequate to cope with the pressure to raise living standards and to provide employment opportunities for an increasing workforce.

After independence, the solution to the most urgent economic problems was sought on many fronts. The Central Bank of Ceylon was set up at the beginning of this period, in 1950, when economic development and diversification of the economy had been the main theme in the budget speeches and policy statements issued by government. It was felt that the Central Bank could play an increasingly important part in economic growth by directly and indirectly promoting the development and expansion of commercial banks and other financial institutions and by channelling credit to areas which had the greatest development potential. Economic development throughout the fifties and the sixties was heavily biased towards increasing the level of investment and modernising the rural economy, which continues to sustain the bulk of the country's population. This was necessary, not only to remove the longstanding social barriers emanating from the feudal origins of society, but also to increase the production of foodstuffs with a view to rapidly making the country less dependent on imported foodstuffs and goods. Greater emphasis on the development of the peasant economy was essential in the light of the revolution which had taken place in the country during the last 30 years in the field of education. From 1946 onwards, even before the country attained independence, Sri Lanka had put into effect a scheme of free education for all categories of students. The greatest beneficiaries of this scheme have been the children from rural areas. Rapid development was necessary to accommodate the skills and aptitudes of the large numbers who were leaving the schools and universities. Moreover, the earlier pattern of development would not have created adequate employment opportunities for an increasingly educated workforce with their social aspirations and educational attainments.

EARLY DEVELOPMENT PROPOSALS

Shortly before the "Korean boom", of 1950/51 the first Finance Minister of independent Sri Lanka announced that government would launch a Six Year Plan of development covering the period 1948/49 — 1952/53. The objective of these development proposals was to make the country less dependent on imports, both food and manufactured items, and to raise the per capita level of consumption. With this end in view, the Plan laid greater emphasis on agriculture, because it was the only means of achieving self-sufficiency in food. The production of foodstuffs was to be achieved primarily by providing incentives and by increasing the productivity of land already brought under cultivation in the wet zone and also by developing new areas of cultivable land in the dry zone. Agricultural production co-operatives were to be set up in different parts of the Island and these were to be assisted by credit from co-operative unions and banks.

The largest land and agricultural development project initiated during this period was the Gal Oya Development Scheme. This scheme was begun in 1949 and development work was undertaken progressively over a period of about seven years. The original estimated capital cost of this project was about Rs. 200 million of which about Rs. 100 million were to be spent on agricultural development, but the actual outlay on the scheme including capital and current costs over the period 1949—1960 as a whole exceeded Rs. 540 million. Proposals were also incorporated in this first development plan for a number of manufacturing industries. The main purpose was to ensure that the country would progressively increase its productive capacity of manufactured goods that had been hitherto imported and also meet the needs of an increasing population. Plans were formulated to establish several factories producing basic items such as cement, steel, caustic soda, textiles and paper. Steps were also taken to rehabilitate a few industries which were set up during the war years.

AFTERMATH OF THE KOREAN BOOM

Soon after the country got its freedom, Sri Lanka enjoyed a short spell of economic prosperity as a result of the stimulus given to the rubber industry with the outbreak of hostilities in Korea in 1949. The boom resulting from the Korean War in 1949 strengthened the economy considerably. The economy was buoyant only for a very short period, but nevertheless, the country benefited in many ways. Foreign exchange earnings resulting chiefly from enhanced export prices pushed up external assets to a very high figure. Apart from this, on account of the favourable balance of payments out-turn Sri Lanka was able to relax restrictions on imports for a few years thereafter. In fact, the resources built up during the "Korean boom" provided Sri Lanka with the means to enjoy a satisfactory level of prosperity throughout the first half of the fifties. Living standards were maintained by keeping restrictions on imports to a minimum.

The most important factor that contributed to economic stability in the aftermath of the "Korean boom" was the government budget. In 1951, the net cash operating deficit had been considerably reduced and up to 1955 government was able to maintain the deficit at minimal levels. The Central Bank had no occasion to apply restrictions on commercial bank credit because the banks were largely concerned with the provision of the legitimate credit requirements of the private sector, mainly for the import-export trade. Moreover, before 1955, commercial banking which was largely in expatriate hands, tended to concentrate on the exports of the plantation sector and import of consumer goods and there were few new avenues of investment because the process of economic diversification had hardly begun. Private sector borrowing for industrial and agricultural purposes, other than for the plantation sector, was limited. In the fifties, the resources available for expenditure on development were largely determined by the size of the subsidy on rice, and to a lesser extent, by other welfare services.

Government spent a considerable amount of its resources derived from revenue, on welfare services particularly on free education and free health services. In addition, government distributed rice on ration at subsidised prices and this has been a controversial item of welfare expenditure throughout this period. Year after year, the Central Bank in its Annual Report and other reports to the government urged that it was important to either do away with the subsidy on rice or to maintain it at a low level. This was found to be an effective way of increasingly diverting resources away from consumption for purposes of economic development. Between 1950 and 1955, the average level of the subsidy bill was about 22 per cent of the total government expenditure chargeable to revenue. While the policy on subsidies tended to curtail the amount of resources available for development, on the other hand, the policy of import liberalization which came into operation during the Korean war, and was continued after the end of the boom, tended to greatly reduce private investment in non-traditional undertakings.

After the end of the "Korean boom" government took heed of the warnings issued by the Central Bank about the deteriorating economic situation. Accordingly, in mid-1952 government launched a programme which was primarily designed to conserve foreign exchange and to eliminate the budget deficit. These measures were reinforced by further steps taken by government in 1953 to improve its budgetary position. These included higher prices for rationed goods, higher rates for services such as postal and electricity and higher tariffs on imports of luxuries.

While the fortunes of the economy fluctuated between 1952 and 1954, Sri Lanka made a remarkable economic and financial recovery in 1955. This resulted from a sharp increase in the price of tea which led to buoyant conditions in the economy. It was the first tea boom that Sri Lanka had experienced in the post-war period. Once again, the boom enabled the country to build up its foreign assets, which had been heavily drawn down after the "Korean boom" and to ease the rupee finance problem from the standpoint of the budget. In the budget for 1955—56, it was emphasized that budgetary policy should be designed to achieve rapid economic development, while maintaining financial stability. With this objective in view, a Six Year Programme of Investment for the public sector for the period 1954/55 to 1959/60 was formulated. This was the first long-term plan prepared for the economic development of the country. The plan, within limits, gave some emphasis to the development of the rural sector; its main object was to safeguard the productivity of the major areas of the economy with a view to sustaining existing levels of income and wealth and to raise the output of the economy by creating new economic activity. In addition, the government issued a statement on foreign investment policy, which emphasized that it was desirable for local capital to participate with foreign capital in the establishment of business enterprises. Explicit assurances were given on the repatriation of capital, dividends and interest; and foreign capital was to participate with local enterprise on equal terms. The emphasis on inducements to attract foreign capital was partly due to the expectation that the balance of payments prospect after the end of the tea boom would be less favourable.

With the change of government in 1956, the new coalition government decided to restructure the programme of development. A National Planning Council was set up. This Council was instrumental in bringing out the Ten Year Plan (1959-68). It was the first attempt made to draft a comprehensive and systematic plan for the development of the economy. It covered both the public and the private sectors unlike the earlier plans which were concerned mainly with investment in the public sector. The perspective of the Plan was extended beyond the conventional period of five years. It was felt that in view of the high rate of population growth and an expanding workforce, a programme of development spread over a period in excess of the normal five years and much more comprehensive in scope, was desirable. The basic objectives of the Plan were to provide employment for an increasing workforce, to bring about a reduction in unemployment and under-employment and an equilibrium in the balance of payments, to raise the standards of living, to diversify the economy so as to make it less vulnerable to changes in the prices of primary commodities and to ensure an equitable distribution of national income. In fact, these goals have been the basic objectives of development policy in the last two decades. Unfortunately, due to unforeseen balance of payments difficulties and the resulting inadequacy of financial resources the Ten Year Plan could not be implemented; and in lieu of this a Short-Term Implementation Programme was prepared in 1962. The development strategy in the period 1965—1970 was to concentrate on individual projects and to finance an enhanced level of imports of intermediate and consumer goods on extensive foreign aid. Thereafter, for a period of ten years from 1962, there was no formal development plan for the economy as a whole until the Five Year Plan was issued in 1972.

AGRICULTURAL DEVELOPMENT

Although the development plans of the fifties and later years, which gave considerable emphasis to industry, could not be fully implemented, agricultural development was not ignored and continued to be a priority area and an integral part of the development strategy. In the fifties, government had taken a large number of measures to increase paddy production and to develop the peasant sector. The results of these policies are evident in the increase in paddy production from 27 million bushels in 1956 to 48 million bushels in 1961/62, an increase of about 78 per cent in 6 years. Further increases were registered when 77.4 million bushels were harvested in 1970. In 1974, the total production of 76.8 million bushels was at a higher level than at any time except in 1970. In the same period (1956-1962), the supply of credit for paddy cultivation increased by about 27 per cent. In addition there was also an increase in average yields per acre from 38.39 bushels in 1964 to 51.3 bushels in 1970 but falling slightly to 45 bushels in 1974. Higher yields from paddy were obtained by increasing the use of fertilizer and by adoption of better agricultural practices. Between 1956 and 1962 the acreage under paddy increased by 358,216 acres or by 30.4 per cent and in 1974 two million acres were under cultivation. This was chiefly due to more land being brought under cultivation in the colonisation schemes and large river valley development projects in the Dry Zone. The government's fertilizer subsidy scheme for paddy, which had been introduced in 1951, and the use of superior varieties of seed were major contributory factors in increasing productivity. Among the inducements offered to the paddy producer was the guaranteed price scheme which had been in operation since 1949. In the fifties, the guaranteed price for paddy was raised on two occasions from the initial level of Rs. 8 per bushel to Rs. 9 and Rs. 12 per bushel. In 1967 the price was Rs. 14 and in 1974 it was raised to Rs. 33 per bushel. Since 1954, government has bought paddy at the guaranteed price through more than 600 co-operative agricultural production and sales societies and multi-purpose societies.

Another factor that contributed to a significant improvement in productivity in the paddy sector was the tenurial reforms, which became effective with the Paddy Lands Act which came into operation in 1958. In 1958, about 40 per cent of the paddy lands or approximately 400,000 acres had been cultivated by some 300,000 tenant farmers. The Paddy Lands Act of 1958 afforded considerable relief to a large number of peasant farmers by giving them security of tenure and the right to cultivate without hindrance the land that was owned by others. The Act also terminated the payment of high rents to the landlords as the rents were determined under the provisions of the Act. The Paddy Lands Act was instrumental in creating and organising at the village level cultivation committees composed mostly of cultivators themselves who were to manage their own affairs governing agricultural activity. The Agricultural Lands Law of 1973 has replaced the Paddy Lands Act of 1958. As in the case of the latter Act, it covers all types of paddy lands. The Law also provides for the establishment of Agricultural Tribunals to adjudicate legal disputes relating to the use of all agricultural land.

The government policy on subsidiary crops has been to encourage their production and thereby to improve rural incomes. Sri Lanka has reached self-sufficiency in a number of subsidiary products. Even where self-sufficiency has not been reached, with the view of encouraging the cultivation of subsidiary food crops the import of such items has been banned. The production of subsidiary crops, such as pulses, cereals, onions, chillies and potatoes has been encouraged by the alienation of lands to peasants under village schemes. Furthermore, guaranteed prices have been given for all these products. Efforts have also been made to increase the supply of milk with the establishment of the Milk Board in 1954. Since then several collecting and processing centres have been set up in the important milk producing towns, mainly in the hill country. Milk purchases are now being made at a guaranteed price and the Board now operates a condensery and a spray drying plant. Due to the inability to step up the production of milk these units have not been able to fulfil the nation's requirements and a substantial portion of the requirements of dried milk has to be met out of imports.

In the fifties the policy of the government was not confined to developing domestic agriculture; due attention was given to the plantation sector because it was the mainstay of the economy. Throughout this period, except in 1950/51 and in 1955/56, the plantation industries had to face severe competition from other producers in world markets which tended to depress prices for the three main export products, tea, rubber and coconut. While the level of investment in these industries to improve their productivity and competitive position lagged behind those of its other overseas competitors,—in the case of coconut, the Philippines and in the case of rubber, Malaysia,—the government continued to offer various incentives to the industry. Rehabilitation programmes were inaugurated for the three plantation industries from the mid-fifties onwards.

The acreage under tea has remained almost stationary at around 599,000 acres in the last fifteen years but there has been a steady increase in output from 306 million lbs. in 1950 to the peak level of 503 million lbs. in 1965. Thereafter, production has fallen markedly to 449 million lbs. in 1974. Average yields per acre have varied from 820 lbs. in 1963 to 756 lbs. in 1974. Before 1958, little or no tea replanting had been done and "The Tea Replanting Subsidy Scheme" was introduced in 1959 to encourage estates to replant their properties with high yielding vegetatively propagated clonal stock. In the last five years only about 6,000 acres per year have been replanted, which is below the target level. Although the replanting programme has slowed down in the sixties and seventies, due to poor returns and the general uncertainty of the future of the tea industry, yet there has been an appreciable increase in yields due to increased use of fertilizer. In 1962, the government inaugurated another scheme known as "The Rubber into Tea Replanting Subsidy Scheme" for replanting uneconomic rubber lands with high yielding vegetatively propagated tea. Tea as well as rubber and to a lesser extent coconut have been major sources of tax revenue to government. To partially counterbalance the effects of taxation government has introduced a number of support programmes for the plantation industry. Apart from the replanting subsidy, aid from the Asian Development Bank was made available for the modernization of tea factories. In 1973, a package programme was put into operation under which Rs. 125 million was to be made available annually for the development of the tea industry. The package programme was largely instrumental in cushioning the effect of increased production costs, resulting from wage increases and the increase in the price of petroleum products.

The total area under rubber has declined from 676,000 acres in 1963 to 565,000 acres in 1974, but despite this there has been an increase in yield per acre. Total output has increased from 113 million lbs. in 1950 to 231 million lbs. in 1963 and to 301 million lbs. in 1974. This has been due to replanted areas coming into bearing. A scheme was inaugurated for the rehabilitation of rubber as early as 1953 shortly after the signing of the Rubber-Rice Trade Agreement between Sri Lanka and the People's Republic of China. In fact, the replanting of rubber had been advocated immediately after the end of the last war with a view to making uneconomic properties more viable. The rubber replanting scheme was originally operative for a period of five years, However, the scheme has been extended subsequently and it continues up to this day. Despite the incentives offered to rubber producers, progress has been limited because of depressed prices in the world markets since the end of the "Korean boom" in theearly fifties. Between 1953 and 1974, about 340,000 acres had been replanted but the acreage of new plantings and replantings has declined from the record level of 27,000 acres in 1957 to a mere 7,276 acres in 1973. The reasons for this unsatisfactory performance have been low world market prices and the increase in replanting costs between 1969 and 1973 from Rs. 1,645 to Rs. 2,475 per acre, or by 50 per cent. If the Sri Lanka rubber industry is to keep pace with its highly efficient and competitive Malaysian counterpart, the present rate of replanting should be stepped up very sharply. More recently, the government has increased the rubber replanting subsidy from Rs. 1,400 per acre for holdings above 100 acres and Rs. 1,500 for holdings less than 100 acres to a uniform Rs. 2,000 per acre. The rubber subsidy is entirely provided by government, because as in the case of tea, there is no replanting cess arrangements to siphon funds from exports for replanting.

Successive studies of the coconut industry have shown that most of the plantations in the Island are very old. Many of them are over fifty years of age. Coconut plantations consist mainly of small holdings and plantations around village gardens; with holdings of less than 5 acres accounting for 35 per cent of the acreage. The number of large estates is much less than in tea and rubber. Coconut production has fluctuated from year to year. In the meantime, domestic consumption of coconut products has increased gradually with population growth and the reduced availability of other food, leaving less for export. With a view to rehabilitating the industry government has pursued a policy of providing high grade seedlings at subsidised rates over the last fifteen years. In addition, fertilizer has been supplied at subsidised rates. In May 1974, government introduced the Coconut Rehabilitation Subsidy Scheme for small holdings. Under this scheme financial support will be provided to small holders with less than 20 acres to develop their properties.

Steps have also been taken to encourage the production and export of minor crops particularly cocoa, cinnamon, cardamom, pepper and citronella. These crops are generally grown on a small scale by smallholders. The main difficulties faced by these producers have been sharp changes in prices, which have tended to affect the secular fortunes of the industry in a big way. In recent years, although production has not increased appreciably, on account of the fact that the area under each of these crops has not increased, export earnings have gone up because of the substantial increases in the prices of these commodities, particularly cocoa, cardamom and pepper. In order to diversify exports, the Minor Export Crop Assistance Scheme was begun in 1972, with the object of providing low interest loans and subsidised inputs for minor export crops.

Government budgetary allocations for capital expenditure on agriculture and irrigation, including the plantations, between 1964/65 and 1973/74 nearly doubled and were about 15 per cent of total expenditure, while current expenditure was about 2.5 per cent. The major focus of agricultural policy since the sixties has been increased self-sufficiency in food production, crop diversification to reduce dependence on the three major crops for foreign exchange earnings, expansion of employment opportunities in agriculture and improvement of rural living conditions and social services. Faced with increasing foreign exchange requirements to finance food imports consequent on rising food prices in world markets, government initiated a Food Drive in 1973 to accelerate domestic food production. Cultivation loans given by the People's Bank were increased sharply, increased allocations of funds were made for the restoration and improvement of small tanks, and farmers were given Rs. 500 per acre for clearing and bringing abandoned land, new land or forest land under cultivation.

In addition to these measures taken to raise productivity in domestic agriculture, the Agricultural Productivity Law of 1972 has helped to set up appropriate institutional arrangements at the village level. Under this Law some 478 Agricultural Productivity Committees have been established in 22 districts in the Island. These committees have far-reaching powers to take action to maximise the use of land, water and other resources. The Law makes it obligatory for owners to utilize land in an optimal manner with regard to the crops grown and the methods of cultivation.

The objects of the Land Reform of 1972 were to increase productivity and employment. Under the Law, ceilings were fixed on all privately held agricultural land. These ceilings were 25 acres for paddy land and 50 acres for lands under all other crops. Lands owned by public limited liability companies, co-operatives and religious organisations were not affected by land reform. The actual take-over of the land was completed by end August 1974. About 61 per cent of the land taken over were under plantation crops, of which tea was 24 per cent, coconut 20 per cent and rubber 15 per cent. In all, 559,377 acres were vested in the Land Reform Commission, which was the authority responsible for the implementation of the law and the consequent take-over of nationalised land. The land vested in the Commission has been alienated to different types of organisations; these include the State Plantations Corporation, District Land Reform Authorities, the Up-country Co-operative Estates Development Board (USAWASAMA), Co-operative societies, and Youth Settlement Co-operatives (known as JANAWASAS). In view of the large acreage of land under plantation crops that have come under land reform, social objectives should be counter-balanced by equally important objectives, particularly the increasing of productivity and of managerial competence.

AGRICULTURAL CREDIT

With a view to rapidly developing the rural sector and domestic agriculture, institutional arrangements for the disbursement of credit have been progressively improved. For a long period of time, the co-operative system in Sri Lanka has provided credit facilities to the peasant and also given him an avenue for marketing his produce. From the early fifties government gave renewed emphasis to the development of co-operatives. Although co-operatives existed at the village level before this period they did not make a significant contribution to the advancement of the rural economy, particularly in marketing. From 1957 onwards, multi-purpose co-operative societies were set up to replace the earlier co-operative agricultural production and sales societies because the activities of the latter category had been rather limited. Through a process of consolidation and reorganisation, the earlier primary and middle level production, sales and credit societies, were formed into multi-purpose societies. In 1965, there were 3,000 multi-purpose societies which were further amalgamated in 1974 to form some 800 multi-purpose societies. These now undertake a variety of functions which had been entrusted earlier to specialised smaller societies.

Today, the co-operatives play a very important part in supplying credit to the peasant sector, particularly for the cultivation of paddy and other subsidiary food crops. Before 1966, the disbursement of agricultural credit had been entrusted to the Department of Agrarian Services and under these arrangements a major problem was the inadequacy of funds that had been made available to the farmers. The greater availability of credit for domestic agriculture from institutional sources has stimulated production to a very large extent and this is reflected in the figures particularly of paddy production. Throughout, the recovery of loans has been a major problem for the banks and co-operatives and the agricultural loan programme has been marred by a very high rate of default. In 1955/56 32.4 per cent of the total loans given had not been repaid, while this figure has risen sharply to as much as 71.2 per cent in 1967. The recovery of loans improved considerably between 1967 and 1970 when rice ration books had been hypothecated by farmers for loans granted to them. After this was withdrawn in 1971, the rate of default rose very sharply once again. A problem that is now confronting the government is how best the problem of default could be effectively overcome.

The rural banks that were established by the People's Bank have also been major avenues for the supply of credit to the rural sector. At the end of March 1975 there were some 332 rural banks which are actually credit departments that have been set up in multi-purpose co-operatives for the purpose of channelling funds to the rural sector. The rural banks can be considered essentially as a part of the co-operative credit mechanism. In a strict sense, rural banks are not commercial banks because they do not accept demand deposits and their range of business is limited, although they have facilities for savings accounts. Where the rural banks do not operate, multi-purpose co-operatives directly handle the disbursement of credit.

A significant change was effected in the mechanism of rural credit when the New Agricultural Credit Scheme was launched in 1967. Its essential feature was that credit to co-operative societies was provided through the People's Bank. The Central Bank was to function as the refinancing agent and the Bank issued a guarantee on behalf of government up to 75 per cent of the loans given by the bank. The risk that was borne directly by the People's Bank was thus limited to 25 per cent. Central Bank provides re-finance to the People's Bank at $1\frac{1}{2}$ per cent per annum and charges $\frac{1}{2}$ per cent as guarantee fee. The People's Bank lends to co-operatives at 8 per cent per annum and the co-operatives in turn lend to farmers at 12 per cent per annum. If the loans are repaid within the stipulated period a rebate of 3 per cent per annum is allowed by the People's Bank to the co-operatives and the co-operatives in turn allow a rebate of 3 per cent per annum to the farmer. With the inauguration of this new credit scheme, government decided to write off all unpaid credits that were outstanding from all co-operatives as at end of 1966. Under the new arrangement, money was released in stages, according to the progress that was achieved in the utilization of credit for production. The level of credit utilization upto 1970 rose sharply and repayments were also satisfactory because farmers had to hypothecate their ration books against the loans.

Although the actual volume of credit from institutional sources to the rural sector still remains less than 15 per cent, there is no direct evidence that it is actually the quantum of credit that determines the level of output. There are a large number of contributory factors of which credit is one. The farmer continues to depend on non-institutional sources for the bulk of his credit needs. There is little data to show whether the volume of non-institutional credit has either increased or decreased in the last decade and what influence this has had on the level of productivity. One of the major problems in providing agricultural credit has been the recovery of loans. It was hoped that with the establishment of the Paddy Marketing Board in 1971, recoveries would be easier because of the monopoly purchasing rights of the Board. But even this does not seem to have been realised. Farmers do not always sell their crop to the Paddy Marketing Board because the free market price for paddy has been higher than the guaranteed price at which the Board makes purchases. Another incentive that has been offered to the farmer to step up output has been the guaranteed price for paddy. Since 1950 the guaranteed price has increased more than threefold. In 1951, the guaranteed price was Rs. 9/- per bushel and was subsequently increased to Rs. 12/- in 1952, Rs. 14/- in 1967, Rs. 18/- in 1973 and Rs. 33/- in 1974.

The response of producers to the higher guaranteed price has been very favourable. The sharp increase in price after 1973 has been largely influenced by the very high cost of inputs particularly fertilizer, farm equipment, fuel, insecticides and labour. In relation to the guaranteed price which is the price at which the Paddy Marketing Board purchases paddy the current margins available to the producer have become quite small due to the high prices of inputs on account of world-wide inflation. The Paddy Marketing Board was set up largely with a view to giving the producer a satisfactory means of disposing of his produce and also to ensure that the government is able to procure the maximum quantity of rice that is required for distribution on the ration. The Board has the monopoly for purchasing paddy and this is done on its behalf by some 4,000 multi-purpose co-operative purchasing stations. The Paddy Marketing Board is responsible for transporting, storing and milling of paddy in its own mills or in private mills. The volume of paddy purchased by the Board has fluctuated in recent years.

Its purchases from the producer have not increased despite an increase in production. This, of course, has to be linked with the quantity of rice that is made available on the rice ration. The Board has been able to procure more rice only at times when the size of the consumer ration is large which in turn has tended to depress the free market price of paddy. When the quantity of rice given on the ration is reduced the gap between the free market price for paddy and the guaranteed price widens and this tends to divert more paddy away from the Paddy Marketing Board to the free market.

INDUSTRIAL DEVELOPMENT AND PUBLIC ENTERPRISE

In the period before 1950 a characteristic of the economy, as pointed out earlier, was the almost total absence of modern industry. Before the mid-fifties, government policy was heavily influenced by the belief that a small country like Sri Lanka cannot undertake large scale industries, in view of the limited size of the market. As a result, direct investment in industry by government was insignificant and the encouragement and support given to private industrialists negligible. The industries that existed before 1950 consisted mainly of plants which processed tea, rubber and coconut products. In this sense the country had rudimentary industrial units consisting of tea factories, rubber factories and mills that processed coconut products such as fibre and desiccated coconut. The era of modern industry in Sri Lanka commenced only after 1960. The period 1950 to 1959 was not very significant from the point of view of industrial development. This was the result of many factors. After the end of the "Korean boom", the country had substantial foreign exchange earnings which enabled it to sustain economic activity and to maintain a reasonably high standard of imports. Then again, in 1956, Sri Lanka enjoyed a short spell of prosperity with the sharp rise in tea prices. The resulting increase in external assets gave sufficient resources to enable the economy to continue its traditional import-export relations with minimum dislocation until 1960. In essence, the country was able to sustain an adequate level of imports and maintain a reasonably high standard of living.

The door was opened for industrial development from 1958 onwards, when for the first time, Sri Lanka was faced with a series of balance of payments deficits of increasing magnitude. Even before this, in 1956, government had given an indication of its industrial development policy. Major industries which were unlikely to be undertaken by the private sector were reserved for the public sector. The private sector was to be given encouragement and support to establish industries. Foreign capital in new fields of industrial activity was to be allowed with guarantees in regard to the repatriation of capital and dividends. From 1959 onwards, government took serious notice of the worsening foreign exchange situation and took steps to stem the outflow of foreign exchange by way of the customary high level of imports. In 1959, government in collaboration with the Central Bank used monetary methods to control the level of imports. Most of the measures were introduced through the intervention of the Central Bank and consisted largely of credit controls. Since these were essentially indirect methods they were of limited effectiveness and had to be replaced in 1960 and 1961 by more direct methods of import control, which included licensing, quotas, prohibitive duties, restrictions on hire purchase finance, and a complete ban on the import of a large number of non-essential items.

After 1960 an impetus was also given to industrial development by the increasingly rigid controls on imports and through a scheme of incentives. A wide variety of tax concessions was offered to industrialists. These included a tax holiday of five years lump sum depreciation on capital equipment and machinery, a development rebate, concessionary import duties on raw materials and equipment and tax exemption of profits from industrial and non-traditional export earnings. These concessions created a new class of industrialists. Persons who had been previously engaged in the retail and wholesale trade found the new avenues for the establishment of industry very attractive. Between 1959 and 1963, over 1,000 industries were approved by the Ministry of Industries while 800 others had started business without formal approval. Most of the new industries were established without foreign participation and technical know-how from abroad and were largely Ceylonese owned. The establishment of industries without foreign participation was, indeed, advantageous to the country and it encouraged the development of local expertise and technical skills both on the management and the technical side. As against this, the fact that the inflow of foreign capital was limited meant that at a time when the balance of payments problem was getting worse Sri Lanka had to depend on its own limited foreign exchange resources to develop new industries.

The new industrial policy was essentially pragmatic. Under a protectionist umbrella set up primarily to relieve the critical balance of payments situation, an artificial incentive was given to the consumer goods industries heavily dependent on imported raw materials. As a result a heavily protected and somewhat monopolistic assembly type industrial complex was permitted to grow. A scheme of priority for manufacturing industry on the basis of the country's needs and a clear idea of which industries would make the greatest impact on the balance of payments was lacking.

Although there are more than 2500 industrial units in the private sector most of them have had to face continuing difficulties. Few of them could use local raw materials and they continue to depend heavily on imports. As most of them are therefore compelled to work below their capacity their unit costs are invariably high. Due to the shortage of manufactured goods in the domestic market, they have been able to sell at high prices and become viable as far as the internal market is concerned. Only a few industries are able to export on a continuing basis so as to earn foreign exchange. The Foreign Exchange Entitlement Certificate Scheme and the Convertible Rupee Account facility have been added incentives offered to industrialists to export. New industries it appears have throughout utilised much more foreign exchange than they earn through exports.

The reference to industrial development so far has been mainly in respect of the private sector. Even before the expansion in private sector industry had commenced after 1960, several industries in the state sector had got under way. The development of public sector industry goes back to the war years, (1939/1945) when several state owned industries were set up to provide essential goods whose supply had been curtailed during the war. Before 1955, most state industrial ventures were run as purely government concerns by the Department of Industries. In 1955, the Government Sponsored Corporations Act No. 19 was introduced. The purpose of this Act was to incorporate industrial undertakings that were run by government departments. The Act gave powers mainly to incorporate existing industrial undertakings. In 1957 the State Industrial Corporations Act No. 49 was passed. This Act covered a wider field and was more comprehensive. It provided for the setting up of new undertakings and for the taking over of industries that were functioning under the earlier Act. When this Act came into operation in 1957, several important state owned industries had already commenced operations and these included cement, paper, ceramics, leather and footwear.

In a policy statement government had laid down that certain industries would be mainly confined to the public sector, while private sector investment would be permitted in other areas. In particular, government reserved for itself "basic industries" such as cement, steel, paper, tyres, mineral sands, salt, flour milling, plywood, petroleum refining and fertilizer. However, in some areas where government interest predominated private enterprise has also been permitted; examples are footwear, leather products, ceramics and textiles. In 1962, there were 14 industrial corporations producing among others cement, textiles, sugar, paper, chemicals, oils and fats, ceramics, mineral sands, plywood and leather. By 1970, the number of state sector industries had increased to 23 and by 1974 the number had risen further to 28. The greatest expansion in public sector industry took place after 1965, and by 1975 there were public sector industries in most fields that had been reserved by the government for itself. The total capital investment in public sector industry in 1974 was about Rs. 2,346 million and has provided employment for about 47,525 persons. Although the record of public sector industries had been quite unimpressive in the fifties and sixties, more recently, definite efforts have been made to put them on a firm footing.

Many corporations that have been running at a loss have become economically viable through better management, more realistic pricing policies, the elimination of waste and grant of incentives to increase worker productivity. Despite this, capacity utilisation in many industrial corporations has remained low; notable examples are the Oils and Fats, Textiles, Plywood, Hardware, Sugar and Steel Corporations.

Apart from the industrial corporations, public enterprises fall into three other broad categories; they are trading corporations, those that provide services, and financial institutions. The total number of public enterprises at the end of 1974 was about 85 and the total investment was about Rs. 5,389 million. These enterprises provided employment for 260,766 persons and the capital invested per employee was about Rs. 24,150 in the industrial sector and about Rs. 19,350 in the services sector.

POPULATION AND MANPOWER

Population trends in Sri Lanka in the last two decades have been quite unique, not only with respect to population growth in this country, but also, from the point of view of trends in other Asian countries. In a hundred years, i.e. between 1871 and 1971, the population has increased sixfold. At the census undertaken in 1871 the population was 2.4 million, by 1921 it had risen to 4.4 million; by 1946 to 6.6 million; in 1953 it was 8.0 million and 10.5 million in 1963. At the last census taken in October 1971 the Island's population was 12.7 million. The mid year population in 1974 was 13.6 million. The post-war years saw a rapid increase in the rate of population growth, which was brought about by a dramatic fall in the death rate. The death rate which was 20.2 per thousand in 1946 fell to 14.3 in 1950, and in 1972 it was only 7.9 per thousand. This sharp decrease was mainly the result of the intensive campaign in the post-war years for the eradication of malaria and the improvement of health amenities.

The last fifteen years also witnessed a fairly sharp fall in the birth rate. The high birth rate of about 40 per thousand in the forties declined to 36.6 in 1960 and fell further to 29.4 in 1972. In 1955 the infant mortality rate was 71 per thousand, in 1960 it had fallen to 67 per thousand and by 1973 it further declined to 46 per thousand. The maternal death rate had declined from 4.1 per thousand in 1955 to 3 per thousand in 1960 and to 1.2 per thousand in 1973. All these figures reflect the impact not only of the eradication of epidemic diseases, but also, the effect of social welfare programmes, particularly the free medical services, which have considerably lowered the death rate, increased the longevity of the population and contributed to the general advancement of the health standards in the country.

Until restrictions were imposed on immigration in 1948, the population increased due both to the natural increase and immigration. Before 1952, net immigration into the country was substantial, but thereafter the outward flow of persons, particularly repatriates to India, increased with the implementation of the Indo Ceylon Agreement of 1964 (Sirima-Shastri Pact). Since 1970, the number of Indian repatriates has increased sharply and has contributed appreciably to a fall in the rate of population growth. The availability of free education has resulted in a marked increase in literacy. In 1911, the literacy rate was as low as 31.0 per cent whilst in 1971 it had risen to nearly 80 per cent and it continues to rise even further. The advancement in education and the high rates of literacy have made it relatively easy for government population control policies to have a rapid impact. In fact in the last decade, the family planning programme of the Ministry of Health, which has been supported by foreign agencies, together with the impact of literacy and education on delayed marriages and limitation on the size of families have been a major factor in influencing the fall in the rate of population growth to around 1.7 per cent in 1974.

A feature of the distribution of population is its concentration in the rural areas, despite some urban migration. When the first census was taken in 1871, the population in the urban areas was 10.8 per cent and by 1971 this figure had moved up to 22.4 per cent, showing that more than 75 per cent of the population still resided in the rural areas. When compared to other countries, where city populations tend to predominate, rural/urban migration has not been appreciable in Sri Lanka. In the postwar years, with the expansion of secondary and higher education, there has been a tendency for greater numbers from the rural areas to come into the towns. But more recently, with the shift in the terms of the trade towards the rural sector, there has been a reverse drift. On account of the profitability of the production of food crops, particularly paddy, and the increasing lack of employment opportunities in the urban areas, educated young people seemed to prefer to remain in the villages.

Details of labour absorption in different sectors of the economy have been available for a period of about 60 years. The major sources of employment data have been the census reports, which give details of employment in agriculture, industry and services. Agriculture, particularly paddy cultivation, has throughout been the most important source of gainful employment for the working population. In the plantation sector, tea continues to provide the largest amount of employment. Unlike as in the case of the two other major exports rubber and coconut, tea, due to the nature of the product and the technology used in production, requires a very large mixed labour force. Certain tasks in the production and manufacture of tea have been traditionally assigned to women who have consequently been employed in a substantial number in the tea industry.

In the first half of the century there has been a fairly substantial fall in the labour force participation rates. But in the postwar years this trend has been reversed. The population census of 1946 disclosed that there were 2.64 million persons gainfully employed in a population of 6.6 million,while in 1953 the number had risen to 2.98 million. The census of 1963 showed that employment had further increased to 3.19 million, representing 30.2 per cent of the population. If the unemployed were included in this total, the labour force rises to 32.7 per cent. The growth of employment in the period 1953 - 1963 was 206,000 or roughly 0.6 per cent per annum. A comprehensive picture of labour force participation in the principal categories of economic activity and the distribution of employment according to the major occupational groups is available from The Socio-Economic Survey 1969/70 of the Department of Census and Statistics. For the Island as a whole, the participation rate in 1969/70 was 33.4 per cent as against 30.2 per cent in 1963. This is in part due to the change in the age composition of the population where the additions to the lower age groups have declined due to the fall in the rate of population increase, whereas those in the age groups above 15 years seeking work have relatively increased.

The population in the working age group 15-59 years represented 63.8 per cent of the population. In the age group 15-24 years there is a high level of unemployment (17.3 per cent) indicating that if more employment opportunities were available, this age group would have had the highest labour force participation rates. In 1969/70, the total work force was 4.1 million of which about 668,000 or 16 per cent were engaged in the cultivation of paddy and other grains. Between 1953 and 1970, employment in paddy cultivation had increased by more than 80 per cent. This has been mainly due to the intensive drive since the sixties to increase paddy production. Between 1953 and 1970 the acreage under paddy increased from 1,048,300 to 1,875,573 and in 1974 two million acres were under cultivation.

In regard to plantation crops, employment in tea cultivation has risen from 550,191 in 1953 to 606,000 in 1970, while the acreage increased from 587,375 to 597,171. This increase in employment is slightly more than proportionate to the area that has been newly brought under cultivation and the employment per acre of cultivated tea land has risen from 0.9 persons in 1953 to 1.1 persons in 1970. In rubber, a noteworthy feature has been the decrease in total employment from 200,171 in 1953 to 196,000 in 1970. In the same period the acreage decreased from 657,472 to 568,900. This was mainly due to the programme of rationalisation in the rubber industry, where uneconomic and old rubber was replaced with high yielding plants. In the coconut industry, employment fell from 95,748 in 1953 to 80,400 in 1970, while the estimated acreage under cultivation has remained more or less at the same level.

Central Bank Labour Force Participation Rate Survey of 1973 showed that the labour force including housewives was 5.9 million. If the housewives were excluded, the size of the labour force would have been 5.3 million. The mid year population in 1973 was 13.2 million, showing that about 38 per cent of the population were in the labour force. This Survey further highlights certain significant features in the disposition of labour. In the 15-19 year age group the male participation rate was 40.8 per cent in 1963, 44.9 per cent in 1968 as against 32.7 per cent in 1973. In the 20-24 age group the rate was 80.2 per cent in 1963, 82.1 per cent in 1968 and 75 per cent in 1973. The substantial decline in employment in the 15-19 year age group is largely due to the progressively greater numbers of young people who are receiving education.

Since the late forties, education has been a major determinant of labour force participation in Sri Lanka, on account of the policy of providing free education for all categories of school-going and university students. The impact of free education on labour force participation rates has become progressively more significant in the sixties and seventies when larger numbers of educated young people have started seeking employment. The actual levels of labour force participation in the economy would have been much higher had the unemployment rate been lower. Although Sri Lanka has throughout had a high labour force participation rate, increase in unemployment in recent years has reduced the level of participation. The Labour Force Participation Rate Survey shows an unemployment rate of 18.3 per cent without the inclusion of housewives. In 1973, as a percentage of the total labour force, unemployment was 14.44 per cent and as a percentage of the total population, 5.99 per cent. The total number of un-employed in the country in 1973 was 790,000, of which 550,566 (nearly 70 per cent) were in the rural sector.

Sri Lanka today has skills in almost all fields and the need to draw upon foreign expertise has been minimal. Greater emphasis has been given to management education and the training of administrators for which a National Institute of Management and an Academy of Administrative Studies have been set up. Trained personnel in some areas, for instance in engineering, law and accountancy have been slightly in excess of needs. Many technically qualified people have during the last five years, left the country for employment abroad. In this process, the country continues to lose the services of technically qualified persons who could make a major contribution to its development effort.

WELFARE SERVICES AND INCOME DISTRIBUTION

The large number of social and economic measures put into operation by successive governments in the last two decades has contributed to a sharp reduction in the inequality of income distribution. Apart from statistics which corroborate this, to those who have travelled in the country in the last two decades the improvement in the economic conditions of the low income groups, especially those who live in the rural sector will be quite apparent. High prices for agricultural products and better social amenities, made available through a multiplicity of welfare schemes, have made a definite improvement in the living standards of the rural community. This is significant because until the mid fifties the rural sector was the most neglected part of the economy. At that time social conditions in this sector appeared to be less favourable than in the plantation economy, because a program of work that corresponded to the systematic policies of the plantation companies for the development and maintenance of levels of production in the estate sector, had not been introduced for the benefit of the rural economy.

Successive surveys carried out by the Central Bank, particularly the Consumer Finance Surveys of 1953, 1963 and 1973, show a significant trend towards the greater equalisation of income distribution. In terms of the earnings of income receivers, between 1963 and 1973 the share of income of the highest decile has fallen from 42.49 per cent in 1953 to 39.24 per cent in 1963 and to 29.98 per cent in 1973. The share of income enjoyed by this decile in 1973 is approximately 70 per cent of the share that this group received in 1953. Although the fall in the share of this income group in 1953 and 1963 is not very significant the decrease between 1963 and 1973 is indeed spectacular. Similarly the income shares of the middle deciles have increased while those of the lowest deciles have decreased. (The Gini Concentration Ratio, which is a measure of the trend towards greater equality in income, reveals that for spending units the coefficient has decreased appreciably from 0.46 in 1953 to 0.45 in 1963 and thereafter to 0.35 in 1973).

In Sri Lanka a sector-wise analysis of income equality is important, because of the distinct socio-economic and structural characteristics of the urban, rural and estate sectors. This is also necessary to enable some kind of assessment to be made of the sectoral impact of economic development in the last two decades. In the urban sector, where some 2.3 million or 18 per cent of the population lived in 1973, the overall change in the trend towards greater income equality is very similar to that for the Island as a whole. In the rural sector, where more than 9.2 million or 71 per cent of the population lived in 1973, the reduction in income inequality was greater than in the urban and estate sectors. The concentration ratio for the rural sector fell from 0.44 in 1963 to 0.37 in 1973. When compared with the urban sector, there has been a greater equalisation of incomes in the rural sector, on the premise that rural income distribution in the base year 1953 was more unequal than income in the urban sector.

The reduction in income inequality has been largely the result of an extensive programme of social welfare, which successive governments in Sri Lanka have committed themselves to since the end of the war. These welfare measures have included subsidies on essential foodstuffs, (particularly rice), free education, free medical care, and subsidised prices for public transportation and housing. In addition, higher income and wealth taxes, a capital levy, ceilings on income, land reform and minimum wage legislation have also contributed progressively to the equalisation of income. The highest incomes from employment today are about ten times higher than the lowest wages, whereas at the beginning of the period under review, the difference would have been more than twenty times.

For more than fifteen years without a break, expenditure on welfare services has appreciably exceeded government capital expenditure. Up to 1950/56, with the exception of 1950/51 and 1951/52, total capital expenditure exceeded total welfare expenditure mainly because the subsidy on rice was comparatively small; but from 1959/60 onwards, expenditure was heavily weighted in favour of welfare. Welfare expenditure has progressively increased over the years, and in 1974 it reached the peak level of Rs. 1,465 million, which is 41 per cent of current expenditure or 112 per cent of capital expenditure. The high level of spending on welfare has tended to progressively enlarge the size of the budget deficits since the mid-fifties and have siphoned away resources from investment to consumption. In 1953/54 and 1954/55 there were overall budget surpluses and these two years stand out in the annals of budgetary management in Sri Lanka. In all other years there have been budget deficits and after 1959/60 these deficits have exceeded Rs. 500 million per year and after 1969/70 Rs. 1,000 million per year. These deficits could be attributed almost wholly to the progressive increase in expenditure on welfare. Had there been no welfare expenditure the budget deficits throughout this period would have been virtually non-existent.

It would be useful here to review each of the major welfare programmes individually. Historically, the subsidy on rice was introduced during the second world war and its purpose was to provide relief to the consumer from the soaring cost of foodstuffs. Since then, the policy of subsidisation has been continued without a break up to this day. In the period 1950-1956, the rice subsidy was contained at a level of less than Rs. 100 million, except in 1950/51 and 1951/52, when the subsidy had to be increased on account of the rise in the world market price of rice. In the period 1955/56 to 1969/70 the average expenditure was about Rs. 250 million. However, between 1968/69 and 1974, the subsidy, net of the profits from the sale of sugar and flour, had more than doubled, rising from Rs. 306.5 million in 1968/69 to Rs. 776.9 million in the year 1974, reflecting largely the progressive increase in the world market price of rice.

The subsidy on rice has appreciably contributed towards the greater equality in incomes. Subsidised or free rice has been instrumental in giving a real income to those who would be regarded as having no income. Thus in the late sixties when the subsidy was withdrawn from income tax payers, its impact on income equality became more pronounced. In Sri Lanka even though a person may be unemployed, yet he would be in receipt of a financial benefit because of the financial worth of the welfare services he receives. An unemployed person, therefore, does not fall into the zero income category because a money value can be imputed to the various welfare services that he receives.

Since 1946, government has incurred expenditure on free education, and the amounts spent have progressively risen over the years. The initial impact of free education was to draw in a great many new students into the existing schools. As admissions increased, steps were taken to increase facilities in the primary and secondary schools in all parts of the Island with the result that today practically every village has a school and every town has one or more well-equipped schools. The number of school-going children has almost doubled in twenty-five years from 1.34 million in 1950 to 2.52 million in 1974. As a percentage of the total population this represented 17.2 in 1950 and 18.8 in 1974. An even sharper increase has taken place in the number of students attending universities. In 1950, when there was only one university campus there were 2,036 students in all faculties; but in 1974, with five campuses, the student population has exceeded 12,000.

Furthermore, the number of faculties have more than doubled and a large number of new subjects and courses have been introduced. Since the early seventies the curriculum in the secondary schools has been more vocationally oriented and a similar trend is evident in the arts courses at the university. With free education there has been a progressive increase in the number of candidates sitting for the Senior School Certificate (S.S.C.) and the General Certificate of Education Ordinary Level (G.C.E. O/L) examinations in the last 25 years. In 1950, 43,528 sat for the S.S.C. examination, while in 1974, 500,676 candidates appeared for the G.C.E. Ordinary Level examination. An important feature is that free education for the first time opened up education for the large mass of people in the rural areas. After 1960, the bulk of the entrants to the universities were from schools in the rural areas. The increasing pressure to gain admission to the universities is reflected in the numbers sitting for the university qualifying examinations. The rapid rate of increase in the number of school-going children since 1946 is an index of the marked increase in expenditure on education. Recurrent expenditure on education has risen progressively from Rs. 85 million in 1949/50 to Rs. 579.3 million in 1974. The sharp increase in expenditure after 1955 reflects the sudden entry of large numbers into the education stream as a result of the population increases that took place during and soon after the war. Thereafter, in the sixties, with the take-over of nearly all the fee-levying schools by the government, there was a further increase in expenditure.

The benefits of the free education scheme are most difficult to quantify, but there is no doubt that it has made a substantial contribution to economic development. It is difficult to identify the current and capital expenditure components in the total sums that have been spent on education. Free education has both directly and indirectly contributed towards higher levels of productivity in different sectors of the economy. The primary social benefit has been that it has provided equal opportunities of having an education to all persons, irrespective of income levels and social standing. As a result, people from the rural areas and the under-privileged have had opportunities of having greater access to all the avenues of employment available in the country. The full impact of the scheme was mostly evident after the sixties, when students from the rural areas for the first time sat for public examinations, which provided them access to the highest posts in the government and administrative services. The social impact of this has been more widespread than is generally believed. Once a member of a family has access to a job, it provides him with the means to sustain the other members of the family. This would not have been possible had free education not given him an opportunity to seek a position with a steady income.

Because a wider segment of the population has had access to jobs with higher income levels, free education has contributed to a more equitable distribution of income, both in the urban and rural areas. With the present system of education, Sri Lanka, unlike some other Asian countries, has not suffered from a shortage of technically qualified manpower. Although the kind of education provided until quite recently in the schools and universities, has had a heavy academic bias, yet the general education that people have received, has laid the foundations for the development of technical and managerial skills which are so essential for the new industries and services. When more than 2,500 small and large industrial units were set up after 1960, the manpower necessary to run these industries was readily available and educated youth were easily able to acquire basic skills in a relatively short time.

Out of the various categories of expenditure on welfare services, the amount spent by government for free health services has been the lowest. Expenditure on medical care is today about one-third of the outlay on free or subsidised rice and is less than half the expenditure on education. Nevertheless the impact of free medical care over the last twenty-five years is seen in the eradication of certain diseases which had taken a very heavy toll of life in the thirties. Included in this group are malaria, tuberculosis and other virulent and communicable diseases. Free medical care has also contributed appreciably to the decline in the death rate since the forties. The death rate has declined from 21.1 per thousand in 1945 to 8.6 per thousand in 1960 and to 7.7 per thousand in 1973. This shows that in less than 30 years, the death rate has been reduced to one-third of the level in 1945. The death rate in Sri Lanka today is one of the lowest among the developing countries. Similarly, the infant mortality rate has fallen from 263 per thousand in 1935 to 140 per thousand in 1950 and to 46 per thousand in 1973. Successive censuses also show that medical care has contributed to an increase in longevity of both males and females in the country. In 1946, the expectation of life for males was only 43.9 years, It rose to 61.9 years in 1960 and to 64.8 years in 1970. The corresponding figures for females are 41.6, 40.6 and 66.9 years, respectively. This shows that the return on investment on medical care seems to be more than commensurate with the outlay. It has contributed to the producing of a healthy workforce which could be geared most effectively to the tasks of economic development.

In addition to direct subsidies, the community has benefited from a wide range of concealed subsidies, which have been operative through pricing policy, particularly in areas such as housing and transportation. The losses that have been incurred by the Ceylon Government Railway and the Ceylon Transport Board in the past are measures of the size of the subsidy. With regard to the Ceylon Transport Board, the fares revision in the early seventies was the first in thirty years. For more than ten years after the bus services were nationalised in 1958 fares had remained stable at the rates charged by private bus operators in the period prior to nationalisation. It is said that until 1970, Sri Lanka had probably one of the cheapest transport services in the world. The Ceylon Government Railway has been operating at a loss since the thirties and this has in part been due to the low fares and the relatively high overheads. With regard to housing, rents have been controlled and there has been a substantial element of subsidy. Rents of most small houses, which were determined during the war years, still remain at the same levels despite the high costs of building materials and the provision of improved amenities.

PRICES AND WAGE POLICY

A major problem confronting the economy in the last three year period has been widespread inflationary pressures. In the two decades preceding 1972 price increases had been very moderate, except in 1950/51 during the "Korean boom". Between 1950 and 1959 a very liberal import policy coupled with relatively low tariffs helped to keep domestic prices very stable. In the fifties and sixties, the cost of living had been contained through the extensive scheme of subsidies, outlined earlier. The relatively modest increases in wages before 1972 helped to keep in check domestic inflationary pressures. However, the major factor contributing to monetary expansion has been the budget deficits. Apart from this, the rise in internal prices has usually reflected the increase in the price of imported manufactured goods and raw materials. High import prices have had a more immediate impact than the budget deficits on the domestic price level.

The inflation that has seriously affected Sri Lanka since the end of 1972 continues even today. External factors have been mainly responsible for the sharp price increases. The difficulty has been to isolate the domestic factors that have been instrumental in increasing prices as a result of inflation being imported. The impact of some factors are clear; for instance, the increase in the business turnover tax in the last two years on some items has pushed up prices. Due to the lack of reliable economic indicators it has been difficult to make a meaningful analysis of the inflationary pressures in recent years. Inflation has been aggravated by the acute shortage of foreign exchange and Sri Lanka has been compelled to maintain its import capacity at a very low level. In fact, an enhanced import capacity would have given considerable relief in the recent inflation. Despite this, Sri Lanka has been able to contain the increases in the prices of essential goods, for a long period, while price levels in other countries have progressively risen. This has greatly contributed to the stabilisation of real incomes particularly of those in the lower income brackets.

Since the sixties, the domestic price level showed three distinct tiers. One price level has been for essential items that come within the Colombo Consumers' Price Index; the only available instrument to measure price changes in the economy. The items that go into the Index have been normally heavily subsidised or generally been subject to price controls. Another price level has been for essential and semi-essential items which are outside or within the index, but are not subsidised or price controlled. The third price level has been for luxury items, which have normally fetched very high prices, due to the severe restrictions on their imports in the last 15 years. These high prices for luxury goods must not be associated with the general increase in all prices that has taken place in recent times. Inflation has been essentially the result of an increase in the domestic prices of goods that fall into the first two categories resulting from high prices of imports and the effect of the latter on the prices of domestic goods and services.

Since the middle of 1973 the government has put into operation a programme with a view to progressively eliminating the subsidy on certain categories of essential goods. Despite this, the government has not been able, in 1974, to eliminate the subsidy entirely because of very sharp price increases of essential foodstuffs, especially of rice and wheat flour in world markets. The major contributory factor in accelerating the pace of recent inflation has been the increase in the price of crude oil by the petroleum exporting countries. Although the bulk of the electrical energy produced in Sri Lanka is derived from hydro-power, yet petroleum products figure in a significant way in other uses, particularly in transportation, illumination and as a fuel. Domestic consumption of imported fuel consists largely of kerosene and automobile diesel. Kerosene is used largely as a source of illumination in the rural areas, while it is used for purposes of cooking in the urban districts. The most serious impact of the energy crisis has been on the balance of payments, where the foreign exchange required to maintain the import of some 1.7 million tons of crude oil required by the refinery has on a gross basis increased by nearly 400 per cent. The sharp escalation in the prices of petroleum products has had its impact on the price of fertilizer and insecticides used in plantation and domestic agriculture and also on raw materials for industrial use. The state industrial and public sector enterprises, which have had to maintain an adequate level of stocks of raw materials on account of foreign exchange difficulties, have had to import their requirements at very high prices. With the recent fall in raw material prices these corporations are faced with the difficulty of not being able to immediately pass on the benefit of these price decreases to the consumer.

Although there has been no comprehensive wage policy for the economy as a whole in the last two decades, considerable attention has been paid to fixing minimum rates of remuneration for all categories of employment. The trade unions in the country have also been instrumental in bringing in an increasing number of trades under minimum wage legislation. Many of the more important trades have come under Wages Boards; at the end of 1965 there were 27 Wages Boards; and in 1974 the number had increased to 35. Workers in Wages Board trades represent the largest group of workers covered by minimum wage fixing machinery. The numbers in these categories today exceed 900,000 and of this, approximately 600,000 are in the tea, rubber and coconut growing and manufacturing industries. Practically all employments today have some form of machinery for the determination of minimum wages and other terms and conditions of service. At the beginning of this period under review, minimum wages applied to less than ten categories of employment. Minimum wages have also been determined under Remuneration Tribunals and the Shop and Office Employees Act. Employments covered by these tribunals include hotel workers, employees in petrol filling stations, textile shops, the pharmaceutical trade and in lawyers' offices.

In recent years, the general policy has been to raise the wages of the lowest wage earning categories. In nearly all employments in the private and the public sector today, the lowest paid workers receive a monthly salary in excess of Rs. 200. Apart from the basic minimum wage, many employments provide a wide range of fringe benefits for workers which include a cost of living allowance, special risk allowance, superannuation benefits, free or subsidised travel, additional holiday and leave facilities with pay and payment for overtime. In order to narrow the gap between the highest income earners and the lowest, ceilings on expenditure have been fixed since 1973 and the present system of taxation has been effective in siphoning away expenditure in excess of the ceiling.

BANKING AND FINANCIAL INSTITUTIONS

A feature of the banking system of Sri Lanka before 1938 was that it was completely devoid of any major national bank. The banking business in the country was exclusively in the hands of expatriate institutions. The first phase in the structural change in the system came with the establishment of the Bank of Ceylon in 1938. Despite this, from 1938 to 1961, the banking system had a relatively simplified structure with eleven expatriate banks of British, Indian or Pakistani origin and one major Ceylonese bank. There was also the Co-operative Federal Bank which was the apex bank of the co-operative credit system. In the forties and fifties, even after the establishment of the Bank of Ceylon, Ceylonese customers did not find it easy to obtain credit. Upto 1960, the branch network was very small; the Bank of Ceylon had opened only 28 branches and most of them were located in the principal towns. Banking was essentially an urban enterprise, while the real need of productive credit was in the agricultural districts and in the villages. Structural changes of a significant magnitude in the banking system appeared with the establishment in 1961 of the second nationally sponsored commercial bank, the People's Bank, owned jointly by Government and Co-operative Societies which helped to open a new chapter in the banking history of this country.

Thereafter, particularly in the last 15 years, major changes have taken place in the banking system of Sri Lanka. The more important structural change has been the creation of a state sector in the banking system, by the establishment of the People's Bank in 1961 and the nationalisation of the Bank of Ceylon in the same year. The number of foreign banks, the mainstay of the system in the pre-war years and in the forties and fifties, has decreased through a process of consolidation and amalgamation. The two state-controlled indigenous banks have between them established more than 450 branches in the last decade. The great majority of these have been in the rural areas. The progress achieved in branch banking, particularly since 1965, is an indication of the tremendous potential that exists for the extension of banking services in the country. Banking today is no longer confined to urban areas and there are more banks in the rural districts than in the towns. In addition to the branches of the commercial banks, there were 332 rural banks dispersed all over the country at the end of March 1975. Although they are technically not branches of banks, and do not fall into the category of commercial banks, they perform important banking services in areas where domestic agriculture predominates. If the rural banks are also taken into account there is approximately one bank office for every 16,000 of the population as against one branch office for 166,000 of the population in 1960 and for 300,000 of the population in 1950. In April 1975, the commercial banks together, had over 1 million accounts, which means that about 9 per cent of the population have banking accounts. At the same time the National Savings Bank had over 4.5 million savings accounts, or one savings account for every 3 persons in the country.

Major changes have also taken place in commercial banking policy. Since 1960, the banking system has been progressively transformed from a foreign trade oriented system to one which is better equipped to finance a wide variety of new indigenous enterprises in agriculture, manufacturing and the services. Before the fifties, practically all the credit was given for export-import business by the foreign banks which were known as exchange banks. Today, an increasing portion has been flowing into domestic agriculture as production credits. Banks have also provided a good part of the working capital for new industries and provided the finance for the creation of the infrastructure for tourism. The unit banking organisation of the thirties and forties has given way to branch banking and the latter has increasingly facilitated the diversification of banking business.

The foreign banks in Sri Lanka, particularly the number of British owned institutions, have decreased in the last decade. Two old exchange banks have given way to successor institutions with a majority of domestic shareholdings, while a certain element of expatriate control remains in these institutions. In 1969, the Eastern Bank, an old established exchange bank ceased to function and a newly constituted commercial bank, the Commercial Bank of Ceylon took over its assets and liabilities. The former Eastern Bank was a fully owned subsidiary of another exchange bank operating in Sri Lanka, the Chartered Bank. The Eastern Bank now holds 40 per cent of the share capital of the Commercial Bank of Ceylon, state corporations hold 30 per cent of the shares while citizens of Sri Lanka hold the other 30 per cent. A small indigenous bank, the Hatton Bank, established in 1933 as a subsidiary of an European firm, was absorbed in 1970 by the newly formed Hatton National Bank, owned by a Ceylonese owned Company the National and Grindlays Bank (now known as Grindlays Bank) and by citizens of Sri Lanka. In 1974, the Hatton National Bank purchased the business in Sri Lanka of the Mercantile Bank which was one of the oldest exchange banks in the country. The reconstitution of some exchange banks into indigenous institutions has been due to the interest taken by the Government, the Central Bank, local banks and foreign private banking interests to gear the system to cater to domestic needs and to take advantage of the potential for expanded banking services in Sri Lanka. The structural changes and the reorientation of policy had become necessary in view of the increasing emphasis on agricultural development after 1960 and the transformation of the rural economy from subsistence orientation to commercial production.

Apart from the changes in the commercial banking system, several financial institutions have been reorganised. The most notable of these has been the amalgamation of the Post Office Savings Bank, the National Savings Movement and the oldest savings institution in the country, the Ceylon Savings Bank, to form the National Savings Bank. The National Savings Bank is now the premier savings institution, controlling more than 40 per cent of the savings in all financial institutions. The National Savings Bank has opened several branches in the country with a view to the greater mobilisation of deposits. It offers a higher interest rate than commercial banks on savings deposits and within specified limits the interest earnings are entitled to fairly generous tax rebates. At present there is keen competition for deposits between the National Savings Bank and the commercial banks, which has induced the latter to progressively raise their own rates on savings deposits.

In 1956, the Development Finance Corporation of Ceylon was set up mainly with a view to financing new medium and long-term investment in the private sector. In addition, changes in policy have taken place in other leading financial institutions such as The Ceylon State Mortgage Bank and The Agricultural and Industrial Credit Corporation of Ceylon where the loans have been increasingly geared to development purposes. These two institutions will shortly be absorbed by the State Mortgage and Investment Bank which is to be established. The Employees' Provident Fund was established in 1958 and its object was to provide provident fund benefits to all categories of employees. Since its establishment, the coverage of the Fund has been progressively increased and of a total workforce of about 5.4 million more than 4 million have come within the Fund. In 1961, the state owned Insurance Corporation of Ceylon commenced business and transaction of new life business by private insurance companies was terminated. From 1964 onwards the Corporation has had a monopoly of all types of insurance business including motor, marine and fire in the Island.

THE TAX SYSTEM

Far reaching changes have taken place in the tax structure in the last two decades. These changes have made a significant contribution to resource mobilisation by bringing in additional revenue to meet increasing budgetary expenditure and have also contributed to the progressive reduction in income disparities. In fact, taxation has eroded the wealth of those in the highest income brackets. Before 1954, government derived tax revenue mainly from customs duty, import and export duties, excise duties, income tax, estate duty, stamp duty and licence fees on motor vehicles. In this period the tax system did not directly contribute to the diffusion of wealth because the only tax that reduced wealth was the estate duty. After 1956/57, fairly extensive changes were introduced in the tax system and several new taxes were made operative, often for short periods of time. Between 1956/57 and 1966/67 the Inland Revenue Department has had to administer no less than 11 to 21 new taxes at any one time.

Although attempts were made to gear the tax structure more closely to the objectives of development, constant changes in the pattern of taxation were made necessary largely because of the need to raise additional revenue on account of the exigencies of the financial situation. Government had to constantly find additional resources to meet the heavy outlays on welfare services. In fact, throughout the years, expenditure on welfare has exceeded the capital outlays in the government budget.

The wealth tax introduced in 1956 has been instrumental in reducing the concentration of wealth in the hands of individuals. Another tax which has tended to reduce the size of wealth holdings has been the gift tax, which is on a graduated scale and is integrated with estate duty. With the budget for 1970/71 government introduced further tax measures to reduce wealth. One such measure is the capital levy on wealth tax payers on a once and for all basis. Another recent tax that has brought in a considerable amount of revenue is the business turnover tax, where the rates of taxation vary from commodity to commodity. With the diminution in importance of customs duties (especially import duties) as a major source of government revenue the turnover tax was increasingly used to augment government revenue. Basic essentials carried little or no tax while the tax on certain luxury items exceeded 30 per cent. With a view to streamlining collection and increasing the coverage of tax payers the Department of Inland Revenue was decentralised and regional offices set up in the districts. In addition, a Pay-As-You-Earn Scheme became operative in 1972 and was followed by a scheme of self-assessment.

BALANCE OF PAYMENTS & TRADE

For more than a decade the acute shortage of foreign exchange has acted as a serious setback to the country's development effort. Sri Lanka's foreign exchange difficulties emerged for the first time in the late fifties. Before this, the country was able to utilize the foreign exchange earnings from the "Korean boom" of 1950/51 and the tea boom of 1954/56 to maintain an adequate level of imports. From 1956 onwards external assets have steadily declined. Since 1957, with the exception of 1965, Sri Lanka's current payments to the rest of the world have exceeded current receipts. Between 1957 and 1960, the primary cause of the balance of payments deficits was the tendency for import demand to exceed import capacity, which had been considerably impaired since the end of the tea boom by a sharp fall in export earnings. The excessive import demand was in turn largely due to expansionary budget deficits.

One of the major secular factors behind the adverse payments situation has been the unfavourable prices paid for Sri Lanka's main exports. Both tea and rubber prices, have on the average, been at exceptionally low levels in the last two decades. In fact, if earnings of exports are presented in terms of constant SDR values, export earnings today are considerably less than the corresponding levels of export earnings in the early fifties, despite the fact that production of all export primary commodities have gone up appreciably. For example, between 1947 and 1970, although the export volume of tea increased by 60 per cent the value increased by only 10 per cent. This in fact reflects the depressed prices for the product in the world markets. From 1960 onwards increased volume of tea exports have to some extent helped to offset losses in earnings from lower export prices; but despite this, foreign exchange earnings have fallen sharply. For rubber as well, increases in the volume exported rather than prices have contributed to higher export earnings throughout this period. Rubber prices were heavily depressed in 1956/57, 1962, 1964 and again in 1967/68, when prices reached the lowest levels. The only exception to this general trend was in 1951 and in 1974 when prices rose sharply. In the case of coconut products there have been both price and quantity fluctuations. While the export volume of coconut has generally shown a secular decreasing trend, particularly since 1964, yearly fluctuations in the export volume have been significant. However, unlike in tea and rubber, the fall in export volume of coconut has to some extent been offset by increasing prices, particularly in 1957, 1969, 1970, 1973 and 1974, where although the volume fell sharply, higher prices enabled earnings to be maintained at satisfactory levels.

The impact of depressed export prices and high import prices on the balance of payments and the economy as a whole is seen in the terms of trade which reflect the purchasing power of the country's exports and which have progressively deteriorated over the years. Between 1962 and 1964, the terms of trade fell from 142 to 105 and between 1965 and 1969, fell from 112 to 88. In 1974 it had fallen further to 58. The increase in the volume of exports in this period was inadequate to offset the loss in foreign exchange earnings resulting from the decline in the terms of trade. It also reflects the problems that Sri Lanka has had to face in its endeavour to maintain certain minimum physical quantities of imports, especially from the point of view of the minimum requirements of imports for accelerating development.

One of the many factors that have contributed to the worsening of the terms of trade has been the very high prices payable by Sri Lanka for her imports. Moreover, in the last decade the country has had to face successive increases in freight rates; since 1973, high fuel costs have added further momentum to these adverse developments. Another reason for the deterioration of the terms of trade has been the poor prices fetched by two of Sri Lanka's major exports particularly tea and rubber. Some element of relief came in 1974 when both tea and rubber fetched good prices. The natural rubber industry in the country has had to contend with increasing competition from synthetics, as well as uncertainties created by the stock-piling policy of the major buyers. Furthermore, in the last decade Sri Lanka has become heavily dependent on foreign credits to finance a substantial proportion of its import requirements, such as foodstuffs and raw materials. Higher prices had invariably to be paid for imports obtained on credit or such aid arrangements. With the increase in oil prices by the Organisation of Petroleum Exporting Countries, import prices have further escalated and in 1974, Sri Lanka paid the highest prices for her imports within living memory.

The deficits in the current account of the balance of payments which occurred from 1957 to 1960 were not burdensome to Sri Lanka's economy, because of a sizeable buffer of external assets accumulated in the preceding years. However, by 1960, it was evident that the liberal trade policy maintained by Sri Lanka throughout the fifties could not be sustained. At the end of 1956, external assets were Rs. 1,194 million and by 1960 these assets had been drawn down to the rock bottom level of Rs. 457 million, mainly as a result of import payments appreciably exceeding export earnings. Roughly from 1960 onwards, a carefully planned balance of payments policy had become a necessity. Thereafter higher tariffs were imposed and physical controls on imports and foreign exchange were extended and tightened. These controls have continued up to this day. However, with regard to imports, there was a brief period of liberalisation under the Foreign Exchange Entitlement Certificate Scheme from May, 1968 up to August, 1970.

Despite these stringent controls, external assets continued to decline from 1961 to 1964, although at a slower rate. The sharp decline in external assets in the five years preceding 1965 compelled the country to have increasing access to credit tranches from the International Monetary Fund. In order to give support to the corrective measures adopted to improve the balance of payments position, the Central Bank employed monetary methods of import control in 1960. As already indicated, this policy did not produce the results that were anticipated and other measures had to be taken. In order to provide support for a balance of payments policy, the Central Bank since 1961 has had a scheme of special reserve requirements of 38 per cent in addition to the statutory minimum reserve requirements. The special reserve requirement was withdrawn in April 1975, when ceilings were applied on Central Bank credit to commercial banks. In addition, since 1965, the Bank has maintained ceilings on bank credit to the private sector. Bank rate was raised progressively on four occasions from $2\frac{1}{2}$ per cent in 1965 to $6\frac{1}{2}$ per cent which is the present rate. Meanwhile on the advice of the Central Bank, the government bond rate was increased from $3\frac{1}{2}/4$ per cent in 1969 to 9 per cent per annum which is the present rate.

A series of exchange rate adjustments have also been effected. The rupee was devalued by 20 per cent in 1967 and the Foreign Exchange Entitlement Certificate Scheme with appropriate monetary measures was introduced in 1968. The Foreign Exchange Entitlement Certificate Scheme amounted to an additional tax on a wide range of foreign exchange payments and gave a premium for certain types of foreign exchange receipts. The object of the scheme was to provide incentives to selected exports and invisible earnings and to impose an additional rupee cost on selected imports and invisible payments. With the inauguration of the Scheme in 1968, although the prices of Certificates were initially to be determined by market forces to be reflected in tender prices of Certificates offered weekly, the Central Bank decided to fix the price at Rs. 44 per Rs. 100 worth of Certificates. The price was increased to Rs. 55 and subsequently to Rs. 65 which is the present price. Under this premium exchange rate many producers of non-traditional products and of minor export crops were able to push sales in markets abroad. The scheme resulted from the realisation that the severe regimentation of the country's foreign exchange transactions and the continued decline in the volume of foreign exchange earnings had considerably retarded the ability of industry and other productive economic activity to exploit existing capacity to the fullest possible extent.

It was felt that a liberalisation of imports, particularly of industrial and agricultural raw materials at a price approximating closely to the scarcity value of foreign exchange would enable the more efficient and more dynamic industries of the economy to increase output. It was also felt that producers of many non-traditional exports, particularly industrial goods, which were sufficiently competitive in export markets, could not export because they were handicapped by the smallness of the raw material allocations under the rigid quota system that had prevailed earlier. In particular, the minor agricultural export sector had for some time found it increasingly difficult to export at profitable prices and this factor had limited or reduced the attractiveness of increasing investment in these industries. It was also recognized that at the prevailing exchange rate there had been a considerable diversion of foreign exchange resources into the blackmarket. The blackmarket in fact emerged as a result of the severe controls that had been a feature of Sri Lanka's external transactions for more than a decade earlier.

In the last decade, Sri Lanka has depended increasingly on external resources for financing the progressively increasing foreign exchange gap. Before 1960, the country largely utilized its external assets to meet its foreign liabilities, and only about 1/5th of the reserve gap was covered by the inflow of foreign capital. Project aid annually up to 1960 had not exceeded Rs. 23 million, while grants constituted the major part of total aid. From 1960 onwards, there has been a marked increase in the size of the resource gap and from 1965 the gap has been financed largely by aid made available by a consortium of donor countries. The external resource gap rose from Rs. 541 million in 1966 to Rs. 649 million in 1968 and to Rs. 1,325 million in 1969. In 1970 the resource gap decreased to Rs. 1,224 million and rose again to Rs. 2,516 million in 1974. In the last 15 years, since external assets could no longer be used as the main source of financing deficits, increasing recourse was made to other sources. As a means of financing the gap, drawings from the International Monetary Fund were made in each of the years 1961, 1962 and 1965. Approximately one fourth of the foreign deficits during these years was financed by such drawings. Project aid, grants, private capital and short-term credits were the other methods.

The increasing recourse to foreign aid has resulted in the accumulation of a substantial foreign debt. In the last 10 years, Sri Lanka has not only had to cope with problems arising from continuously adverse terms of trade, but also with problems which have been the outcome of a large foreign debt. For the first time, in 1969, foreign borrowings from commercial banks on a substantial scale were utilized to finance the resource gap. Since 1965, these together with International Monetary Fund drawings, suppliers' credits and short-term credits have provided nearly three fifths of the financing, while commodity aid has largely provided the rest. Under the exceptional circumstances prevailing in 1974, as foreign aid and credits from the usual sources were inadequate, there was extensive recourse to assistance consisting of credits from the International Monetary Fund, the oil exporting countries and the use of balances lying in Sri Lanka's favour under bilateral trade and payments agreements.

In the last two decades the direction and pattern of trade has undergone change. In the period before 1950 the main market for exports and imports had been the United Kingdom. Today most markets for the country's produce have been found in the European countries, in Australia, the United States of America, the socialist countries and in the Middle East. These new trading arrangements have helped to diversify Sri Lanka's export markets considerably. Similarly imports are being obtained from a large number of countries including the socialist countries of eastern Europe. Sri Lanka's trade with the socialist countries upto the early fifties was practically non-existent. Apart from the change in the direction of trade, there has been considerable diversification in the composition of exports. Non-traditional products have progressively obtained a greater share of exports.

Sri Lanka concluded several bilateral trade and payments agreements in the fifties and sixties with countries such as the People's Republic of China, the Union of Soviet Socialist Republics, Middle Eastern countries and the socialist countries of Europe such as Poland, Rumania and Bulgaria. Since the favourable balances accumulated in Sri Lanka's favour under these agreements could not always be readily utilized, from 1974 onwards, most of these agreements have been replaced by trade agreements payable in convertible currency.

DIVERSIFICATION OF EXPORTS

The composition and pattern of exports of Sri Lanka have undergone considerable change particularly in the last 10 year period. The value of non-traditional exports which averaged around Rs. 115 million in the period 1950—1965, started rising sharply from 1958 onwards. By 1971 non-traditional exports had reached Rs. 200 million, and further increased to Rs. 230 million in 1972 and to Rs. 952 million in 1974. The sharp increase between 1972 and 1974 was due to the appreciable increase in the price of refined petroleum products which are now a major non-traditional export. Non-traditional exports were less than 10 per cent of total exports in the period before 1970; today they amount to about 27 per cent. These include not only minor agricultural exports such as cardamom, cinnamon, pepper, cloves and nutmeg, but also a wide range of industrial goods, gems and petroleum products such as bunkers, marine diesel and furnace oil. The increase in non-traditional exports reflects not only the production of new manufactured goods but also a certain element of diversification in production and export of agricultural commodities.

Tourism has today become a fairly important source of foreign exchange to Sri Lanka. The increase in tourist arrivals and the resultant rise in the foreign exchange earnings from Rs. 10 million in 1968 to Rs. 95 million in 1974 reflects the potential for its further development as a non-traditional export. In 1966, the Ceylon Tourist Board was established as a state corporation and was entrusted with tourist promotion and development. Up to the year 1967, tourist traffic to the country fluctuated around 19,000 arrivals per year and earnings were more or less stagnant. Since then, tourist arrivals have progressively increased reaching about 85,000 in 1974. The increase in traffic since then could be attributed to the promotional and organisational efforts of the Tourist Board and to the private investments that have gone into the industry.

At the end of 1974, total accommodation capacity available all over the Island exceeded 2,700 rooms. The Ceylon Hotels Corporation has been largely responsible for developing the smaller hotels and the old resthouses in the non-urban areas for the promotion of tourism. At present, most areas that have tourist resorts are well served with hotel accommodation. Particularly in the city of Colombo, the room capacities seem to be adequate to cater to the needs of the anticipated increase in tourist arrivals in the next few years. The bulk of the investment in the tourist trade has been by the private sector. A factor that has contributed to private investment in the construction of new hotels and the provision of related services has been the very handsome tax incentives which have been offered for new investments in tourism. The development of tourism has stimulated activity in the transport trade, in other ancillary services and revived many old handicraft industries such as woodwork, metal work and textiles.

A wide range of incentives has been offered for non-traditional exports. These include tax holidays on export profits, relief for investment in export projects, exemption from the business turnover tax and exemption of export profits from compulsory savings and from the ceiling on income. These tax incentives have been further reinforced by the Foreign Exchange Entitlement Certificate Scheme since 1968. The latter scheme gives a premium rate of exchange for all exports other than tea, rubber and coconut. The Convertible Rupee Account Scheme, which came into operation in July 1972, has given a further impetus to exports. A certain proportion of the earnings from exports are permitted to be deposited in Convertible Rupee Accounts which could be utilized by holders for the importation of consumer goods, industrial raw materials, capital goods and for other specified forms of expenditure outside the country. The amount of foreign exchange earnings permitted to be deposited in convertible accounts varies with the nature of the export.

The Convertible Rupee Account Scheme gave the greatest push to the export of precious and semi-precious stones. Whereas for a decade before 1970 export of precious stones did not exceed Rs. 4 million, after 1973 exports rose to a figure in excess of Rs. 140 million. In 1974, exports fell to Rs. 110 million due to the recession in the industrial countries. With a view to promoting the gemming industry and the gem export trade, the State Gem Corporation was established in November, 1971. The Corporation's principal line of activity is to purchase and export gems and in this it competes with the private trade. The share of the latter is much higher than that of the Corporation. The Corporation has been instrumental, to some extent, in modernizing the gem mining and gem cutting industries by taking steps to train workmen and by providing facilities to procure modern equipment.

The structural change and diversification that has taken place in the economy in the last ten years provides a very favourable background for accelerated development in the immediate future. The economic planners in Sri Lanka are now looking for avenues through which a significant break-through could be effected in the development process. The economy must be in a position to generate new economic activities which will enable substantial import savings and will result in an increase in foreign exchange earnings. One such activity is the recent effort made by the Ceylon Petroleum Corporation in oil exploration in the north-western part of the Island. If the country is eventually able to obtain its own oil, this would mean a very substantial saving in the foreign exchange bill. Apart from this, a break-through in the food production effort may also be forthcoming through the Mahaveli River Development Scheme, the first stage of which is now nearing completion. With the diversion of the Mahaveli waters to the Dry

Zone nearly 100,000 acres of paddy land would be assured of a continuous water supply irrespective of weather conditions. This is likely to entirely change not only the cropping pattern in the Dry Zone but would also greatly conserve and augment existing water resources. With a view to diverting more resources to investment from consumption government continues to explore ways and means of further reducing consumer subsidies. Apart from these factors, another favourable development has been the decline in the rate of population growth. Even making allowance for immigration the rate of natural increase has fallen appreciably. There are clear indications that the present drive towards population control is having a fairly significant impact on economic conditions. Present trends show that a further substantial decline to a figure of less than 1.5 per cent per annum would be easily attainable before the end of the decade. The fall in the rate of population increase and the rapid implementation of development proposals should make a favourable impact on the balance of payments situation and should pave the way for a growth strategy which is not constrained by either a shortage of foreign exchange or by excessive controls which have stood in the way of the development of key sectors of the economy.