ECONOMIC SITUATION AND TRENDS

IN

CEYLON

A Programme of Reform

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The body economy, like the human body, is a living organism. The pulse, temperature, blood pressure, and pathological reports, help in diagnosing human ailments. The basic clinical data for locating economic ailments, and formulating remedial measures, are the trends in Production, Prices and the (Balance of) Payments – the three economic P's. Economic ill-health, wherever it may originate, must sooner or later get transmitted to Production, Prices and Payments. Equally, the economy's good health and progress must necessarily show up in the three economic P's. Evidence of economic and social progress will be reflected in the pace of expansion in Production, in Price stability and in a Balance of Payments equilibrium or surplus.

2. Correct diagnosis is half the cure in both economic and human ailments. To gain a correct assessment of the condition of the body economy, we may briefly review the present situation and trends in the three economic P's in Ceylon.

I. Production

3. National income statistics show that production has not progressed fast enough. From 1960-1965, real income rose at a meagre annual rate of less than 2 per cent. [1] Population grew more rapidly, the annual rate for the same period being 2.7 per cent. [2] Consequently, per capita income has been declining.

4. It is possible that the thin upper crust of top income groups have been generally able to maintain their consumption standards at undiminished levels of affluence [3] against this background of falling per capita income. This implies an even more rapid erosion of mass well-being than national income statistics suggest.

5. These developments are a serious matter in a democracy, especially in the context of two more or less evenly balanced party alignments, where the opposition is ever on the alert to capitalize on the errors or policy ill-effects of the Party in power. A major policy objective

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[1] Recent Economic Trends – Ceylon, World Bank, September 1966 p.8.

[2] International Financial Statistics , IMF , September 1996, P.74 ; and Recent Economic Trends – Ceylon , loc. cit. , p.v.

[3] A review of the data on consumption of luxury goods would provide evidence of this. The value of imports of bottled liquor in 1966 was Rs. 2 million (estimate) As against imports of the value of Rs. 1.72 million in 1965. Ceylon Customs returns, December 1965, pp.79-86; and August 1966 , pp.79-86

should be, therefore, to halt the decline in the living standards of the masses and to reverse this trend without delay.

6. Income being the financial counterpart of the production, declining per capita income implies declining per capita production. The latter, in turn, may be due to the working of two factors; first, a fall or decay in the capital equipment per worker and, secondly, an increase in unemployment; as unemployed workers make no contribution to the national product, increased unemployment would lower the national average output per capita, without necessarily lowering output per worker. Though we have no statistics of unemployment, the increase in the number of registrants at Employment Exchanges [1] suggests an increase in unemployment during the period under review. It is possible, therefore, that this factor may have made some contribution to the decline in per capita output.

7. The decline in per capita output from the other factor, namely, a fall or decay in the ratio of capital per worker may be more significant. Overall capital formation [2] declined by 13 per cent, from Rs. 1, 059 million, in 1959 to Rs. 924 million in 1965, or by 2.2 per cent, per year, in the context of a rapidly expanding population (Table I). To maintain the flow of production undiminished, capital formation should have grown at least at the same pace as population growth, namely, at an annual rate of 2.7 per cent; to permit the expansion of per capita income, capital formation should outpace the expansion of population. The decline in capital formation indicates that the resources gap - i.e., the difference between the quantum of capital necessary for maintaining an undiminished flow of output per worker and the quantum of capital actually available has grown overtime.

8. Viewing capital formation sectorally, it is most distressing that Transport, the lifeline and integrating factor of a modern economy has been the worst sufferer. The pace of capital formation here fell by about 60 per cent in 6 years; Transport in the private sector has suffered even more than these overall figures indicate. On the other hand, capital formation in the public sector improved at an annual rate of 5 per cent. The whole of the impact of decelerated capital formation, therefore, fell on the private sector. The damage of this arrangement to production, income and national well-being may be gauged from the fact that the contribution of the public sector to the national product -- apart from administrative expenditures – may be of the order of 10 per cent, while the private sector contribution may

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[1] Central Bank Annual Report, 1965 Table 44.
[2] Recent Economic Trends- Ceylon, op. cit., – p. 77.

be around three-fourths of the national income. It may be noted, too, that the average returns capital invested in the public sector have been low. [1] Thus, in the matter of resource allocation, the major national sector has been penalized and the minor sector – the public sector – has been rewarded.

9. The clay for capital formation is drawn from Saving, which is the sum of (i) currently generating domestic savings and (ii) imported savings in the form of foreign aid and private capital inflows. The decline in capital formation reflects a decline in this sum.

10. Balance of payments statistics show (Table II) that during the whole of the post-war period, private capital and savings have been, on balance, leaving Ceylon. The restrictions on remittances of savings and on capital transfers abroad, first imposed in 1957 and further tightened in 1960 and 1964, did not stop this trend. Remittances and transfers in excess of the permitted minima passed through the free market for foreign exchange. Foreign exchange to feed this market was drawn from the proceeds of under-invoicing exports, over-invoicing imports, and smuggling out Ceylon gems, other domestic produce, and manufactured consumer goods imported into Ceylon from abroad. Balance of Payments statistics show that the aggregate net remittances of savings and capital transfers abroad amounted to Rs. 1, 180 million during the 16 years ended 1965.

11. These capital outflows were, however, balanced by the inflows of foreign aid on a government - to- government basis, comprising grants and loans, such inflows amounting to Rs. 1, 200 million, during the same period (Table II). But this is only a statistical balance. It is not safe to assume that the erosion of capital resulting from private capital outflows was compensated by the inflows of foreign aid. The grants part of aid, which is credited to Revenues, financed public consumption. The loans part of it added to capital formation in the public sector, much of it being used extravagantly or otherwise misallocated. The damage done to capital formation in the private sector from capital exports remain largely unrelieved.

[1] The average profits of 17 State Corporations in 1965 was 3.3 per cent . On the other hand , Government Enterprises (Railway, Electrical department, Port , Harbour and warehousing, Post and Telecommunication and Broadcasting) have been working at heavy loss. See Central Bank Annual Report, 1965, Table II B b.2, p.54 and Recent Economic Trends – Ceylon, op.cit. , Table XIII, p.82

12. Balance of Payments Statistics, moreover, do not present a complete picture of private capital outflows. Unrecorded capital exports, which cannot fall within the net of the balance of payments statistician, have been taking place through the free market in foreign exchange on a scale which it is not possible to assess. We have no indicators, direct or indirect, of the magnitude of this traffic. If so, looking to the post war period as a whole, the net outflows of private capital have exceeded the net inflows of foreign aid on official account.

13. Statistics of national savings as a ratio of G.N.P show a decline from 13.6 per cent in 1959 to 10.7 per cent in 1965 (Table III). This would seem to reflect the accent on consumption in the prevailing economic set-up in Ceylon, a major contribution to it coming from fiscal operations, more basically, the socialist policies, involving consumption subsidies. Revenue collections in Ceylon represented about 24.6 per cent of national income in 1964-65 (Table IV). The expenditures on food subsidies, direct relief payments and social services (education, health, housing and special welfare services) amounted to Rs. 829.5 million, or 45.7 per cent of Revenue collections. These subsidies correspondingly increase the real consumption of the recipients without increasing their real output. They have, therefore, a debit effect on national savings.

14. In a poor economy, where the flow of national savings [1] is meagre, there is great need to conserve and stimulate savings, rather than stimulate consumption, if we wish to have a rapid enough increase in production, income, employment and mass well-being. Political statesmanship demands resistance of the immediate electoral gains -- which, in any case, cannot last indefinitely in the context of decaying capital formation – from consumption subsidies in preference to the lasting and long-term advantages of placing the national economy on the right road to progress through strengthening its capital base.

15. This suggests the importance and necessity of reducing or eliminating the subsidies through a phased programme of charging a price in such sectors of subsidised consumption as

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1 Rate of Saving (gross domestic investment as % of GNP) of Some Countries

Australia	29.3%
Canada	24.7%
West Germany	23.5%
Japan	27.5%
U.K.	14.8%
U.S.A.	28.7%

Source: In the case of U.S.A., Statistical Abstract of the United States, 1964, pp. 321 & 334 . In the case of other countries, Growthmanship, by Colin Clark, Table VI, p.47.

may bear the incidence of a price without causing under hardship. We have evidence to show that even in affluent economies like U.K.national progress is slipping back as a result of the heavy weight of the capital consumption, which the policy of subsidised services necessarily involves. Poorer economies, which are struggling to develop, can ill afford to follow the bad example of U.K.and other "welfare" states.

16. To summarise this review, Per capital production, in recent years, has been dangerously on the decline. This has been due to the decay in the national average of capital formation per capita, more especially in the private sector, which latter contributes about 75 per cent of the national product. The decay in capital formation is related to the continued and heavy exports of private savings and private capital. This capital decay has remained largely unrelieved by the inflows of government-to-government foreign aid. The grants part of this aid has subsidised consumption. The loans part of it has gone into public sector capital formation, much of it being misallocated or wasted. Nor has national savings been able to stop capital decay. National savings have been on the decline. The decline of savings is largely the outcome of the prevailing accent on consumption in the economic set-up, a major contribution coming from the socialist policies of distributing to the entire population certain economic services and goods free of charge or at much below cost, the incidence of this being borne by the national Revenues. This has necessarily involved conversion of national savings into national consumption via the agency of fiscal operations.

17. To achieve true socialist progress, i.e., to realise a rapid enough increase in production, income and mass well-being, the decay in per capita capital formation must be stopped and reversed without delay.

18. The biggest single problem on the Production front is shortage of national savings.

II. Prices

19. Being without statistics of general prices, we have no direct data of the inflationary situation and trends in Ceylon. The Cost of Living Index does not seem to present the full picture of the extent of price inflation, especially, since recent years. It is more than likely that this Index is vitiated by controlled prices, which deviate by a lesser or larger margin from free market prices in the case of virtually all commodities and services.

20. To finance an expanding national product at constant prices, money supply must expand at the same pace as the national product. [1] Any acceleration of money supply beyond this rate may be inflationary. Applying this criterion to Ceylon, during the six year period 1960 to 1965, money supply moved well ahead of the requirements of the national product (Table V). The former rose by 46 per cent and the latter lagged behind with a rise of about 20 per cent. We may say, therefore, that, as at the close of 1965, inflationary pressures in Ceylon rose by 26 per cent over the position in 1960. This brings out the unreliability of the Cost of Living Index as a measure of inflation. It showed a rise of but a little over one per cent per year during the decades ending 1965.

21. Relating expansion of money to the national product, we find that the current phase of inflation began around 1957. Since then money supply has grown, with short-lived breaks, faster than the national product. The largest increase in inflationary pressures during this phase took place in 1963, the addition to the money supply during the year being Rs. 163 million. Thereafter, the pace of inflation slowed down each year, the expansion of money currently being at an annual rate of Rs. 70 million.[2]

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[1] This statement ignores that, in a set up of expanding per capita income and price stability, the cash balances requirements of the public would grow commensurately. In such a context, to maintain price stability, the expansion of money must proceed at a somewhat faster pace than the national product to provide for the increase in the cash holdings of the public. Under conditions of a slow pace of expansion of the national product and price inflation, as in the case today in Ceylon, this factor, making for an increase in the cash requirements of the public, may not be quantitatively pronounced, especially over short periods.

[2] Central Bank Annual Report, 1965, Table 1, and Central Bank Bulletin August 1966, p. 16

22. In under-developed economies, ordinarily, inflation ensues from budget deficits. Inflation in these countries though credit creation by commercial banks is generally an off-shoot of deficit spending by the government, so that, if the budget tap is dry, the banking tap may be dry, too. The minor role of commercial bank contribution to inflation is the result of two factors. First, the bulk of the monetary circulation in under-developed countries being currency notes - currently, currency notes account for over 50 per cent of the total monetary circulation in Ceylon [1] - the credit creating capacity of commercial banks is limited. Secondly, capital in these countries being scarce, surplus reserves and excess liquidity of commercial banks in them is not, more generally, of an order to permit significant expansions of lending. The other possible sources or inflation, namely, expansion of money through balance of payment surpluses or through activation of latent inflation are but maters of academic interest, though they had practical relevance during the war and the immediate post-war period, respectively. In current discussion, these sources of inflation are of no relevance. Currently, as in other under developed countries, budget deficits constitute the tap root of inflation in Ceylon.

23. In Ceylon usage, the term "Net Cash Operating Deficit", stands for the excess of the aggregate governmental outlays (whether charged to Revenues or to Capital receipts) over aggregated Revenue collections. The Net Cash Operating Deficit is financed in two ways: first, by appropriating foreign aid and voluntary domestic savings of the public and, secondly, (i) by borrowing from the Central Bank and commercial banks, (ii) by using up U.S. aid counterpart funds in rupees, and (iii) by drawing down the Cash Balances of the Government. The first method of financing is loan financing of budget deficits and is non-expansionary. It does not involve additions to the monetary circulation. No additions to the money supply take place when the savings of the people are claimed by the government to finance its outlays; such operations merely shift moneys from the pockets of the savers into the pockets of the recipients of government disbursements. In their final analysis, foreign aid funds add to the supply of goods, not the supply of money. [2]

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[1] Central Bank Bulletin, August 1966, p. 16

[2] B.R. Shenoy, Indian Economic Policy, Bombay, 1967, Chap. III

24. The second method of deficit financing, however, involves expansion of Central Bank money. [1] This is obvious when deficit financing is effected through Central Bank borrowing either as Ways and Means advances or against sales of Public Debt to the Central Bank. In either case, equivalent Central Bank money gets issued into circulation. The same and result emerges when Public Debt is sold to commercial banks. The latter pay for them in Central Bank money held in their reserves and deficit financing, then, causes the issue of such money into circulation. Central Bank money gets issued into circulation, too, when budget deficits are covered by drafts on Cash Balances. In examining the impact of fiscal operations on money supply, our primary concern is the second method of financing the "Net Cash Operating Deficit".[2]

25. We have, then, a measure of the expansionary effects of budget deficits in the sum of (i) the increase in the Public Debt (including Treasury Bills) held by (a) the Central Bank and (b) commercial banks,3 and (ii) the depletion of Cash Balances.

26. On this basis, expansionary deficit financing in recent years has remained at a high level. This deficit reached a peak of Rs.287 million in 1959-60. During the following four years, it declined steadily and dropped sharply in 1964-65 to Rs. 61 million (Table VI).

27. Relating these budget deficits to the expansions in money supply we find however, that the expansions of money supply are not commensurate with the statistics of expansionary budget deficits. In 1959-60 , when the budget deficit had reached its peak, the expansion in money supply was the lowest for the years under review, being but Rs. 29 million. The increase in money supply had been generally lower than the figures of expansionary budget deficits.

28. This is contrary to logical expectation. Expansions of money supply should be larger than budget deficits, as to the direct increases in money supply from such deficits should be added the amounts of secondary expansions of money by commercial banks which ensue from deficit financing by government. An explanation of this phenomenon, however, would

[1] Except when such financing relates to the appropriation, for us in the public sector, of External Assets. See footnote (1) on page 9, below.

[2] In Indian usage, the terms "Budget Deficit" and "Deficit Financing " apply to this part of fiscal operations.

[3] This sum, it will be noted, does not expressly include U.S. aid counterpart funds. If these funds come into being in the same way as P.L. 480 counterpart funds in India, the amounts of the drafts on counterpart funds, for assessing the magnitude of the expansionary part of the budget deficit, would be covered in the government debt holdings of the banking system and, therefore, do not need to be entered separately in assessing the magnitude of deficit financing; to do this may be double counting. C.f <u>Recent Economic Trends</u>, op.cit., Table 13, p.82.

call for a closer review of the fiscal, banking and monetary statistics than is necessary for our immediate purposes.

29. It is possible that the statistical budget deficits include non-expansionary borrowings from banks. This may happen when foreign exchange in external assets are acquired for use in the public sector against debits to Cash Balances or against issues of treasury bills or other public debt [1] to the Central Bank. These operations do not involve any issue of money by the Central Bank, though, in budget accounts, they would appear as deficit financing. Trends in the relative expansions of currency notes, demand deposits an savings deposits indicate the possibility, too, that some of the increases in money supply ensuing from deficit financing may have leaked into the savings deposits of commercial banks as an effect of the tax on current account debits in terms of the Bank Debits Tax Act, 1957.

30. The need for clarifying these rather technical issues apart, inflationary expansions of money in Ceylon stem, directly or indirectly, from budget deficits. In the prevailing economic context, such expansions cannot take place from the other possible inflationary sources indicated above.

31. Budget deficits are not due to Revenue collections falling short of expenditures charged to Revenue. In the post-war period, aggregate Revenue collections have generally remained ahead of aggregate Revenue expenditures. From 1958-59 to 1965-66, Revenues rose by about 45 per cent; and expenditures charged to Revenues by about 48 per cent. Nevertheless, Revenue collections have been larger than expenditures drawn from Revenues, so that the Revenue part of the budget yielded a steady surplus of an order of Rs. 80 million, per year. [2]

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[1] When external assets are acquired by public sector enterprises or corporations, the Central bank being paid for them in either debits to Cash Balances or in government debt, there will be not additions to the monetary circulation, though, in the budget accounts, such financing of the purchases of external assets would be classified as deficit financing. When external assets are purchased by debits to Cash Balances, the Assets as well as the Liabilities of the Central Bank will remain unchanged, as here external assets in the Central Bank will be replaced by rupee assets. In either case, there will be no issue of money into circulation.

[2] Central Bank Annual Report 1965, Table 20.

32. Expansionary budget deficits have emerged wholly from the Capital part of the budget (Table VII). The Capital outlays have kept ahead of capital account receipts.

33. The bulk of the capital outlays are under "Economic Services" and "Government Enterprises" (Table VIII). The two together accounted for an annual average of about 74 per cent of the capital outlay during the period, 1960-61 to 1965-66. The rest of the capital outlay is on "Administration" and "Social Services". Government Enterprises comprise Railway Department, Electrical Department, Department of Posts and Telecommunications, Department of Information and Broadcasting, and the Colombo Port Commission [1], and Economic Services comprise Agriculture and Irrigation, Fisheries, Manufacture and Mining, Trade and Communication. Agriculture and Irrigation, Government Enterprises, and Communication may be deemed basis services, which private enterprises may not immediately undertake. But Fisheries, Manufacture and Mining, and Trade are not normal governmental activities. Capital outlays on them amounted to an annual average of Rs. 75 million during the six-year period ending 1965-66. The annual overall budget deficit of the same period was Rs. 152 million. During the past three years (1963-64 to 1965-66) on this part of "Economic Services" the annual average capital outlays (Rs. 103.0 million) exceeded the annual average overall budget deficit of the same period (Rs. 101.6 million)

34. The Revenue part of the budget has been much larger than the Capital part. Excluding payments under "Government Enterprise", which are not drawn from Revenues but from receipts under the corresponding heads shown in the current account receipts side of the budget, the Revenue part of the budget has been, on an average, in recent years over double the Capital budge, or was about two thirds of the total budget outlay. Food subsidies, Other Director Relief payments and "Social Services' accounted for the bulk of Revenue payments (Table IX). The three together represented an annual average of over 54 per cent of the Revenue payments during the six years ending 1965-66. The rest of the payments

[1] Central Bank Annual Report, 1965, Table 17, note j. Public Sector undertakings comprise "Government Enterprises", defined above, "State Corporations", Departments providing "Economic Services" (see Central Bank Annual Report, 1965, Table 20) not included elsewhere, and "State Sponsored Companies" (See Ferguson's Ceylon Directory, 1966, p. 269). State Corporations, of which there are 19, and State Sponsored Companies, of which there are 6, come under the Ministry of Industries and Fisheries.

were under Administration, Defence, Economic Services, Interest on Public Debt, Pension and grants in aid to Local Authorities. These items together absorbed, on an average about 44 per cent [1] of the Revenue payments, per year, during the six years, 1960-61 to 1965-66.

35. Food subsidies alone averaged, during the same period, about Rs. 274 million and represented about 19.2 per cent of the average Revenue payments, per year. Food subsidies and other Direct Relief Payments amounted to an average of Rs. 317 million, per year, or 22.2 per cent of Revenue payments. Food Subsides and other Direct Relief Payments, however, do not constitute the entire consumer subsidies. To the same category belong the expenditures shown under "Social Services". The latter include, Education, Health, Housing and certain Special Welfare Services. [2] Education and Health services are provided free of cost to beneficiaries, i.e., apart from the burden of taxation, which finance these services. The subsidies on Housing and the Expenditures on Special Welfare Services. The subsidies on Housing and the Expenditures on Special Welfare Services, though still small, have been galloping ahead; in a decade, their budget cost went up by over 4 1/2 times. In the current year, these subsidies and expenditures amounted to Rs. 9.0 million.

36. Inflation in Ceylon cannot be controlled without balancing the Budget. As prima facie logic and empirical evidence have repeatedly demonstrated, any attempt to control inflation by restrictive measures on the expansion of commercial bank credit must necessarily lead to frustration and to a chaotic disarray of the factors and forces in the market for credit, [3] which must impinge adversely on the national product. The problem of flood control cannot be tackled by restricting the flow of water down the canals.

37. Statistically speaking, the Budget may be balanced through appropriate discipline in respect to capital account outlays, as the Revenue part of the Budget has invariably shown a surplus, and the overall Budget deficit has been wholly due to capital account expenditures running ahead of capital account receipts. Capital account outlays ensue from the need to maintain and expand the capital stock and capital resources of public sector undertakings.

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[1] See Note to Table IX below.
[2] See Central Bank Annual Report , 1965, Table 20
[3] For a brief review of the effects of selective credit control in India see Shenoy, op.cit., Chap III.

38. It is, clearly, not practical policy to put a stop to capital expenditures in these undertakings; or even in a selection of them to yield sufficient economies in such expenditures to permit balancing the Budget. Public sector undertakings are organically integrated with the rest of the body economy. The demand of the community for their output (or for any selection of this output) cannot be commanded to stop growing. In the context of a rapidly rising population, the output of electricity, irrigation water, basic transport and communication services, school buildings, fertilisers, cement, footwear, ceramic production, salt and so on, [1] must keep rising, too. A primary policy objective is to help expand production. Freezing capital outlays would conflict with this objective.

39. But any freezing of capital expenditures is unnecessary for balancing the Capital part of the Budget. As a general rule, governmental undertakings are run at lesser efficiency and larger factor cost than similar undertakings of private entrepreneurs. This is the experience not only in Ceylon [2] but also virtually everywhere, especially in underdeveloped economies, where (in addition to the more normal weaknesses of civil service management of business and industrial enterprises) pressures for employment operate unduly on politicians and incompetent people tend to occupy managerial positions in public sector undertakings. We have seen that public sector undertakings in Ceylon include activities which do not fall within the normal duties and responsibilities of government. Fisheries, Manufacture and Mining , and Trade belong to this category. State Corporations and State Sponsored Companies, [3] in this part of the public sector may be denationalised. Denationalisation would yield budget benefits, on the positive as well as the negative sides. It will stop further budgetary outlays on these undertakings, on the negative side; on the positive aide, the sales of the shares of the undertakings would bring capital account receipts.

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[1] Products of public sector undertakings include, in addition, hardware, hardboard, oils and fats, plywood, sugar, tyres, mineral sands, steel, textiles, small industries, engineering goods, paper, chemicals and flour. See Report of the Auditor General, Ceylon, 1964-65 , Part I, P.250.

[2] See foot note (1) p. 10 above.

[3] Memorandum on "Tax Proposals" presented by the Ceylon Chamber of Commerce, Colombo, to The Taxation Commission, p. 25.

40. If the experience of the past three years, when fresh capital expenditure on this category of undertakings exceeded overall Budget deficits (Table VIII) , should hold true currently, putting together these negative and positive gains of denationalization, it should be possible to plan a phased programme of selling to the public State Corporations and State Sponsored Companies, such that the persisting capital deficits get wiped out. It is a matter of detail and of strategy whether to sell first undertakings which are a comparative financial success or those which have not been faring so well. This issue merits separate consideration. Once the phased programme will have been completed, with the removal of the root cause of Budget deficits may also go the regime of unbalanced Budgets. A noteworthy merit of this arrangement is the achievement of budget balance without the necessity of curtailing any part of the current expenditures charged to Revenue.

41. Another statistical alternative of balancing the Budget is to step up Revenue collections sufficiently and produce a large enough Revenue surplus to cover overall Budget deficits. The Revenue surplus of the past three years averaged Rs. 77 million and the Capital Budget deficit averaged Rs. 179 million, per year. An average increase in Revenues of Rs. 102 million, per year, would have lifted up the Revenue surplus wholly to wipe out the Capital account deficit of this period.

42. This alternative is beset with pitfalls. Past experience in Ceylon, which is in line with experience in virtually all parts of the world, is that in a democratic set up political and other pressures are heavily on the side of more and more spending by the government. When Revenues increase, under the weight of these pressures, expenditures too increase to meet, or even exceed, Revenue collections. In Ceylon during the past seven years Revenues rose by 45 per cent and Expenditures charged to Revenues by 48 per cent. There is a real danger that any programme for increased Revenue collections may be attended by a corresponding increase in the consumption expenditures of the government, and little may be left of the additional Revenues to cover Budget deficits.

43. Increased Revenue collections under these conditions would militate against the paramount need to step up national savings. We have seen above, that national savings and capital formation are dangerously on the decline; that the biggest single problem on the Production front is to stop and then reverse the erosion of saving, and that heavy taxation has played a major role in this phenomenon of capital decay. Taxation in Ceylon is already too high and needs to be scaled down. Currently, Revenues appropriate about 22 per cent of

GNP, which is over double the average in India and well above the average in Germany, Italy and U.S.A. [1]

44. During the seven years ending 1965-66 , the annual increases in Revenue collections in Ceylon amounted to Rs. 2,470 million. Savings from these additional Revenues in the form of Revenue surpluses amounted to Rs. 105 million, yielding an average marginal rate of saving of 4.2 per cent. The national average savings in Ceylon is, currently, 10.7 per cent. The corresponding rate in India is about 7.5 per cent. [2] The marginal rate of private saving in India may be of the order of 25-30 per cent. The national average income in Ceylon being higher than in India, the marginal rate in Ceylon may be higher. Placing this even at an order of 30 per cent, the picture of the potential increases in national savings from a given reduction in Revenue collections seems tempting. If Revenues had been frosen at the 1958-59 level, the incomes of the people after tax would have gone up during the following seven years by an aggregate sum of Rs. 2,470 million. Savings from these additional incomes would have lifted up national savings by a net amount of an order for Rs. 640 million.[3] Gross National Savings in 1965 being Rs. 826 million, [4] this programme of freezing Revenue collections may have increased these Savings by an order of 10 per cent.

45. On the same reasoning, any programme for increased Revenue collections would impinge heavily on national savings. Every Revenue increase of Rs. 100 million would eat up Rs. 30 million of potential private savings and, adjusting for the marginal rate of saving of the government (4.2 per cent), the net debit effect of this on national savings may be Rs. 26 million.

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[1] In West Germany this percentage was 13.7% , India 10.2%, Italy 18.2%, Japan 13.9% and USA. 17.7% See International Financial Statistics, IMF September 1966.

[2] Shenoy op.cit., Chap. I

[3] Rs. 2,2470X3/10 ; less Rs.105 million = Rs. 642 million

[4] Recent Economic Trends-Ceylon, World Bank, op. Cit.., Table VI, p.77

46. Even in the event of the government being able to save from Revenues and add to capital formation at the same marginal rate as private citizens, the case for resisting increases in Revenue collections remains. The yields on public sector investments are a fraction of the yields in industries where the increased private sector savings, ensuring from economies in government consumption, may be invested. The average yield on the capital invested in 21 State Corporation in 1965 was under 0.5 per cent. [1] By contrast, current yields on Tea and Rubber shares are, respectively, [ ]per cent and [ ]per cent. Thus, the same amount of capital in the hands of the government add to the national product a fraction of the additions by the private sector.

47. The case against attempts to balance the Budget by increasing Revenue levies, thus, seems decisive.

48. The third alternative method of balancing the Budget is to increase the Revenue surplus by reducing sufficiently expenditures debited to Revenues. We have seen that sample scope exists for such economies. Well over one half of Revenues, or about 11 per cent of GNP, is sued up in distributing free of charge, or at below cost, economic goods and services to the entire population of the country.

Rice is issued to consumers on ratio cards at Rs.0.25 per measure, [2] every individual getting two measures per week. The total quantity of rice issued through ration shops averaged 903, 346 tons, [3] per year, during the past three years. It costs the Government Rs. 0.50 per measure [4] at c.i.f. value, in the case of imported rice, and Rs. 0.58 per measure [5] in the case of domestic rice. Domestic rice is price supported

[1] Based on the data given in the Report of the Auditor General of Ceylon, op.cit. p.250
[2] Or at 12 1/2 cents per lb. See Administration Report of the Food Commissioner Ceylon, 1964-65, p. II29.
[3] A ton of 2240 lbs. is equal to 1120 measures. Figures of the quantities of rice issued through ration shops are taken from the Administration Report of the Food Commissioner, lcc. cit., p.II31-32
[4] Ibid, p. II29
[5] Administration Report of the Commission of Agrarian Services, Ceylon, 1964-65 pp. KK 60-61 . The price of 0.58 per measure is arrived at by converting the support price of Rs. 12 per bushel of paddy into the equivalent price of rice per measure on the consumption that two units of paddy yield one unit of rice.

at Rs. 12 per bushel of paddy [1] (unhusked rice). Assuming a ratio of two units of paddy after getting one unit of rice, the support price of rice seems to bet he highest in the world, being about the same price as obtained in USA in 1964, under the US price support scheme.[12] While c.i.f. values have moved up with the risked in the international price of rice, and he support price of domestic purchases remained at a high level, the ration price of rice declined from Rs. 0.35 per measure in 1959 to Rs. 0.25 per measure, currently. The incidence of the difference between the rationed prices and the prices of the domestic and imported rice is wholly taken by the national Budget.

49. Food subsidies moved up from Rs. 36 million in 1954-55 to Rs. 374 million in 1963-64 . In 1964-65, production of rice declined sharply [2] by about 28 per cent; and the purchases of rice by the Government under the Government Procurement Scheme (GPS) declined, too. This involved an increase in imported rice from 547,000 tons in 1964 to 642,000 tons in 1965. As the guaranteed price of domestic rice is higher than the landed cost of imported rice, the decline in domestic purchases of rice and the compensating increase in imported rice meant a reduction in the amount of the Good Subsidy. This explains the fall in this subsidy in 1964-65 to Rs. 290.0 million and to Rs. 272 million in 1965-66 [3] with the recovery in food production, the burden of the subsidy may increase. The average Food Subsidy of the past three years amounted to Rs. 312 million. The annual average of other Direct Relief payments was Rs. 43 million.

50. The Budget cost of Social Services averaged even higher than Food Subsidies, though the latter has provoked much more attention that Social Services. The cost of Social services averaged Rs. 468 million, per year, during the past three years.

51. The average overall Budget deficit of the past three years being Rs. 102 million, it should be possible to balance the Budget by a combination of economies in consumer subsidies. Budget balance may be achieved by reducing the food Subsidy alone by one third, i.e., by raising the rationed price of rice by about 10 cent to 35 cents, per measures; or by a combination of economies in consumer subsidies, some price element being introduced in

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[1] The US price of rice was $ 5.99 per cwt, the Ceylon support price of Rs. 12 per bushel of paddy approximates to $ 6.00 per cwt. For the US price see Food for Peace, Twentieth Semi Annual Report on P;L. 480, Washington, 21 September 1964, pp 22 & 26.

[2] Production of paddy (unhusked rice) fell from 50.5 million bushels in 1963-64 to 36.3 million bushels in 1964-65 or by 28.2 per cent. Budget Speech 1966-67, p.5

[3] Central Bank Annual Report 1965, Table 20

respect to Social Services and the balance of the finance for covering the Budget deficit being found by economies in food subsidies and Other Direct Relief payments.

52. Budget balance may be realised, too, by a suitable combination of denationalisation of public sector undertakings and economies in Food and other consumer subsidies.

53. To summarise this review, being without an index of general prices, we have no direct data of the inflationary situation and trends in Ceylon. The Cost of Living Index does not portray the full picture of price inflation. Relating expansion of money to the expansion of the national product, the pressure of inflation, currently seems to be about 26 per cent higher than in 1960. The current phase of inflation began around 1957, reaching its peak in 1963. Inflationary expansion of money seems to be, currently, taking place at an annual rate of Rs. 70 million.

54. Inflation has resulted wholly through expansionary deficit financing of Budgets. Budget deficits may be balanced by a phased programme of denationalizing public sector undertakings; or by a combination of denationalization and economies in consumer subsidies. Consumer subsidies represent well over 50 per cent of the Revenues and about 10 per cent of Gross National product. Ample scope, therefore, exists for economies in consumer subsidies for balancing the Budget.

55. Thus, the biggest single problem on the Prices front is the problem of Budgetary deficits. This problem, in turn, is linked up with the problem of denationalization of public sector undertakings and reducing or abolishing food and other consumer subsidies.

IV. Measures of Policy Reform

The foregoing analysis of the state of affairs in the three major fronts of Production, Prices and Balance of Payments, indicates that the entire body economy is ailing, not any part of it alone. Wherever, and in whatever way, this ailment may have originated -- this is now little more than of historical interest -- it has spread and taken roots in all sectors of the economy. The malady, therefore, calls for multisided and basic reforms.

2. Our analysis has brought out that:

(i) the biggest single problem on the Production front is shortage of national savings, the result of the accent on consumption, a major contribution coming from fiscal operations, more basically, the socialist policies involving subsidized consumption, which eat up an average of 53 per cent of national Revenues and 11 per cent of the Gross National Product;

(ii) the biggest single problem on the Prices front is the problem of inflationary Budget deficits, this problem being, in turn, linked up with the problem of current capital outlays in public sector corporations, and of reducing or abolishing food and other consumer subsidies; and

(iii) the biggest single problem on the Balance of Payments front is the problem of over-valuation of the Ceylon rupee, the result of continued inflation in the context of an unchanged exchange rate, the latter having remained at 1s.6d. since April 1925.

(i) Need for Zero Inflation

3. These conclusions have a common factor, namely, inflationary Budget deficits. The biggest single problems on all the three major fronts are directly linked up with these deficits. This suggests that the first link in the chain of reform should be elimination of the inflationary part of Budget deficits, to reduce inflation to zero.

4. We have been in the foregoing review that the whole of the Net Cash Operating Deficit is not expansionary. Part of it, which is financed by Administrative Borrowing, Foreign Loans and Grants and Non-Bank Borrowing is, clearly, non-inflationary. Foreign aid adds to the supply of import goods, not to the supply of money. The other Borrowings merely shift funds from one set of pockets to another set of pockets.

5. The expansionary part of the Net Cash Operating Deficit represents the sum of Bank Borrowings and the decline in Cash Balances. Bank Borrowings here include the sales to, or purchases by, the Central Bank of Treasury Bills and other Public Debt, either directly from the Government of via the market. Bank Borrowings include, too, similar acquisitions of Treasury Bills and other Public Debt by commercial banks and cooperative banks. As Treasury Bills and other Public Debt acquired by banks are paid for by debits to their reserves with the Central Bank, purchases of Public Debt by these banks are on a par with the acquisitions of such debt by the Central bank. In both cases the supply of Central bank money with the public would go up by the amounts of the Public Debt purchases, i.e., when the Government disburses the proceeds of the Public Debt.

(ii) Net Cash Operating Deficit to be Wholly Non-Expansionary

6. Not the whole of the expansionary part of the Net Cash Operating deficit is inflationary. The expansion of money supply may be balanced by the expansion of the national product. It may be argued, therefore, that some Net Cash Operating Deficit is an essential part of fiscal policy in a developing economy. But the responsibility to provide the necessary measure of flexibility to the flow of money, to match the flow of output, is more properly that of the Central Bank; The Central Bank, being in continuous touch with the money market, has better feel of the money needs of the economy than the civil service in the Treasury. Moreover, the provision of flexibility through suitably varying the daily operations of the Bank is functionally more apt and efficient than the provision of such flexibility through varying Budget operations.

7. These considerations suggest that fiscal policy should aim at a fully balanced Budget, in the sense of zero money expansion through the Budget tap. There would be no net borrowing from the Central Bank or commercial banks to finance any part of the payments of the government. Such finance must come wholly from Revenues, Administrative Borrowings, foreign aid and Non-Bank Borrowings. The "Provisional Advances of the Central Bank to the Government" should be, in fact, provisional and temporary, the whole of these Advances being repaid from the non-expansionary receipts of the government at the due dates. The Cash Balances should be more or less constant, though they may be naturally subject to within-the-year variations.

8. The Central Bank should provide the community's money requirements through purchases of, or loans against, government debt, or other eligible assets of Central Bank

acceptability. In the context of the bias for the expansion of pubic sector investments, there may be no scarcity of government debt in the market for providing the necessary basis for the expansion of money supply. More generally, in a developing economy, the normal pace of expansion of government debt and financial assets, like commercial bank bills of Central Bank acceptability, may provide enough backing for the necessary expansion of money. As a general rule, the Treasury should not dabble in the field of monetary policy and central banking activity. This is more properly the concern, for specialist attention, of the Central Bank.

(iii) Alternative ways of Balancing the Budget

9. The problem of balancing the Budget - in the sense of wholly eliminating the expansionary part of the Net Cash Operating Deficit - is a difficult one. But it must be tackled and solved. The foregoing discussion has brought out that there are four several ways of balancing the Budget:

(a) denationalisation of a selection of State Corporations [1] in Fisheries, Manufactures and Mining, and Trade;

(b) increased Revenue collections sufficient to cover the Overall Budget Deficit;[2]

(c) reduction of Expenditures charged to Revenues so as to increase the Revenue surplus sufficiently to wipe out the Capital account deficit, thus reducing to zero the Overall Budget Deficit;

and (d) an appropriate combination of alternatives (a) and (c) above.

(iv) Increase in Revenues to be Ruled Out

10. Of these alternatives, alternative (b) must be wholly be discarded. Any increase in Revenues would be disastrous.

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[1] For a definition of "State Corporations " see footnote (1), p.10, Section II. Prices

[2] The term Overall Budget Deficit, being net of the Revenue and Capital parts of the Budget, is here used in the same sense as the expansionary part of the Net Cash Operating Deficit. See Table VII.

As we have argued in Section II, Prices [1] this would accentuate capital consumption and the decay in capital formation, the biggest single problems on the Production front; and would deter true socialist progress by holding back the pace of expansion of the national product, of employment and of mass well-being.

11. We have, therefore, to make our selection from alternative (a), (c) and (d). This choice, to begin with, may be a matter of political expediency. But, if we are to tackle and overcome the biggest single problem on the Production front -- namely, shortage of national savings, and of over-capitalization and wastage of savings in the Public Sector -- whether we adopt, first, alternatives (a), (c) or (d) , we must soon move from one alternative to the other. Denationalization is essential to remedy the evil of capital misuse and capital wastage in the Public Sector. Reduction of the burden of consumer subsidies, accompanied by a scaling down of the ruinous rate of taxation, is essential to step up national savings and capital formation.

(v) Denationalization of State Corporations

12. Denationalization of State Corporations in the Ministry of Industries and Fisheries -- i.e., sale of the share capital of these Corporations to the public, their new share holders being, then, responsible for their management -- may help to reduce to zero the Overall Budget Deficit, if we may assume that this deficit may be of about the same order as the Capital Outlays in the Budget on account of these Corporations. This has been the case during the past three years, when the Overall Budget Deficits average Rs. 102 million, per year, and the Capital Outlays in the Budget on these Corporations averaged Rs. 103 million, per year. The arithmetic of the relationship between the two magnitudes, currently, is a matte for detailed scrutiny.

13. Eventual denationalization of virtually all government undertakings is a desirable and important part of this Scheme of Reform in order, first, to release resources to sectors where the output per unit of capital is comparatively higher and, secondly, to ensure efficient and competitive management of the Corporations, so that the community may derive full benefit from the capital invested by way of net additions to the national product, in place of having to make good the losses on them. It is as well, therefore, that denationalisation of a selection of State Corporations is resorted to for balancing the Budget. This has the additional advantage

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[1] Paragraphs 42 to 46 , Section II. Prices

of achieving Budget balance without disturbing the hornet's nest of Food and other Consumer Subsidies.

14. The selection of the Corporations for denationalisation would be determined by considerations (i) strategy, (ii) the negative gain to the Budget of the foregone capital outlays on the Corporations concerned, and the positive gain of the sale proceeds of the shares of the Corporations to the pubic and (iii) the total amounts of the economies needed in the Capital Budget for covering the Overall Budget deficit. This, too, is a matter for detailed scrutiny.

(vi) Listing the Capital of Public Sector Undertaking for Quotation on the Stock Exchange

15. As a first step to denationalisation, we may consider the feasibility of listing for quotation on the Stock Exchange the capital of all State Corporations to be denationalised. This may indicate the market valuations of the several individual Corporations and may provide a guide for the pace of release of the shares on the market, this being adjusted to the prices offered and the capacity of the market. Market quotations may help, too, in the selection of the Corporations for denationalization and the formulation of a schedule of such denationalisation.

16. Quotation of the share and other capital of all Government or Government sponsored enterprises on the stock exchange, whether or not they are to be denatinationalised in the near future, merits consideration, too. Such quotation need not necessarily call for passing on the management of these enterprises to the pubic. The Government may retain a sufficient proportion of the shares to ensure management control. This may have the advantage of the Government getting back part of the funds invested. Too low quotations in relation to the prices of comparable Scrips -- as this may reflect inefficiently and lax management -- may tone up managerial efficiency of the enterprises and induce greater concern for, and attention to, the costs and quality of the output. Since, on general grounds, the case for the Government puling out of all business and industrial enterprises, including even Railways and Electricity, is strong, this arrangement may facilitate their denationalisation, after the decision to denationlise will have been taken.

17. The share capital of State Corporations which are a financial success or have bright prospects may quote at premiums and their denationalisation may yield a capital gain to the Budget. But the poor showing of the profit and loss statements of most of the Corporations suggest the likelihood of a capital loss to the Budget. The net capital less from denationalisation has to be written off.

(vii) Replacing Food Subsidy by a Cash Subsidy

18. If denationalization of State Corporations proves sufficient for balancing the Budget, there may be no immediate need to resort to alternative (c), reduction or abolition of Consumption Subsidies. But, as the foregoing review has made clear, a phased programme for reducing and abolishing Food Subsidies is inescapable for stopping up national savings and for accelerating economic and social progress, the subsidies under Social Services being tackled next. Aggregate Consumer Subsidies eat up an average of 11 per cent of GNP and 53 per cent of Budget Revenues. In a background of declining savings and capital decay, there can be no justification for continuing these subsidies at this ruinously high level.

19. As a first step to the solution of the problem of Food Subsidies, we may change the technique of giving these subsidies. In place of selling rice at 25 cents per measure, it may be sold at actual cost --i.e. the average cost per measure to the Government of imported rice (the landed cost of this rice in 50-56 cents per measure) and of rice purchased under the GPS scheme (the cost of this rice is Rs. 12 per bushel of paddy or Rs. 24 per bushel of rice) -- plus a small margin to cover the administrative expenses of handling imports, of purchasing domestic rice and of distributing rice through ration shops. The distribution of rice may continue as presently in the first phase of this Scheme.

20. At the same time every rice ration cardholder may be paid outright, in cash, the amount of the de facto payment which he now receives in the form of rice at below cost. Immediately, this would involve no change in benefits to the rice consumer; nor in the Budget cost of the Subsidy.

21. It is important for purposes of this Scheme to separate the payment of the Cash Subsidy and the payments for rice by the ration card holders. The two transactions must be effected by two different agencies, to avoid the payment of the Cash Subsidy being set against the payment for rice. The cash subsidy may be paid through, say, the Post Offices, while rice will continue to be sold through ration shops.

22. This arrangement -- selling rice at cost and paying the Subsidy in Cash -- has many advantages. It stabilises the Budget incidence of the Food Subsidy at the present level. The consumer becomes familiar with the Ceylon market price of rice. He may offer his full cooperation in any arrangement for reducing the cost of rice, such as reducing the guaranteed GPS price and importing more rice, which is vastly cheaper than domestic rise. If the international price of rice should rise, the Budget cost of Food Subsidy need not go up, too. When rice has to be purchased at market price, this being much higher than the rationed price of 25 cents per measure, the consumers in the lower income groups may economise on the consumption of rice and use cheaper food substitutes. This will, on the one hand, reduce the need for imports and, on the other, stimulate (through the price device) the production of rice substitutes. There is little inducement for the functioning of this corrective and helpful mechanism when rice is sold at 25 cents a measure.

23. Empirical evidence in support of this possibility is provided by recent experience in India. When rice is rationed at controlled prices, the demand for rice is much higher than when rice is distributed through the market, at the competitive market price. In the latter case there is greater pressure to use rice substitutes than in the former. The burden of providing rice is larger under rationing than normally. In Ceylon, the numbers of the population availing of rationed rice increased when the ration price of rice was revised downward .[1]

24. Not the least important benefit of this arrangement is that a Cash Subsidy may be easier to nibble at than a Price Subsidy. It is not every citizen that may like to queue before a

[1] In 1960s, the ration price of rice fell by 7 cents to 28 cents per measure and the population availing of rationed rice increased by 461,526. With the fall in the ration price of rice by another 3 cents to 25 cents pre measure in 1961, the numbers of the population availing rationed rice increased by 270,620. See <u>Statistical Abstract of Ceylon</u>, 1964, p.279, and <u>Administration Report of the Food Commissioner</u>, for 1964-65, Part I-Civil (II), pp. II 31-32.

Post Office to collect a family allowance of 75 cents or less per head, per week, the average amount of the Food Subsidy in 1963-64. [1] Statistics show that about one tenth of the population, do not avail of rationed rice today, [2] preferring perhaps to buy it in the free market, or because they grow their own rice. It is a matter of local knowledge whether it is likely that the number who may forego the Cash Subsidy may be larger. It becomes possible to appeal to the public sentiment of the people to forego the Cash Subsidy. The Cash Subsidy may be subjected to a means test. Receipt of the Subsidy may, then, carry, social odium and the number of claimants may decline. Finally, when the Ceylon rupee is floated, the landed cost of rice may jump up. Under the prevailing arraignments of a Price Subsidy, this will correspondingly drive up the amount of the Budget cost of the Subsidy. This need not happen automatically, under the new arrangement of Cash Subsidy. Finally, following a phase of nibbling, it may become possible to drop the Cash Subsidy altogether, especially in a back ground of rising production, rising incomes and continued improvement in mass well-being, which may ensue with the adoption of the present Scheme of Economic Reform. Nibbling at and abolishing the Price Subsidy of rice may be much more difficult.

25. Though the distribution of rice may continue as presently in the first phase of the change-over from Price Subsidy to Cash Subsidy, this distribution, including wholesale transactions, may be progressively transferred to private trade on a competitive basis, the Cooperative unions, Cooperative Societies and private Authorised Distributors [3] no longer having a monopoly over such distribution.

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[1] Per capita food subsidy in 1963-64 , when the Budget cost of the subsidy amounted to Rs. 375.4 million was 75 cents per head per week on the basis of population availing of the rationed rice; the national average of this subsidy per head per week was 67 cents. The amount of the subsidy was lower in 1964-65 and 1965-66 . See Central Bank Report, 1965, Table 20, and Administration Report of the Food Commissioner, 1964-65, op.cit., pp.II 21-32

[2] In 1965, 1.23 million people, about 11 per cent of the total population, did not avail of rationed rice. See Administration Report of the Food Commissioner, 1964-65, op. Cit., p.32

[3] Administration Report of the Food Commissioner, 1964-65, op.cit., p 32.

Free competition may reduce the cost of distribution much more than in legislation or administrative emissaries and consumer may, possibly, get rice at a somewhat lower price than under the governmental machinery. The average number of persons per ration shop presently is over 900[1]. Removal of monopoly distribution would permit every grocer to stock and sell rice, with easier availability of rice to the consumer.

26. Once Price Subsidy is eliminated, and the distribution of rice becomes wholly free, the case for continuing the institution of universal rationing becomes weak. At an appropriate time, universal rationing may be abolished, though the Government may hold buffer stocks for a rainy day. The criterion for the abolition of universal rationing may be the relationship between the official price of rice and the free market price of rice. Universal rationing may be abolished when the free market price is equal to or lower than the official price. This relationship should obtain when trade in ride, including imports of rice, is free and the price of rice is not subject to price control, Government agencies and private trade selling rice competitively.

(viii) Need to Scale Down Consumer Subsidies

27. If denationalisation of State Corporations is not feasible or if it should fail to yield sufficient Budget gains for eliminating the Overall Budget Deficit, it becomes immediately necessary to avail to alternative (c), either to cover the Deficit in its entirely or to supplement the benefits from alternative (a) for balancing the Budget. To combine alternatives (a) and (c) is to resort to alternative (d) given above.

28. But Budget balance may be achieved by economising on Food Subsidies alone during the past five years, Food Subsidies averaged Rs. 287 million and Overall Budget Deficits Rs. 154 million. A halving of food Subsidies would have more than covered the Overall Budget Deficits, during this period. The precise extent of the necessary economies on Food Subsidies for balancing the Budget is a matter for close scrutiny.

29. From the experience gained in tackling the Food Subsidy, a similar technique may be applied to tackle the Subsidies under Social Services. Social Service Subsidies are larger than Food Subsidies, their annual average being Rs. 458 million , during the six years ending 1965-66, as against the annual average Food Subsidies of Rs. 274 million, during the same

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[1] In 1965, the number of ration shops was 12, and the population of Ceylon 11.3 million. The number of the population per ration shop was ,therefore, 914 . See Administration Report of the Commissioner of Food, op.cit.p.32

period. Social Services subsidies accounted for a little under one-third of the Expenditures charged to Revenue during this period, the corresponding proportion in respect to Food Subsidies benign 19 pr cent. Social Service Subsidies, therefore, damage national savings and capital formation much more than Food Subsidies. The present arrangement of providing Health and Education to the entire population free of charge and of subsidising Housing cannot continue without considerable bars to economic development and to accelerated social progress. Since social progress hangs on the curve of production, Social Service Subsidies on the present scale is self-defeating.

30. Since the benefits of the Subsidies on Health, Education and other Social Services accrue only to those who will of these Services, the technique of replacing the subsidies by a per capital Cash Subsidy is not feasible. We have to device other ways of reducing their budget burden. These ways may be to apply a means text and to charge a price in the case of such Services as any bear the incidence of a price without causing undue hardship, the prices charged being, initially, below cost. Considering the extensive public weakness, on sentimental grounds, for the continuation of some of the Social Service benefits, e.g. provision of medical aid to be needy, it may be exceedingly difficult to eliminate, or even to reduce substantially, certain categories of Social Service subsidies. But in the long run national interest of speeding up economic progress and mass wellbeing, it is imperative that the Budge cost of these Subsidies should be reduced to the possible minimum.

(ix) Need to Scale Down Taxation Drastically

31. To solve the biggest problem on the Production front, it is not enough merely to balance the Budget. From the foregoing review we have seen that the marginal rate of saving of the Government is a fraction (4.2 per cent) of the marginal rate of saving by the public (possibly, an order of 30 per cent) . Every increase in Revenue collections, therefore, takes, a heavy toll of national savings. We have seen that every increase of Rs. 100 million in Revenue collections would have a net debit effect of an order of Rs. 26 million in national savings. Taxation destroys potential national savings into a bon-fire of public consumption. There is not better device of spending up national savings, capital formation and true socialist progress, in the sense of continued acceleration in mass well-being than to scale down taxation. Considering that, currently, savings and capital formation in Ceylon are on the decline, there is great need for a drastic scaling down in taxation.

32. Ceylon is among the most highly taxed countries in the world; and probably the most highly taxed country in the poor and under developed parts of world. We have seen that, in Ceylon, Revenues as a ratio of GNP are over double the average in India and far above the average in Germany, Italy, Japan and USA. A review of the rate of saving, the ratio of Revenues to GNP and the rate of increase in GNP demonstrates that the countries with the highest rate of economic development are also generally countries where the rate of saving is the heights and the tax burden comparatively low. During the last decade or more, the Japanese economy has progressed at near world record levels and the rate of savings in Japan is about the highest in the world, gross savings begin 38 per cent of GNP in 1962; and Revenues as percentage of GNP was under 14 per cent.

33. The need to reduce taxation arises from another consideration, too. Public sentiment in Ceylon favours Ceylonisation of the ownership of capital assets in the country. Ruling out expropriation, the progress of this Ceylonisation must be in proportion to the accumulation of current savings by the Ceylonese people. Past savings of the rich national being already invested, cannot be utilised of buying Ceylon assets of foreign nationals. When the current national savings fall short of even the needs of maintaining undiminished the per capita capital equipment in the country, it is not possible to utilise national savings for purchasing foreign owned Ceylon assets. When taxation at the top income slab is 80 per cent, there is little elbow room for the accumulation of savings on any significant scale. Progressive taxation is in fact, regressive in respect of the rate of saving and capital accumulation. Whatever may be the suitability of steeply progressive taxation to affluent countries, economies struggling to develop can ill afford steeply progressive tax system. To facilitate rapid accumulation of savings, there is great need to consider replacing the progressive system of taxation by taxation at a flat rate.

34. The programme of denationalisation of State Corporations, the phased programme of abolition of Food Subsidies and the phased programme of reduction to a minimum of the social service subsidies my usher is a period of Budget surpluses. These surpluses should be utilised to reduce the rates of both direct and indirect taxation. It will be detrimental to the national interest to permit any increase in expenditures for absorbing the surpluses.

(x) Need for a Floating Rupee

35. In the foregoing review we saw that the biggest single problem on the Balance of Payments front is the problem of persisting Balance of Payments difficulties _ not merely Balance of Payments deficits, which may be usual in the early phases of developing economies -- and the continued reliance on foreign aid and drafts on External Assets to cover the deficits. This problem has become the biggest single problem of the Ceylon economy, today, External Assets have fallen to a low level and the flow of foreign aid has become uncertain.

36. We have seen, too, that Ceylon's Balance of Payment difficulties began around 1957. Until then, the External Reserves position of the country was one of continued affluence. The Reserves fell in a row from 1957 to 1964, the total losses being Rs. 925 million. Recent trends indicate that the improvement in the Reserves in 1965 may turn out to be temporary.

(x) (a) Trade Deficits and Terms of Trade

37. Balance of Payments difficulties may not be due to imports being too high; nor exports being too low. Since 1957, the volume of exports have fluctuated upward, their index in 1965 being higher than in 1957 by 30 per cent. Simultaneously, the volume of imports flagged more than it rose, and, latterly, has fluctuated downward. In 1965, the volume of imports was about 19 per cent lower than in 1957 (Table X).

38. As the volume of exports rose distinctly faster than the volume of imports, export receipts should have correspondingly remained higher than import payments. But throughout this period Ceylon had heavy trade deficits, though, in 1965, this deficit was nominal.

39. The trend in the terms of trade does not provide a satisfactory explanation. The terms of trade remained in favour of Ceylon, relatively to 1957, until 1961. They fell by two points to 87 in 1962 (1958=100) and dropped more sharply in 1964 and 1965. Export prices generally remained higher than 1957 in the first part of this period. The index of the volume of exports rose distinctly faster than the fall in export prices throughout this period (TableX). There was, therefore, no case for export receipts to remain lower than import payments over this period viewed as a whole, even if it should be different in certain individual years.

(x)(b) Trade Deficits, Transfer Payments, and Inflation

40. The main explanation for the trade deficits and the drain of External Assets during this period, despite the rise in the volume of exports, would seem to be threefold. First, Ceylon ahs heavy remittance obligations on account of (i) service on external debt, (ii) transfer of profits and of savings, the latter of immigrant workers mainly and of other non nationals employed in Ceylon, and (iii) heavy net exports of private capital since about the middle of World War II and throughout the post war period (Table XI). In normal years, when the country had substantial trade surpluses, the sum of (i) and (ii) above absorbed from about 20 per cent to 30 per cent of the trade surpluses. When these outflows of funds get reinforced by (iii), the needs of the flight of foreign private capital, the aggregate remittances may claim about one half of trade surpluses, as happened in 1951. [1]

41. Invisible payments abroad on current or capital account have been subject to license for long; and the phenomenon of concealed remittances, which this restriction induced, has also prevailed for long. Remittances, which were denied licenses and could not, therefore, use the official channels for doing so, availed of the services of free markets.

42. Following the change of Government in April 1956, the issue of licenses for remittances was, apparently, severely restricted, at first for capital transfers and later, after a year, also for current account transfers. On the other hand, the normal pressures of demand for these remittances grew in strength from fear that such transfer payment may be subjected to more drastic measures or penalties. This stopped up abnormally the demanded for foreign exchange in the free markets and the premium on foreign exchange in terms of Ceylon rupees moved up. Under the inducement of the higher premiums, larger amounts of foreign exchange flowed into the free market, through under invoicing and over invoicing imports. Consequently, export receipts as recorded in the Exchange Control and Customs returns fell below the actual receipts by the traders, and export payments, as appearing in these returns, rose above the actual amounts paid for imports. These opposite movements intrude in trade returns, produced a trade deficit, in place of the more normal trade surpluses, thought the volume indexes of imports and exports suggest the continuance of trade surpluses[2] (Table XI) Since trade surpluses, when surpluses appear, may but be of an order of 7 to 10 per cent of

[1] See Table XI and Ceylon Central Bank Annual Report, 1965, Table 20
[2] The verifiable part of this paragraph needs to be checked up.

total trade, a trade surplus may get more than wiped out, if underinvoicing and over invoicing amounted to about 10 per cent of total trade.

43. The imposition in 1964 of a foreign exchange tax of 10 to 20 per cent on current and capital transfers; the moratorium for one year on the remittance of profits, dividends and other investment income; and the ban on the export of capital beyond certain limits did not improve matters. These measures raised apprehensions of more restrictions and gave an impetus to the concealed flow of funds.

44. Secondly, beginning with 1961, money supply in Ceylon rose faster than the rate of increase in the national product. Inflation added to the money incomes and money savings of the people without adding to the national product. Such expansions of money incomes injected into the domestic economy three pressures (among other disturbances): (i) it led to the use or consumption at home of exportable goods; (ii) it added to the demand for import goods and led to increased imports to the extent possible and (iii) imports being restricted, resources got diverted from export production into producing goods for home use.

45. These developments, which had remained more or less incipient when inflation was moderate, became more pronounced without the acceleration of inflation, which reached its peak in 1963-64 . They acted as a drag on exports and stimulated imports, thus contributing to the factors making for trade deficits. If inflation continued, the impact of these processes may become more visible than presently.

(x)(c)Balance of Payments Difficulties and Currency Over-Valuation

46. Thirdly, continuing inflation, in the context of the unchanged exchange rate of the rupee -- this rate has remained fixed at 1s. 6d. per Rs. 1, since April 1925 -- led to over--valuation of the Ceylon rupee at the official exchange rate. This over valuation is reflected in, as the foregoing review has shown, three phenomena, which are both consequences and evidence of over-valuation. First, the US dollar and other convertible currencies are quoted at premiums, in terms of the Ceylon rupee, in the free markets for foreign exchange. Secondly, import licenses fetch tempting prices, varying with commodities. Finally, Ceylon has been experiencing continued balance of payments difficulties, not merely balance of payments deficits, which have defied solution. All three phenomena have grown in strength in recent years.

47. The premiums on foreign exchange in the free markets were comparatively moderate until 1957. They moved up with the pressures of demand for concealed remittances, which ensured with the tightening of restrictions on open remittances during the year. These pressures and premiums got pushed up further by the acceleration of inflation, which reached its peak in 1963-64, and the introduction of more drastic measures against open remittances in 1964, the average quotation for the US dollar during the year being Rs. 13.60 (Bid) as against Rs. 7.05 (Bid) in 1959 (Table XI). As explained in the foregoing review, these premiums reflect over valuation of the Ceylon rupee at the official rate, though the amount of the premium may not be a precise measure of the extent of over valuation.

48. We have no data of the prices offered for import licenses. But gossip suggests that these prices, possibly, followed a similar trend. The prices of these licenses reflect the gap between landed costs and market prices of import goods. And these gaps increase with the over valuation of the rupee. The persistence of Balance of Payments difficulties, as reflected in the trend of External Assets, began 1957. These difficulties were intensified with the progress of inflation and the increase in the premiums on foreign exchange. During the four years, 1957-1960, the paymetns difficulties were covered up by heavy drafts on External Assets, amounting to Rs. 830 million. With the volume of these Assets gone thin, the difficulties have emerged on the surface.

49. Of these three phenomena, our immediate concern in Balance of Payments difficulties. The explanations of the origin of the two markets for foreign exchange -- the official market, where the fixed statutory par of exchange prevails and the free market, where exchange rates of fluctuate -- and the issue of the causes of the wide disparities in the official and free market exchange rates apart, Balance of Payments difficulties must remain so long as there are two markets for sterling, dollars and the foreign exchange at the same time, the prices in one being temptingly higher than in the other and far above the risks and cost of moving funds format the official market to the free markets. Under these price divergences, it will be next to impossible --as the experience of country after country has demonstrated -- to prevent purchases of foreign exchange in the official market for sale in the free market; or to prevent the diversion of foreign exchange, in other ways, from the former to the latter.

50. As is now clearly soon, diversion of foreign exchange, format the official market to the free market, takes place through under-invoicing exports, over invoicing imports,

smuggling out import goods, Ceylon gems and like items, and by routing into the free market tourist funds of visitors to Ceylon. To battle against these movements of foreign exchange, when the price disparities are so enormous, is like trying to control the rush of flood waters down the river beds, though such attempts by sincere but vane administrators are common enough sights in many under developed parts of the world; and the results of these misguided efforts, as experience has relatedly demonstrated, is disastrous -- not beneficial -- to the official Balance of Payments position.

51. The tightening of the payments restrictions in 1957 and the more drastic measures imposed in January 1964, did not restrain the overall flow of funds out of the country, as the drop in the Balance of Payments statistics of these remittances -- which related to only one of the two markets, the official market might mislead us into thinking (Table XI). These restrictions and tax penalties did little more than shift the business of remittances from banks to the markets -- the customers now relied more on the Tandu and other systems of transfer operating within Ceylon or the free markets overseas. These measures moved from the official market to the free market foreign resources as well as the demand for them. In the process, the banks lost business and income, and the official foreign exchange market got saddled with more Balance of Payments deficits.

52. Certain analytical reflections on the shift of foreign exchange business from the official to the fee markets are no less unpleasant. The foreign exchange earnings of the country, the result of hard work, get appropriated (through under invoicing and over invoicing) , at the official exchange rate, by operators of the Tandu system of transfer and other dealers in the free markets for foreign exchange; these operators and dealers then dispose of this foreign exchange at enormous profits, which, currently, are more than 100 per cent. By continuing an arrangement, which must necessarily yield heavy premiums of foreign exchange, we keep these anti social operator and dealers in business, in comfort or in opulence.

53. Cutting the fingers of the guilty, the penalty imposed by some irate Monarchs of the Middle Ages, did not stop the working of Gresham's Law and put an end to the evil of clipping and debasing coinage, until the Monarchs themselves abandoned financing their opulence and wars through the debasement of currency; even so, rigorous of import restrictions cannot possible throw these operators out of business or put in an end to the

Balance of Payments difficulties emerging from currency over-valuation unless the free market premiums on foreign exchange are eliminated.

(x) (d) Balance of Payments Difficulties, Import Restrictions and Import Substitution

54. As we have explained in some detail in the foregoing review, the Balance of Payments difficulties cannot be solved by intensifying the rigorous of exchange control and import restrictions; nor by extending the schemes for expanding domestic production to substitute import goods -- the so called measures for "economising" on foreign exchange. Intensification of the rigorous of exchange control and import restrictions may reduce the quantum of import goods flowing into the market. It cannot reduce the flow of moneys seeking to purchase goods, either for consumption or for investment. This flow of money is determined by the national product and the inflationary part of the Net Cash Operating Deficit.

55. The result of intensified import restrictions is that part of the money income hitherto feeding on import goods are no longer able to do so. Consequently, these incomes move from counter to counter and end up in consuming exportable goods; or, which is the same thing, cause resources of production to be diverted from export production into fabricating at home consumer and investment goods, to meet its requirements. In either case, exports decline so that, every time import restrictions are tightened, exports shrink; and the pre-existing Balance of Payments difficulties persist. The remedy to this problem lies in putting a stop to inflationary financing, not in tampering with the normal course of international trade.

56. Nor is import substitution a remedy to the problem of the scarcity of foreign exchange. Expansion of production at home, to replace the banned or restricted import goods, necessarily involves withdrawal of a requisite package of resources -- raw materials, skilled and unskilled labor, technological know-how and managerial and entrepreneurial personnel -- from other sectors of the economy. By a process of elimination, we have seen that this transfer of resources impinges on export industries. Exports as a consequence fall, so that the pre-existing Balance of Payments difficulties persist.

57. In addition, such schemes of pressurised import substitution will have a debit effect on the aggregate national product, in proportion as the factor cost in the import substitution industries is higher -- as is the usual experience -- than the factor cost in export industries.

58. This is not to argue against the desirability and importance of import substitution. In the case of Ceylon, in particular, there is great need for a suitable diversification of industries, as the country so heavily depends on three major items -- tea, rubber and coconut -- for its income and offering exchange earnings. But if progress must be accompanied by stability, and if progress must be continuous and assured, import substitution must be natural, nor pressurized. Import substitution must take place somewhat on the lines of the experience of Japan and, currently, Israel.

(x)(e)Alternative of Devaluation and a Floating Rupee

59. Economic statesmanship lies in seeking a solution to the Balance of Payments problem though merging the two markets for foreign exchange _ the official market and the free markets -- into one. This may be achieved in two ways:

(a) devaluing the rupee to the equilibrium level ; and

(b) floating the rupee, so that it always remains at the equilibrium level.

Under and equilibrium exchange rate, the aggregate demand for foreign exchange would be balanced by the available aggregate supply of foreign exchange; i.e., the prevailing demand for foreign exchange would be met in full at the rate of exchange of the rupee, ruling in the integrated market.

60. To resort to alternative (a) above, we must first ascertain the correct equilibrium value of the rupee; otherwise, there is a danger of the new rate chosen being short of the equilibrium point, or beyond it. More usually, the danger is that it may fall short of the equilibrium point; and we may, then, have a continuation of the old troubles of two markets for foreign exchange and persisting Balance of Payments difficulties, though, if the devaluation is substantial, the pressures of these difficulties may be of a lesser order than currently.

61. But it is almost an impossible task to arrive at the equilibrium value of the rupee, through any slide-rule technique. The historical base of reference of the equilibrium exchange rate of the Ceylon rupee dates back to the pre-war period. Very significant and divergent developments since then in the fields of money income flows, costs, pattern of production and international trade, in Ceylon and in the major trading partners of the country,

have deprived the historical equilibrium rate of the rupee any meaningfulness as a starting point for deriving a possible equilibrium exchange rate today.

62. The free market quotations for the rupee may provide a rough guide to the order of the magnitude of the equilibrium value of the rupee. But, as we have seen in Section III. Balance of Payments, the free market rates may over state the extent of depreciation of the rupee. The wide gap between the "Bid" and "Offer" rates in the Case of Ceylon, which is, currently, of an order of 30 per cent [1] indicate the risk of relying on the free-market quotations as indicators of the equilibrium exchange rate.

63. This inseparable hurdle apart, there are certain basic difficulties, which suggest deferment to a more propitious later date, if not complete abandonment, of alternative (a). First, devaluation of the rupee to another fixed point would call for continued monetary and fiscal discipline to ensure that the new rate chosen remains in equilibrium. Any inflationary deficit financing, or lax monetary policies, may cause a run on External Assets; persistence in deficit spending and in lax monetary policies beyond the limits determined by the capacity of the External Assets to suffer depletion - the effects of the fiscal and monetary lapses - may drive domestic prices up and render the rupee over valued again. Under developed countries, in particular, can ill-afford the luxury of fixed exchange rates, seeing that their foreign exchange reserves are generally close to rock bottom and the political pressures confronting the Administrators frequently get the better of the need to stick to tenets of non inflationary fiscal and monetary policies.

64. Secondly, if to these difficulties should be added any prolonged phase of adverse terms of trade, stability of the new exchange rate may be jeopardised. In either case, we may have the old troubles of currency over-valuation all over again.

65. On both counts -- the difficulty of ascertaining the equilibrium exchange rate and the paramount need for no inflationary fiscal and monetary policies -- alternative (b), namely, a floating rupee seems preferable. Three is no better device of discovering the equilibrium rate of exchange than to release the rupee to the pressures and supports of the free market forces. A floating rupee and exchange over valuation cannot go together. Lapses from fiscal and monetary measures, appropriate to the prevailing economic complex, will show up in

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[1] The difference between the "Bid" and "Offer" rates expressed as a percentage of the average of the "Bid" and "Offer " rates.

exchange rare deprecation, automatically. But the floating rupee will be always an equilibrium rate. There can be no balance of payments head-ache under its regime. With so many other problems of great moment to attend to, relief from this major distraction may be a gain of no mean order.

66. A floating currency has a special appeal in the case of Ceylon. We have seen that net current and capital account transfer payments absorb the major part of the trade surplus even in normal years, when the country has trade surpluses; to these transfer payment constitute a serious balance of payments problem in items of trade deficits; and that they always exert heavy pressures on the exchange value of the rupee. When the exchange rate is not in equilibrium, the weight of these pressures will fall wholly on External Assets.

67. Under a floating rupee, these pressures may impinge on the price of foreign exchange and add to the cost of the remittances; and as remittance costs become more and more painful, the falling exchange value of the rupee may cause deferment of the remittances to a later date when the trade position may improve and the exchange rate recover. Under a fixed exchange rate, this price restraint on remittances is not only absent; a fixed exchange rate may induce remittances at more than the ordinary pace, especially if any doubts should develop on the ability of the Central Bank to defend the exchange rate. In these conditions a fixe exchange rate becomes a costly handicap, while a floating rupee, by adding to the cost of remittances, may provide some relieve to the money market at home and to the Balance of Payments position.

68. Measures to float the rupee include:

(i) repeal of the Central Bank obligation to convert foreign exchange offered to it at rates based on the statutory parities, such parities being no longer binding;

(ii) removal of exchange control regulations which require residents to surrender their foreign exchange acquisitions to Exchange Control;

(iii) repeal of the Central Bank obligation to provide foreign exchange to importers who hold import licenses; and to those who have other payments to make abroad and hold the necessary Exchange Control permit;

(iv) Abolition of the system of import licensing and of the system of permits for remittances abroad.

69. The sudden removal of import restrictions and exchange control need not spell disaster, especially in the context of the safety-valve protection of a floating rupee. The Philippines removed Exchange Controls overnight and the following extracts from an account of the effects of this, prepared by the Research Department of an American Central bank, may be of interest;

"On January 22, 1962, after over 12 years of exchange controls, the Philippine people suddenly found themselves free to import any commodity they desired or to engage in any type of foreign capital transaction that interested them. They could exchange pesos freely for foreign exchange and deposit it in the U.S., or buy U.S. stocks, or deposit it in Swiss banks, or use it to buy French perfume, or, in short, use it in anyway they desired. Before this, the bulk of import and capital transactions were subject to governmental controls, even down to the purchase of a 10 cent postage stamp from the U.S.

"What was the effect of this sudden dropping of exchange controls by the Government? Did the volume of imports mushroom as predicted, since the public was left free to purchase foreign luxuries at the slightest whim? Was there a sharp drain in international reserves as controls were dropped overnight? Did prices rise sharply as the peso was devalued?

"Contrary to these dire predictions, the sudden dropping of exchange controls in the Philippines has not produced the disastrous results predicted by some defenders of controls. Instead, the country has a new economic lease on life. Equilibrium has been restored in the balance of payments, exports are rising more rapidly than earlier, and there has been a resurgence of interest by foreign investors in the Philippines.

"The experience of the Philippines with exchange control and an overvalued exchange rate is one that is common to many under developed countries. What makes the Philippine story interesting, however, is that decontrol was accomplished overnight without disastrous consequences".

(x)(f) Effects of Floating Rupee

70. We may briefly dwell on the possible effects of the floating rupee on the three major economic fronts of Production, Prices and Balance of Payments.

71. The possible effects on the Balance of Payments front is clear from the foregoing analysis. There is no room for Balance of Payments difficulties under a floating rupee. Under a floating rupee, the free markets and the official market for foreign exchange would merge into one market, and all foreign exchange transactions would be effected at one single rate, with the usual margins between buying and selling rates. The black markets in foreign exchange being thus absent, there will be no under-invoicing of exports nor over-invoicing of imports. In all probability there may be a trade surplus. Any current account deficit will get adjusted by market forces to the inflows of foreign aid and other foreign capital.

72. Removal of import licensing and of remittance restrictions is a natural corollary of a floating rupee. This cannot upset the balance of payments position. The floating rate being an equilibrium rate, the demand for import goods and for sending funds abroad on current and capital account, would be met in full at the prices of these goods and of the costs of the remittances determined by the floating exchange rate. Imports and remittances, under price restraints, will remain within the capacity of the Balance of Payments position, the latter being always kept in equilibrium. What import licensing and exchange controls have failed to achieve, will be achieved by price restraints operating <u>via</u> the floating exchange rate.

73. Though the floating rate may vary from day to day, as prices of commodities in general do, in the context of non-inflationary Budgets -- which forms part of this Scheme of Reform -- such variations would be narrow. The floating rupee, then, would be more in the nature of a flexible rate, moving within narrow margins, not a widely fluctuating rate.

74. The floating rupee should produce a stabilising effect on the Prices front. Price stability may result from the working of two factors. First, import liberalisation would add to the supply of import goods in the market, which today is starved of them either through outright bans on import goods, or by severe restrictions on imports.

75. Secondly, general prices must get stabilised under non-inflationary Budgets, an essential part of this Scheme of Reform. A floating rupee may assist in the efforts to balance the Budget. Under the head of Foreign Aid alone, the floating rupee may increase Budget receipts in rupees by much more than the expansionary part of the Net Cash Operating Deficit. In the Budget for 1965-66, receipts under foreign aid amounted to Rs.175 million. Under a floating rupee this amount may be more then double. A floating rupee would drive up the landed costs of import goods to their market prices. As ad valorem duties are levied on the c.i.f. values of imports, the lifting up of landed costs to market prices would, correspondingly, increase Revenues from import duties, at the prevailing rates. If, as has been proposed above, Food Subsidies are converted into Cash Subsidies, the floating rupee would not add to the cost of Food Subsidies. On the other hand, the Budget cost of import goods entering into Administrative and other Expenditures of the Government and on account of external debt services may go up. On balance, however, the Budget may show substantial net gains. If the other measures for improving the budgetary position recommended above, namely, denationalisation of the State Corporations and reduction of Social Services Subsidies are adopted, the floating rupee may bring heavy Budget surpluses. In accordance with this Scheme of Reform, it would, then, become possible to utilise these surpluses for tax reductions. The details of the Budgetary effects of the floating rupee are a matter for close scrutiny.

76. Though the Budgetary incidence of the Food Subsidy would be freed of the effects of the floating rupee by the advance step of converting Food Subsidies into Cash Subsidies, the possible effects of the floating rupee on the price of rice, of subsidiary food-stuffs and of other necessaries merit close attention. The largest single supplier of rice today in Communist China. These rice imports, presumably, form part of a bilateral trade agreement with China. The rupee cost of this rice is the rupee costs of the goods supplied to China in exchange for rice. This reasoning applies also to the imports from other bilateral agreements. Since domestic prices would remain stable, the rupee costs of bilateral imports may not rise under a floating rupee. The assurance of this would lie in non-inflationary Budgeting. The necessary data of bilateral agreements and their working not being available here, this is a matter for close study.

77. Since the Food Subsidy is an important political issue, we may like to ensure that the incidence of any possible rise in food prices does not impinge heavily on consumers. This may call for an increase in the Cash Subsidy. Since the floating rupee may considerably improve the Budgetary position, an increase in Cash Subsidy may become feasible, without

upsetting the important requirement of non-inflationary Budgeting. The amount of the increase in the Cash Subsidy would depend on the rupee costs of imported rice under a floating rupee. While the rupee costs of rice imported under bilateral trade agreements may not rise, the rupee costs of rice imported from hard currency countries may go up by a considerable margin above the present rationed price of 25 cents per measure. In the absence of the necessary details, it is not possible to assess the average landed costs of imported rice.

78. Alternatively, we may consider introducing an arrangement whereby exporters would be required to surrender to the Government a certain percentage of their export receipts at the official exchange rate, the balance of their export receipts being disposed of at the floating rate. Food imports in 1965 represented about 18-20 per cent of the total imports during the year. This suggests a foreign exchange surrender requirement at a flat rate of 18-20 per cent of export receipts. This would ensure that the Government has sufficient foreign exchange at a favourable rate to import rice and other food-stuffs, without unduly lifting up their c.i.f. costs. This is, however, merely a device of shifting the Budget incidence of a floating rupee, in so far as it relates to Food Subsides, to the shoulders of export industries. It is in the nature of an export tax. While this arrangement might seem attractive, it is not wholly necessary as an increased Cash Subsidy can very well take care of the political difficulty of a possible rise in food prices. Moreover, surrender of part of export receipts introduces multiple exchange rates in place of a unitary rate, and the IMF may raise objections to it.

79. It is important to note that the rupee prices of import goods in general need not go up under the floating rupee. Domestic prices need rise only if inflationary deficit financing continued. The landed costs of import goods (c.i.f. values), however, would go up as a consequence of the floating rate of the rupee diverging from the present statutory rate. The landed cost would then approximate to the prevailing market price of import goods, the difference between c.i.f. values and market prices being the normal margin of profits. Importers cannot grumble against this development. As hitherto, they have been drawing heavy and unmerited subsides from the economy, the result of currency over-valuation. The incidence of the floating rupee would be, not on domestic prices of import goods but on the values of import licenses. These values would now fall to zero.

80. The impact of the floating rupee on the Production front should be beneficial, too. Currency over-valuation, especially in recent years, has been working as a handicap on exporters. The rupee receipts on exports have been less than their real rupee worth. Currency over-valuation has been in fact working as an export duty. The floating rupee will remove this handicap. Since export production accounts for about 26 per cent of the GNP,

the ensuing expansion of export production may contribute significantly to the growth of national income. The decay in capital formation in Transport, the life-line of a modern economy, may be largely due to import restrictions. The abolition of the system of import licensing will permit speedy recovery of capital formation in Transport.

81. On the other hand, the floating rupee may impinge harshly on some of the newer manufacturing industries. They will now forego the exchange subsidy in the form of low cost import goods, which they have been receiving under currency over-valuation. They may also suffer from the effects of the removal of the protection from exchange control and import restrictions. Though from the economic view-point and the wider national interests, the best course may be to leave these industries to their own resources, political considerations may call for their protection. This protection may be given by way of import duties, cash subsidies or tax relieves. Such protection, however, should be limited to a period of time, to permit rehabilitation of the industries concerned from the incidence of the floating rupee and of import liberalisation. Balance of advantages lie in giving them cash subsidies, rather than the alternative ways of protection.

(x) (g). <u>Need to Remove Controls</u>

82. For the economy to derive full benefits of the floating rupee, it is exceedingly important that all restrictions on production and the flow of output should be removed. This implies removal of all price controls, movement and allocation controls, and abolition of all monopoly purchases including monopoly imports by the Food Commissioner, the C.W.E. and other Government Agencies. If during the period of transition, it should be considered necessary for these Agencies to engage in international trade, this should be done on a competitive basis. Private trade should be free to engage in imports, too. The importance of releasing the economy from these administrative restraints and interventions lies in facilitating the shifts in the pattern and course of production and trade in order to enable maximisation of production, income and mass well-being. In the absence of the necessary data regarding price and other controls now operating in Ceylon, it is not possible to go into the details of this part of the Scheme of Reform. This is a matter for careful scrutiny.

V. SUMMARY OF MEASURES OF REFORM

83. The above analysis has indicated that the prevailing economic difficulties in Ceylon have taken root in all sectors of the economy and, therefore, call for multi-sided and basic reforms. If the prevailing policies continued, capital formation, production and mass well-being may deteriorate further. This involves risks of political and social instability. The depletion of External Assets to close to rock bottom and the uncertainty of the flow of foreign aid, leave no alternative but to face unpleasant facts and grapple with the root causes of the malady. The Scheme of Reform outlined above is an attempt to do so. These Reforms may be briefly summarised:

(1) The first link in the chain of reform should be elimination of the inflationary part of Budget deficits, to reduce inflation to zero. This involves that the magnitude of the Net Cash Operating Deficit cannot exceed the sum of :

- (a) drafts on Cash Balances;
- (b) foreign aid in the form of loans and grants;
- (c) Non-Bank Borrowing.

(2) The expansion in the money requirements of expanding production at constant prices should be provided by the Central Bank through purchase of Government Debt and other eligible assets from the market.

(3) The inflationary part of the Net Cash Operating Deficit may be reduced to zero by :

- (a) denationalisation of a selection of State Corporations;
- (b) increased taxation;
- (c) reduction in expenditures;
- (d) a proper combination of (a) and (c).

Of these alternatives, alternative (b) need to be ruled out and the feasibility of alternatives (a) or a suitable combination of (a) and (c) merit consideration.

(4) As a first step to denationalisation of State Corporations, the share and other capital of these Corporations may be listed on the Stock Exchange, small quantities of the scrips being released for sale on the market.

(5) As a first step to reducing and eliminating the Food Subsidy, the Price Subsidy may be replaced by a Cash Subsidy, the Budget cost of the Cash Subsidy being the same as the Budget cost of the Price Subsidy.

(6) The Social Services Subsidies may be sealed down to a possible minimum, through charging a price for such of these Services as may bear the incidence of a price without causing undue hardship.

(7) Every opportunity offered by Budget surpluses should be availed of to scale down taxation. It will be damaging to true socialist progress to permit any further increases in Revenue collections.

(8) There is no solution to the Balance Payments difficulties other than to eliminate the free market premiums on foreign exchange. Of the two alternatives of achieving this, namely, devaluation to the equilibrium level and allowing the rupee to float, the alternative of floating the rupee merits preference.

(9) A floating rupee involves abolition of all exchange control and import restrictions other than Customs duties.

(10) A floating rupee may lift up the c.i.f. costs of rice and other food-stuffs imported from countries outside bilateral agreements. This problem may be tackled by :

(a) Increasing the Cash Subsidy;

(b) Requiring a part of export receipts to be surrendered to the Government at a penalty rate to the sellers.

Of these two alternatives, alternative (a) merits preference.

(11) As a first aid measure for balancing the Budget, which is capable of being introduced at once, import licences, instead of being issued virtually free of charge, may be sold by open tender; and import duties may be levied at the market prices of import goods instead of at c.i.f. values. This may bring sufficient revenues to scale down or to wipe out the inflationary part of the Net Cash Operating Deficit. It is important, however, that this should be a purely temporary measure, pending the adoption of a floating rupee.

(12) For deriving full benefit of the floating rupee, it is important that all controls including price and allocation controls, interfering with production and the flow of output should be removed. Monopoly imports by state agencies and other monopoly transactions should be abolished. If state trading must continue during the transitional period, this should be on a competitive basis, private entrepreneurs being allowed to participate in it.

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18 December 1966

TABLE I

GROSS DOMESTIC CAPITAL FORMATION IN CEYLON

(Rupees million in current market prices)

			1959	1960	1961	1962	1963	1964	1965[1]
I.	**Private Sector and Public Corporations**								
	(a)	Fixed Capital Formation Planting and replanting	62	63	63	64	70	70	65
		Building, other construction	336	341	320	342	262	331	306
		Plant and machinery	119	77	113	113	154	177	119
		Transport	153	109	85	92	63	50	63
		Imported capital goods n.i.e.	64	59	55	57	59	55	29
		Total	733	649	637	668	607	682	582
	(b)	Change in Stocks	12	-31	16	-41	3	-36	-67
	(c)	Private Capital Formation	745	618	652	627	610	646	515
II.	**Government and Public Enterprise**								
	(a)	Fixed Capital Formation	336	317	341	364	384	341	387
	(b)	Change in Stocks	-22	-14	54	40	5	-5	+22
	(c)	Public Capital formation	314	303	395	403	389	336	409
III.	**Total Capital Formation**								
	(a)	Gross Fixed Capital Formation	1069	966	978	1031	991	1023	969
	(b)	Changes in Stocks	-10	-45	69	-1	8	-40	-45
	(c)	Total	1059	921	1047	1030	998	982	924

(1) Preliminary

Source: Central Bank of Ceylon (copies from Recent Economic Trends – Ceylon, World Bank, September 1966, Table V, p.77

TABLE II

MOVEMENTS OF SAVING AND CAPITAL (CEYLON)

(Rupees Million)

	Private			Official			
	Remittances	Loans & Investments	Total (1 + 2)	Remittances	Loans & Investments	Total (4 + 5)	Total (Private & Official) (3 + 6)
	1	**2**	**3**	**4**	**5**	**6**	**7**
1950	-69	-22	- 91	-	- 24	- 24	-115
1951	-77	-41	-118	-	- 29	- 29	-147
1952	-104	25	- 79	-	- 10	- 10	- 89
1953	-59	-38	- 97	14	86	100	3
1954	-67	-49	-116	24	90	114	- 2
1955	-78	-57	-135	17	- 34	- 17	-152
1956	-83	-20	-103	28	11	39	- 64
1957	-66	-38	-104	27	58	85	- 19
1958	-78	- 4	- 82	55	21	76	- 6
1959	-56	4	- 52	44	93	137	85
1960	-31	- 5	- 36	53	19	72	36
1961	-30	6	- 24	41	- 5	36	12
1962	-30	- 3	- 33	37	40	77	44
1963	-30	1	- 29	44	77	121	92
1964	-36	- 8	- 44	76	174	250	206
1965	-24	-17	- 41	60	113	173	132

Note: Minus sign stands for outflow of funds, and no sign for inflow of funds.

Source: Annual Report, Central Bank, Balance of Payments, Table 30

TABLE III

GROSS NATIONAL SAVINGS IN CEYLON [1]

	1959	1960	1961	1962	1963	1964	1965
Gross Domestic Investment	1059	921	1047	1030	998	982	924
Less: Net Borrowing Abroad [2]	-208	-221	-94	-140	-168	-148	-98
Gross National Savings	851	700	953	890	830	834	826
Net Factor Payments	37	44	40	47	53	34	22
Net Remittances and Transfers [3]	12	-22	11	7	13	40	37
	900	722	1004	944	896	908	885
Gross National Savings in % of GNP	13.6	10.8	14.6	12.9	11.6	11.0	10.7
Gross Domestic Savings in % of GDP	14.3	11.3	15.3	13.6	12.4	12.0	11.4

(1) The data presented in this table are derived solely from the relevant national income aggregates. No independent estimates of savings exists.
(2) Includes loan repayments to the United Kingdom and use of external reserves.
(3) Consists of private remittances and public grants.

Source: Central Bank of Ceylon (copied from Recent Economic Trends – Ceylon, World Bank, September 1966, Table VI, p. 77

TABLE IV

CONSUMPTION SUBSIDIES, REVENUE RECEIPTS AND GROSS NATIONAL PRODUCT

(Rupees Million)

	1958-59	1959-60	1960-61	1961-62	1962-63	1963-64	1964-65	Annual Average
1. Total Revenues [(1)]	1,151.7	1,213.0	1,322.5	1,416.9	1,383.9	1,532.4	1,587.9	1,372.6
2. Gross National Product [(2)]	5,854	6,080	6,142	6,418	6,716	7,104	7,388	6,529
3. 1 as % of 2	19.7	20.0	21.5	22.1	20.6	21.6	21.5	21.0
4. Food Subsidies	146.5	193.0	248.0	235.4	225.8	375.4	290.0	244.9
5. Other Relief Payments [(3)]	71.2	46.7	41.7	42.5	40.4	41.1	48.0	47.4
6. 4 + 5	217.7	239.4	289.7	277.9	266.2	416.5	338.0	292.3
7. Social Services [(4)]	372.9	415.3	411.8	430.5	446.0	465.2	491.5	433.3
8. 6 + 7	590.6	654.7	701.5	708.4	712.2	881.7	829.5	725.6
9. 4 as % of 1	12.7	15.9	18.8	16.6	16.3	24.5	18.3	17.8
10. 4as % of 2	2.5	3.2	4.0	3.7	3.4	5.3	3.9	3.8
11. 8 as % of 1	51.0	54.0	53.0	50.0	51.5	57.5	52.2	52.9
12. 8 as % of 2	10.1	10.8	11.4	11.0	10.6	12.4	11.2	11.1

(1) Total Revenue receipts less receipts from Government Enterprises. See Table 17, Central Bank Annual Report, 1965
(2) GNP of relevant Calendar Year
(3) Comprising Direct Relief and Other Transfer Payments
(4) Comprising Education, Health, Housing and Special Welfare Services.

Source: Central Bank Annual Report, 1965, Table II(A)4, p.11, Table 17 and Table 20

Table V

Increase in G.N.P. and Expansion of Money Supply

(Rupees Million)

	1	2	3	4	5	6	7
Year	Cost of Living Index (Colombo Town (1952 = 100)	Gross National product at Constant 1959 Prices	Index of G.N.P. at Constant 1959 (1959=100)	Money Supply	Index of Money Supply (1959=100)	Excess Money Supply beyond requirments of increase in G.N.P.	6 as Index of Money Supply 1959= 100
1959	105.2	5854	100.0	1177.7	100.0	-	(100.0)
1960	103.5	6066	103.6	1208.9	102.6	-11.1	-
1961	104.8	6240	106.6	1288.6	109.4	+33.2	2.8
1962	106.3	6472	110.6	1342.7	114.0	+40.2	3.4
1963	108.8	6599	112.7	1506.0	127.9	+178.7	15.2
1964	112.2	6888	117.7	1621.8	137.7	+235.6	20.0
1965	112.5	7024	120.0	1715.7	145.7	+302.5	25.7

Source: Central Bank Bulletin, August 1966 for (1) and (4) and Central Bank Annual Report, 1965, for (2).

Table VI

BUDGET DEFICITS AND EXPANSION AND EXPANSION OF MONEY SUPPLY

(Rs Million)

Year	1 Changes in Cash Balances (Increase-)	2 Increase in Government Debt with Banks (1)	3 Budget Deficit (1+2)	4 Drafts on External Assets	5 3 - 4	6 Increase in Money Supply
1959-60	6.0	280.6	286.6	178.1	108.5	29.0
1960-61	-	245.6	245.6	44.9	200.7	49.8
1961-62	-40.2	223.6	183.4	62.8	120.6	46.0
1962-63	0.4	179.8	180.2	-	180.2	182.0
1963-64	45.4	115.4	160.8	111.3 (2)	49.5	115.8 (2)
1964-65	24.8	36.6	61.4	-	61.4	83.1

(1) Government Debt holdings (including Treasury Bills) of Central Bank, Commercial Banks and Cooperative Banks

(2) Calendar Year

Source: Central Bank of Sri Lanka Annual Report

Re. Table VI please give the figgures of External Assets (Column 7) and "Foreign Aid" (i.e., grants representing Official "Transfer Payments" plus loans, representing "Loans Received" by the Central Government as given in Table 30 of Central Bank Annual Report, 1965) (column 7 of Table VI), by fiscal years (August-September). This may involve some trouble but will greatly clarify the monetary impact of Budget Deficits. Please check up the figures in the other columns in the Table, in particular, the figures in Column 2.

Table VI

Budget Deficits, Food Subsidies, Trade Balance, Changes in External Assets, Foreign Aid and Money Supply

(Rupees Million)

End of Year [1]	Cash Balances (increase -)	Public Debt [2] holdings of Central Bank and Commercial Banks (decrease-)	Budget Deficits (surplus -) (1 + 2)	Food Subsidies	Trade Balance (3)	Foreign [4] Aid (3)	Depletion of External Assets (increase -)	6 + 7	3 - 8	Money Supply (decrease -)
	1	2	3	4	5	6	7	8	9	10
1950 - 1951	-66.2	-3.8	-70	131.6	238.0		-83.9	-83.9	13.9	
1951 - 1952	73.0	171.6	244.6	247.8	-297.0		343.0	343.0	-98.4	-110.4
1952 - 1953	15.4	76.3	91.7	127.0	-138.0	13	233.4	246.4	-154.7	-69.0
1953 - 1954	1.6	-93.9	-92.3	12.5	340.0	94	-303.9	-209.9	117.6	-130.3
1954 - 1955	-88.6	-83.8	-172.4	36.0	415.0	25	-284.5	-259.5	87.1	115.8
1955 - 1956	-11.0	18.1	7.1	79.5	196.0	37	-46.9	-9.9	17.0	53.9
1956 - 1957	21.0	127.8	148.8	105.5	-95.0	50	213.8	263.8	-115.0	-86.7
1957 - 1958	47.5	61.5	109.0	112.0	-89.0	77	128.7	205.7	-96.7	36.7
1958 - 1959	61.7	180.8	242.5	146.5	-185.0	59	199.2	258.2	-15.7	100.9
1959 - 1960	6.0	280.6	286.6	193.0	-210.0	73	192.7	265.7	20.9	31.2
1960 - 1961	-	245.6	245.6	248.0	-87.0	60	9.6	69.6	176.0	79.7
1961 - 1962	-40.2	223.6	183.4	235.4	-143.0	77	27.8	104.8	78.6	54.1
1962 - 1963	0.4	179.8	180.2	225.8	-161.0	119	41.6	160.6	19.6	163.3
1963 - 1964	45.4	115.4	160.8	375.4	-193.0	83	111.3	194.3	-33.5	115.8
1964 - 1965	24.8	36.6	61.4	290.0	-5.0	96	-88.9	7.1	54.3	93.9

(1) Fiscal year ended September. (2) Including Treasury Bills and other short-term debt. (3) Calendar year

(4) Foreign aid is made up of grants, representing Official "Transfer Payments" plus loans, representing "Loans Received" by the Central Govt. (as given in Table 30, **Central Bank Annual Report**, 1965)

Source: **Central Bank Annual Report 1961**. Tables 20, 22 & 23A; and **Central Bank Annual Report, 1965**. Tables 20, 23, 25, 30, 31 and Table 1.

Table VII

Overall Budget Deficits *

(Rupees Million)

Year	Revenue (1)	Current Expenditure (2)	Losses of Government Enterprises	Revenue Surplus (1-2+3)	Capital Receipts: Administrative Borrowings (3)	Capital Receipts: Net Foreign Loans & Grants	Capital Receipts: Non-Bank Borrowing	Capital Receipts: Total (5+6+7)	Capital Expenditue (4)	Capital Deficit(-) (8-9)	Overall Defici(-) (4+10)	Overall Deficit Financed By: Bank Borrowing	Overall Deficit Financed By: Decline in Cash Balances
	1	2	3	4	5	6	7	8	9	10	11	12	13
1958 - 1959	1236.6	1131.7	-34	70.9	27.6	51.2	109.0	187.8	498.8	-311.0	-240.1	179.3	61.7
1959 - 1960	1331.8	1245.7	-16	70.1	57.4	35.9	86.5	179.8	179.8	-317.2	-247.1	241.1	6.0
1960 - 1961	1443.4	1350.7	-22	70.7	29.4	26.6	165.2	221.5	221.5	-311.8	-241.1	241.4	-
1961 - 1962	1595.3	1431.8	-19	144.5	104.5	55.8	109.4	269.7	269.7	-330.5	-186.0	226.6	-40.2
1962 - 1963	1534.9	1477.2	-24	83.7	-33.8	93.5	153.5	213.2	213.2	-262.1	-178.1	178.1	0.4
1963 - 1964	1612.8	1553.6	-20	39.2	-1.1	96.8	206.1	301.8	301.8	-199.8	-160.6	115.2	45.4
1964 - 1965	1762.9	1644.8	(est)-22	96.1	56.7	100.1	243.2	400.0	400.0	-138.6	-42.5	17.7	24.8
1965 - 1966	1795.9	1677.0	-22	96.9	25.0	175.0	275.0	475.0	475.0	-199.0	-102.1	99.1	

(1) Figures in this column do not tally with the figures of Revenue in Table IV. The figures in the present table (Table VII) are taken from Table XIII of **Recent Economic Trends - Ceylon**, World Bank, September 1966, p. 82.

(2) Adjusted for Rubber and Tea subsidy, Electrical Department Reserve expenditure and such other payments from extra-budgetary funds. See **Recent Economic Trends**, loc.cit., p. 82n.

(3) Inter-departmental "Deposits and Miscellaneous Borrowing". See **Central Bank Annual Report, 1965**, Table 20.

(4) Including Advance Payments (net).

* This Table has been adapted from Table XIII, "Summary of Government Accounts and Financing". **Recent Economic Trends - Ceylon,** World Bank, September 1966, p. 82.

Table 7

Increase in G.N.P. Mid Expansion of Money Supply

(Rupees Million)

	1	2	3	4	5	6	7
Year	Cost of Living Index (Colombo Town) (1952=100)	Gross National Product at Constant 1959 Prices	Index of G.N.P. at Constant 1959 Prices (1959=100)	Money Supply	Index of Money Supply (1959= 100)	Excess Money Supply beyond requirements of increase in GNP	6 as Index of Money Supply (1959 = 100)
1959	105.2	5,854	100.0	1,177.70	100.0	-	(-100.0)
1960	103.5	6,066	103.6	1,208.90	102.6	-11.1	-
1961	104.8	6,240	106.6	1,288.60	109.4	+33.2	2.8
1962	106.3	6,472	110.6	1,342.70	114.0	+40.2	3.4
1963	108.8	6,599	112.7	1,506.00	127.9	+178.7	15.2
1964	112.2	6,888	117.7	1,621.80	137.7	+235.6	20.0
1965	112.5	7,024	120.0	1,715.70	145.7	+302.5	25.7

Source: Central Bank Bulletin, August 1966 for (1) and (4) and Central Bank Annual Report, 1965, for (2).

Table VIII
CAPITAL EXPENDITURE

(Rupees Million)

Year	1 Administration & Social Services		2 Economic Services and Government Enterprises		3 Fisheries, Manufactures and Mining, and Trade (1)		4 Total Capital Expenditure (2)	5 Budget Deficits
	Amount 1(a)	% of 4 1(b)	Amount 2(a)	% of 4 2(b)	Amount 3(a)	% of 4 3(b)		
1960 - 1961	98.2	18.9	373.7	72.0	64.4	12.4	519.1	241.1
1961 - 1962	110.9	18.9	388.5	66.3	73.7	12.6	585.6	186.0
1962 - 1963	96.9	19.8	382.2	78.2	69.6	14.2	489.0	178.4
1963 - 1964	112.3	21.7	376.2	72.7	88.0	17.0	517.6	160.6
1964 - 1965 (3)	105.4	18.2	441.5	76.1	113.5	19.6	580.0	42.5
1965 - 1966 (4)	121.7	18.1	514.2	76.3	107.6	16.0	674.0	102.1
Annual Average	107.6	19.2	412.7	73.6	75.4	13.4	560.9	151.8

(1) These comprise part of Economic Services
(2) Figures in this column and the corresponding figures in column 9 of Table VI do not tally as the latter include, and the former exclude "Advance Payments (not)", the category given in Table XIII of **Recent Economic Trends - Ceylon**, op.cit., p. 82
(3) Provinsional
(4) Original Estimates

Source: **Central Bank Annual Report**, 1965, Table 20

Table IX

REVENUE AND EXPENDITURE

(Rupees Million)

	1	2		3		4		5	6		7	
Year	**Expenditure on Revenue Account (1)**	**Civil Administration, Defence, Economic Services, Interest on Public Debt, Pensions and Grants-in-aid to Local Authorities**		**Social Services (2)**		**Food Subsidies**		**Other Direct Relief**	**Total (4+5)**		**Total Consumption Subsidies(3+6)**	
		Amount 2(a)	% of 1 2(b)	Amount 3(a)	% of 1 3(b)	Amount 4(a)	% of 1 4(b)		Amount 6(a)	% of 1 6(b)	Amount 7(a)	% of 1 7(b)
1960 - 1961	1259.5	558.0	44.3	411.8	32.7	248.0	19.7	41.7	289.7	23.0	701.5	55.7
1961 - 1962	1284.2	575.8	44.8	430.5	33.5	235.4	18.3	42.5	277.9	21.2	708.4	55.2
1962 - 1963	1307.8	595.6	45.5	446.0	34.1	225.8	17.3	40.4	266.2	20.4	712.2	54.5
1963 - 1964	1730.2	637.8	36.9	465.2	26.9	375.4	21.7	41.4	416.8	24.1	881.7	51.0
1964 - 1965	1485.0	689.8	46.5	491.5	33.1	290.0	19.5	48.0	338.0	22.8	829.5	55.9
1965 - 1966	1506.4	690.2	45.8	502.5	33.4	271.5	18.0	42.2	313.7	20.8	816.2	54.2
Annual Average	1428.9	624.5	43.7	457.9	32.0	274.4	19.2	42.7	317.1	22.2	774.9	54.2

(1) "Total Current Payments" less Payments under "Government Enterprises".

(2) Comprising Education, Health, Housing and Special Welfare Services.

Notes : As columns 2b and 7b do not add up to 100, the figures in this table require refinement, which it has not been possible to undertake immediately.

Source: **Central Bank Annual Report**, 1965, Table 20

Table X

Volume and Terms of Ceylon's External Trade

Year	Volume of Exports Index (1958=100)	Volume of Imports Index (1958=100)	Export Prices Index (1958=100)	Import Prices Index (1958=100)	Terms of Trade (1958 = 100)
	1	2	3	4	5
1950	86	74	101	103	98
1951	88	83	123	122	101
1952	91	85	96	132	73
1953	94	88	98	120	82
1954	97	88	109	105	104
1955	102	86	114	106	108
1956	98	94	107	119	90
1957	93	99	102	115	89
1958	100	100	100	100	100
1959	98	110	104	109	95
1960	103	104	104	109	95
1961	108	97	95	107	89
1962	116	94	91	105	87
1963	112	83	93	111	84
1964	120	114	93	120	78
1965	120	82	98	126	78

Source: Central Bank Annual Report,1965, Table 32 and Central Bank Bulletin, August 1966, Table 24.

TABLE XI

Outflow of Private Capital and Overvaluation of Ceylon Rupee

(Rupees Million)

Year	Remittances	Investments	Total Private Capital (1+2)	Changes in External Assets	Quotation for U.S. Dollar in terms of Ceylon Rupee BID	OFFER
	1	2	3	4	5	6
1950	-69	-22	-91	-169.2	-	
1951	-77	-41	-118	-83.9	-	
1952	-104	25	-79	343.0	-	
1953	-59	-38	-97	233.4	-	
1954	-67	-49	-116	-303.9	-	
1955	-78	-57	-135	-284.5	-	
1956	-83	-20	-103	-46.9	-	
1957	-66	-38	-104	213.8	-	
1958	-78	-4	-82	128.7	-	
1959	-56	4	-52	199.2	Rs. 7.05	Rs. 6.20
1960	-31	-5	-36	192.7	Rs. 7.18	Rs. 6.31
1961	-30	6	-24	9.6	Rs. 7.77	Rs. 6.94
1962	-30	-3	-33	27.8	Rs.10.53	Rs. 8.88
1963	-30	1	-29	41.6	Rs.10.33	Rs. 8.87
1964	-36	-8	-44	111.3	Rs.13.60	Rs.10.56
1965	-24	-17	-41	-88.9	Rs.12.37	Rs.10.04

Source: Central Bank Annual Report, 1965, Table 30 and Table 31.

(1) Price lists of Foreign Exchange, Swiss Bank Corporation, Zurich, monthly statements from 1959 to 1964 and fortnightly statements from 1965. On 30-11-66 the Bid and Offer quoations for the US Dollar were Rs.15.38 and Rs.11.36 respectively. Quotations in this statement are averages of six monthly quotations.