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Inadequate Base of Production

by R. G. Holloway, London

Ceylon has the highest standard of living in South Asia. Lacking extensive mineral deposits and with only a small manufacturing sector, the island's relative prosperity has been due to the development of plantation crops for the world market. However, the economy is now in a process of rapid transition from excessive reliance on foreign trade.

Production of the main export crops—tea, rubber and coconut products—has risen substantially over the past decade but has been accompanied by market saturation and deteriorating returns so that, reinforced by the effect of income redistribution and inefficient resource management during the 1956-65 period of nationalist-communist coalition under Mr Bandaranaike, there has been a marked decline in the capacity to finance development from personal and corporate savings. Aggravated by the misguided economic policies of the 1956-65 period, a further consequence has been a dangerous decline in the country's gold and foreign exchange reserves. Ceylon devalued by 20 p.c. in November 1967 and has since established a multiple exchange rate.

Inflationary Pressures

The shortfall in private sector savings was partly due to the failure of the tea and, more especially, the rubber estates to make adequate allowances for depreciation to cover replacement cost. Dividends, in effect, were paid out of capital. The shortfall is also linked to the very heavy burden of taxation. Despite the considerable channelling of local resources to government revenue, and largely because of heavy recurrent expenditure on extensive welfare services and subsidies, the Bandaranaike coalitions of 1956-65 had continuously to resort to borrowing from the banking system in order to finance their development programmes. Unfortunately, much of the expenditure on these programmes was either ill-advised or misapplied.

To make matters worse, this deficit financing added to the money supply without mobilising

counterbalancing unused resources and, aggravated by labour agitation, this action resulted in rapidly rising prices. In the absence of adequately effective controls, sustained inflation raised the demand for imports, diverted resources from export to local use, and raised the costs of producing for export; thereby increasing the adverse pressure on the balance of payments.

The present coalition of moderates, headed by Dudley Senanayake, has reduced consumer subsidies and brought the monetary situation under better control. A World Bank mission reported in 1968 that the former atmosphere of crisis was no longer present and resources were being used more productively.

Foreign Aid and Investment

There has been a considerable increase over the past decade in the volume of foreign aid negotiated to ease the pressure on the balance of payments. But difficulties arose under the Bandaranaike coalitions as the result of the inadequacy of the programming machinery in relation to the conditions which were generally attached to this aid and much of it remained unutilised. The greatest difficulties arose with Chinese and Soviet bloc aid and the fewest with international loans and Western food gifts and export credits. The emergency phase of group commodity aid initiated in 1965 is now giving way to a more normal development aid operation as the containment situation is being transformed into a renewed growth effort. Aid promised over the past four years totalled about \$200 mn, with the United States and Britain the main donors.

Other countries in Asia have benefited considerably from an inflow of foreign direct investment but, largely as the result of the expropriation of American oil distribution interests, the threatened nationalisation of the foreign-owned estates and restrictions on foreign banks and insurance companies, the flow of private investment into Ceylon during the Bandaranaike era was negligible. The

situation was not aided by the blocking of outward transfers of capital and the introduction of a moratorium on remittances of profits and dividends in 1964, even though pioneer industries were exempted. The present Government has lifted this moratorium and it is intended to eliminate the backlog by the end of 1970. Despite this, the net outflow of private direct investment has been renewed.

Improved Growth

While, as a consequence of the combination of adverse factors, the level of investment achieved by the economy as a whole (and by the private sector in particular) had, until 1966, tended to decline, capital expenditure has since risen sharply. In 1968 fixed capital formation increased by 21 p.c. The gross national income increased by an impressive 7.0 p.c. in 1968 equalling 16 p.c. of GNP in constant price terms, compared with 2.5 p.c. in 1967—thus improving real income per head by 4.8 p.c. (the rate of population growth being 2.2 p.c.). Previously the value of output had continued to expand, usually slowly, in both current and constant price terms though not always in per capita terms. In real terms, per capita income has risen by 21 p.c. since 1959.

The fundamental cause of this previously sluggish growth was the low productivity of investment. Linked to this was poor resource management and a contributory factor was the persistent abuse of the price mechanism. The use of prices as a means of income redistribution seriously interfered with their role in guiding the allocation of resources as well as in generating surpluses for financing further investment. The high support price for rice, coupled with the provision of irrigation either free or well below cost, seriously reduced the attractiveness of alternative crops while artificially low prices for rail and bus fares, electricity, postal and telecommunication services, and domestic water supplies stimulated demand and so caused premature investment in these sectors. Further, the scarcity of imported goods was not always reflected in government-administered prices. In short, the attempt to insulate consumers from the realities of rising costs directly harmed the rate of growth.

The rapid rate of growth achieved in 1968 mainly took the form of expansion of output for local use and was partly due to Government stimuli applied particularly to the agricultural sector (though the gains in agriculture were also substantially due to favourable weather). The value of real output in agriculture, construction and manufacturing rose by 6.9 p.c., 27.1 p.c. and 7.7 p.c., respectively. On the supply side, the growth of manufacturing output was largely due to the liberalisation of materials imports though better labour relations also helped.

The relative importance of agriculture has fallen over the past decade but it still accounts for more than a third of the gross domestic product. Perhaps surprisingly, food accounts for an even higher proportion of Ceylon's imports. Changes in comparative cost advantage have, however, induced a growing emphasis on expanding local food production. Government assistance has been concentrated on the peasant sector and particular emphasis has been placed on increasing rice production.

Tea as Most Important Crop

Tea is the most important of the island's crops and accounts for more than half of Ceylon's export receipts. High quality tea, of which Ceylon has for some years been the main exporting country, is grown at high elevations, mainly on large estates owned by companies registered in the United Kingdom. It is widely recognised that these are some of the finest tea properties in the world.

Most of the bushes are 70-80 years old. Those at the lower levels retrogress after about 60 years while the older bushes in the cooler up-country areas which have not shown signs of regression have been rendered technically obsolete by the development by the Ceylon Tea Research Institute of vegetatively-propagated tea yielding over 5,000 lb per acre (the average yield of the older stock, grown from seed, being about 800 lb). Re-planting costs as well as the upkeep of immature areas have been allowed as revenue expenses for tax purposes but, largely owing to the very high costs involved, practically no replanting had been undertaken prior to the introduction of a replanting subsidy scheme in 1959. Over 27,000 acres of the total of nearly 600,000 have since been replanted. The rate of replanting has been stepped up and in both 1967 and 1968 exceeded 5,000 acres. A further factor affecting the scale of replanting has been the gradual price erosion which has taken place for more than a decade due, in part, to the slow growth of tea consumption in high income markets.

Ceylon has also lost some of its principal markets in Middle Eastern countries which have themselves been faced with serious foreign exchange difficulties and have therefore been prepared to continue purchasing tea only on a reciprocal trading basis. This is a requirement which India has been better able to meet. Additional competition has also had to be faced from African producers. Heavy taxation has further reduced the profits available for reinvestment while the adoption of nationalisation of the foreign-owned estates as Government policy (never implemented, however, and quietly abandoned by the incoming Administration in 1965) did not encourage them to re-invest and many of them sold part or all of their land. Official anxiety about the fall in output and tax revenue which often accom-

panied the transfer of estates from European to Ceylonese ownership led to the appointment of a committee which reported that the impairment was caused chiefly by the fragmentation of estates into relatively small blocks of uneconomic size. Legislation enacted in 1958 has, with minor exceptions, prevented the further subdivision of estates into units of less than 500 acres.

A rehabilitation subsidy scheme was brought into operation in 1959 to provide assistance to owners of less than 150 acres for improving the condition of their land and by providing planting material. Most of the increase in production which has been subsequently achieved is directly attributable to this scheme—in particular, to the increased application of fertiliser. But a significant part of the increase is also due to export duty rebates. The conditions laid down for these rebates (which, until 1968, were effectively confined to smallholders) discourage the production of very poor tea.

Need for Imports

Rice is the most important crop grown in the peasant sector and is second only to tea in its contribution to the total value of agricultural production. Productivity, however, is fairly low and more than half the country's cereal requirements have to be imported. With the implementation of the current crash development programme, the need for imports is expected to rapidly decrease.

The acreage under paddy has been increased by dry zone colonisation schemes designed to put land into the hands of landless peasants. State land has been leased under a special system of tenure—the chief characteristics of which are perpetuity of leasehold, prohibition of mortgage, protection from seizure for other debts, and prevention of fragmentation. The clearance of jungle, irrigation and cultivation have been supervised by specialists and subsidies have been provided for soil conservation, well construction and housing while planting materials have also been distributed. The acreage under paddy has also been extended by the use of terraced and channelled land which had not been regularly cultivated or which had been used for other crops but which shows economic returns for paddy under the guaranteed price scheme. The acreage double-cropped has also increased as the result of improvements to existing irrigation and drainage facilities.

Most of the increase in rice production has resulted from increased acreage but a good part is the result of improved yield—now over 40 bushels per acre. This improved yield is mainly due to the widespread use of improved seed and to the increased use of fertiliser which is distributed through co-operatives with the Government bearing half the cost.

Coconut is the second most important peasant crop. Coconut products (principally coconut oil, copra and desiccated coconut) together constitute the second most important export and the industry also makes a significant contribution to domestic supplies. More than four-fifths of the land devoted to coconuts is in the hands of those who own less than 20 acres, many of them with only one or two trees. To arrest a decline in production, a rehabilitation scheme was introduced in 1956, providing for the subsidised distribution of fertiliser and for stepping up the pace of replanting on worn out coconut lands by supplying high-yielding seedlings at subsidised rates. Roughly one-fifth of the million acres under coconut has since been replanted.

Rubber is the only other major crop, providing a sixth of Ceylon's export receipts. It is grown principally on estates, few of which are now owned by British companies. The rapid transfer of foreign-owned estates to local ownership which took place between 1948 and 1957 is one of the main reasons why the substantial savings and reserves of foreign exchange with which Ceylon ended the war have been depleted. It is obvious that the money could have been put to better use if there had not been a very strong social importance attached to the ownership of land and if there had been greater confidence in the prospects for industrialisation.

Despite legislation enacted in 1958 which has, with minor exceptions, prevented the fragmentation of estates into units of less than 250 acres, smallholder participation has increased slightly. This has been due to the provision of allotments under highland colonisation schemes, to preferential subsidies, and the provision of planting material and fertilisers by the Government. With most of Ceylon's rubber trees well past their prime and giving poor yields, a replanting scheme was introduced in 1953 under which subsidies have been paid to owners of uneconomic rubber lands who are prepared to replant with approved varieties of high-yielding clones developed in Malaysia. The replanted acreage now produces two-thirds of the output.

Industrial Growth

Largely as the result of technical and financial aid from the Soviet bloc, the public sector has constituted the major area of medium and heavy industrial growth. A steel rolling mill, a flour mill, a tyre and tube factory, a hardware factory, a cement plant, and a ceramics factory have been brought into commercial production in the last three years and a petroleum refinery designed to meet all Ceylon's requirements, another legacy of the Bandaranaike Government's negotiation of Soviet aid, came on stream this year.

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GERMAN PRISM

Composition of the West German Export Surplus

In the first seven months of the current year the Federal Republic's export surplus was smaller by DM 903 mn than in the previous year's corresponding period. This is mainly a result of the smaller export surplus vis-à-vis the United States and Canada declining by DM 762 mn (to DM 197 mn) and vis-à-vis the EEC-countries decreasing by DM 610 (to 1,414 mn). In trade with the EFTA-nations, Asia and the East-bloc the export surplus has increased. In trade with the African states the foreign trade deficit rose by DM 281 mn to DM 2,213 mn.

Hamburg's Container Terminal Expanding

At the moment, containers are the talk of Hamburg! On October 21, this year's container exhibition has been opened in the exhibition park "Planten un Blomen" on 30,000 square-meters. 155 firms from 13 countries have sent their products to Hamburg. This exhibition is the greatest special show of the world.

We take this as an occasion to point to Hamburg's highly modernised container facilities, which have been—and will be—steadily extended and improved.

Early in September the second construction stage of the container terminal at Burchardkai has been finished and is now operating. The completion of this sector enables the Department for Economic Affairs and Transport of the Free and Hanseatic City of Hamburg to offer an 860 metres long quay for four container ships and an acreage of 240,000 squaremetres suited for container operations. After completion of the second stage the third construction stage has been started. This sector comprises the building of a quay measuring 600 metres in length for the fifth and sixth container berth and the preparation of a handling area of 299,400 squaremetres. All facilities are also equipped for conventional transhipments of general cargo.

In the container terminal Hamburg a total of 18 to 20 berths—depending on the size of the vessels—can thus be built for container ships at quays of a total length of 4,200 metres together with areas suited for container operations totalling 1.75 mn squaremetres. A possible future demand for container operation facilities surpassing this capacity could be satisfied, too, since in the harbour extension area a long-term reserve acreage of about the same size is available. The problem of approaches to this area is solved by an already existing port.

7th Overseas Import Exhibition "Partner des Fortschritts"

The 7th Overseas Import Exhibition "Partner des Fortschritts" ("Partners of Progress") ended in Berlin on September 28. Most of the 476 (1968: 225) exhibitors from 53 countries in Asia, Africa and Latin America as well as importers could—as compared with the previous year—frequently book more orders and make numerous new business contacts.

Among the most successful exhibitors is the People's Republic of China, that with more than 30 separate contracts could sell textiles and tinned asparagus to the value of DM 4.5 mn. Good results have been also achieved by the exhibitors from the Republic of Korea who also concluded contracts for the delivery of textiles and handicraft products valued at DM 4.5 mn, or by Pakistan firms which sold cotton textiles to the value of DM 1.7 mn. Five Brazilian firms made contracts for the delivery of furniture, jewelry and finery, as well as buckram valued at DM 1.4 mn.

The organiser's abundant efforts (ADB Ausstellungs-Dienst, Berlin) to promote the trade-character of the Overseas Import Exhibition by consultation services have obviously been successful. For, in the aggregate the exhibitors offered a considerably wider range of goods that above all was increasingly oriented towards German and European market conditions. It is particularly noticeable that on this exhibition apart from trade

between overseas producers as well as exporters and German as well as foreign importers, exhibitors between themselves also concluded trade agreements and made promising contacts.

Slackening Exports to France Anticipated

Almost half of the German enterprises are expecting a considerable deterioration of their export transactions with France. This is the result of a survey of the German-French Chamber of Commerce in Paris. According to this survey the devaluation of the Franc as well as rising wages and prices in the Federal Republic endanger Germany's position in its most important export market. Export prices should increase by 15 p.c. Two thirds of the German enterprises do not see any chance of balancing their disadvantages in the price sector by other competitive measures. The French Government's check to economic activity will cut down French demand for German goods. The Chamber of Commerce stated that 45 p.c. of the firms questioned—i.e. enterprises in the sectors of consumer goods and of capital goods—are anticipating a considerable deterioration of their position in the French market. In the opinion of the German-French Chamber of Commerce two thirds of all German mechanical engineering firms working in France are expecting a considerably impaired market position, while one third does not expect particular difficulties. The future prospects of the chemical industry seem to be quite similar, while those of the electrical industry are judged to be somewhat more favourable.

The Federal Republic's Foreign Trade with COMECON-Countries

The exchange of commodities between the Federal Republic of Germany and the COMECON-nations could be strongly expanded in the first half of the current year. It has risen from DM 3.5 bn to DM 4.1 bn or by 17 p.c. as compared with the previous year's corresponding period. Considerable differences occurred, however, between the Federal Republic's imports from these countries and its deliveries to them: While West German exports to the COMECON-countries expanded by about DM 400 mn to DM 2.4 bn and thus registered a higher growth rate (19 p.c.) than West Germany's total exports in this period (17 p.c.), the growth of the Federal Republic's supplies from this area with 12 p.c. remained conspicuously below the growth rate of its total imports (24 p.c.).

This disequilibrium is of major importance for the COMECON-states' economic development as a whole. For, their import capacity is limited by the level of their exports. Although at present the Federal Republic absorbs 21 p.c. of the East-bloc nations' Western exports, it is believed that this trade constituting but 4 p.c. of West German total foreign trade could be extended still. To what extent these efforts might succeed does not depend alone on the signing of trade agreements but above all presupposes a better diversification of the COMECON-countries' export offer. As long as this is limited mainly to foodstuffs, raw materials and semi-finished products, the "big leap" ahead is not to be anticipated.

Almost One More Million of Motor Vehicles

On July 1, 1969, the Federal Republic's number of motor vehicles (including cars not registered temporarily) exceeded the previous year's corresponding level by 0.95 mn (6.6 p.c.). Together with a further decline in the number of motorcycles and scooters—small as it is anyhow, and one third of it not registered—the number of cars and vans rose by 902,000 (7.7 p.c.). The number of trucks (3.9 p.c.) and tractors (3.8 p.c.) increased at a considerably smaller rate.

High Rates of Growth in the Electrical Industry

The Berlin Association of Electrical Engineering states in its semi-annual report that during the first six months of the current year the negative consequences of the recession of 1966/67 have completely been overcome. There is a continuing upward trend and the hopes harboured at the beginning of the year should certainly be exceeded even. A number of capacities could be better utilised if the required manpower would not be missing.

The Berlin electrical industry's values of goods delivered has reached DM 1.76 bn in the first half of the year and with that has increased by 21 p.c. in terms of money. Since in 1969 the price index has been rising by only 0.8 points, the rate of growth in real terms achieved a value of fully 20 p.c. Export deliveries with 22.7 p.c. increased somewhat more still, so that the export quota rose by 21 p.c. The growth rate of production values with 22.4 p.c. surpassed even that of turnovers. With that the growth rate of 21.6 p.c. registered by the West German electrical industry has been surpassed rather considerably.

The main cause for the failure of a number of these public corporations to reach capacity output quickly has been the difficulty of materials supply. Some of the corporations have done well but the majority have been troubled since their inception by premature investment, ill-conceived technical facilities and weak management. Added to these difficulties, there have been strong political pressures for excessively low selling prices. The Government has failed to establish firm guidelines for the public corporations and its attitude towards the private sector remains equivocal.

The private sector produces a large variety of light consumer goods required in the domestic market and also makes a minor contribution to exports in the form of such items as batteries and biscuits. As import quotas have been most restrictive for luxuries, a large number of the new factories which have been brought into production are in the inessential category. They are, in addition, generally large users of imported materials so that the net saving of foreign exchange has been small and this, in turn, led to restrictions on the importation of materials and some factories have consequently worked at less than full capacity. The initial impetus to local investment has therefore been spent, and it is possible that many of these new factories can never hope to become fully competitive with foreign production.

The Government has therefore decided that new industrial projects must draw their inputs more from the existing or developing sectors of the economy than from imports; and priority is now given to investment in projects designed for the production of capital and intermediate goods, especially those of the heavier industries.

Expansion of Exports

Ceylon's prospects depend heavily on the expansion of export earnings. The prospects for greatly increasing these earnings are not, however, encouraging. The island's exports are almost entirely primary commodities, lacking diversity, of which tea is likely to remain by far the most important. The area under tea cannot, however, be greatly expanded while replanting with higher yielding stock is costly and the response to the increased use of fertilisers may soon reach its technical limit. There is, moreover, little point in rapidly increasing production when demand is relatively inelastic. In the case of rubber, the situation is even more unfavourable since demand for the natural product is increasingly subject to inroads made by advances in synthetic alternatives while the relative cost of production in Ceylon is high and is likely to become even higher. With declining prices, the margin of

profit will remain extremely narrow and may disappear altogether. The position with regard to coconut products is less unfavourable but the scope for exports of manufactures is severely restricted. Favourable prospects exist, however, for fish and there is a slender hope of finding oil.

While, on the whole, it is difficult to envisage from current trends any worthwhile increase in export income within the next decade, the need for imports will more than proportionately increase. With the introduction of import controls, it has been possible for the Government to reduce the rate of less essential consumer imports. These, however, form a relatively small part of total requirements. Industrialisation requires a sharp increase in imports of machinery, fuel and materials. Restraining these imports seriously defers the structural development of the economy and, combined with restrictions on imports of consumer goods, adds to inflationary pressures. Imports could be maintained at an adequately increasing level, despite relatively stagnant export earnings, if high levels of foreign exchange reserves existed; but they do not.

Transformation of Production Structure

As there seems to be no reason to anticipate a strong improvement in the response of foreign investors—at least in terms of the capital involved—Ceylon's problems of economic development appear to resolve themselves into a series of interlocking vicious circles which can only be broken by the massive application of external aid. Fortunately aid has been stepped up. The most important fact for Ceylon's economy is that the existing narrow base of physical production is clearly inadequate to substantially raise the island's standard of living in the face of the decelerating but still fairly rapid increase in population (now 12 million) or even to remedy the sizeable extent of unemployment and underemployment which already exists.

Even with adequate external assistance, there can be no real solution to the fundamental economic problems of Ceylon without an effective transformation of the structure of productive capacity. A reduction in the large import bill for rice and other foods by extending the margin of cultivation to the island's less fertile land and, more particularly, by increasing yields from existing acreages is both possible and desirable but would eventually be contained by physical limits if not earlier restricted by unremunerative cost. The relatively rapid expansion of the service sector over the past decade lacks a sufficiently mature physical base, and may be interpreted as much as a regression to a less developed form of economic organisation as an unusual anticipation of an industrially advanced society. In the final analysis it is to industrialisation that a concept of cumulative expansion is most applicable.