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# Ceylon on the Road to Long-term Decline?

by Dr Jörn Fitter, Colombo \*

**Since the day of Independence the Administration of Ceylon has tried by a great number of measures to cope with the country's social and economic problems. But the much desired change for the better has not been realised so far. On the contrary: There are many indications of a threatening collapse in Ceylon's economy.**

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**T**he economic difficulties that reached crisis proportions in 1971/72 can principally be traced to an incapability of restricting present consumption for future benefits and of enforcing social discipline in a situation where the burden of national welfare measures is threatening the economy's total collapse. Despite of constant demands by the Prime Minister to work harder and honestly and various austerity appeals, it had virtually been impossible to formulate collective goals in such a way that they inspire enthusiastic participation in a common effort to save Ceylon from possibly its worst economic disaster ever.

The dominant policy objective has been the commitment to raising the standard of living of the masses. There are indications that Ceylon has been remarkably successful in achieving the major objectives of its social policy: a more equal distribution of income. This commitment found its expression in two basic issues in Government policy:

- ☐ an adequate supply of mass consumption goods like food and textiles at low prices by means of subsidies and
- ☐ the provision of education, health and transport either free of charge or substantially below cost.

There are two threats to the survival of Ceylon's economic and social system. First, since independence the population has risen on an annual average of about 2.7 p.c. and its absolute size has nearly doubled from 7 mn to almost 13 mn in 1972. The large contributions of the export sector to GNP had been the financial basis of the social benefits extended to the masses of the people. Secondly, with a constant decline in the export prices of the three export crops—tea, rubber and coconut—the Government found it increasingly difficult to maintain its social policy in view of a population growing at that high rate.

To ensure that adequate supplies of goods of mass consumption, mainly food and textiles, continued to be available at traditionally low prices, the Government had been forced to introduce exchange and import restrictions. This system became another element in the series of measures for maintaining a policy of raising the standard of living of the masses.

## **Consumption Versus Growth**

As the import policy had to be pursued in view of stagnating per-capita income resulting from a lack of adequate incentives for the production of mass consumption goods, in view of an investment policy which directed the scarce resources mainly into infrastructure and heavy industry with marginal contributions to output, in view of a failure to improve exports and a decline in external assistance, the dynamics of the social objectives in the context of a rapidly growing population soon changed the nature of the allocation problem. It was no longer a question of inter-personal distribution of consumption but became instead a conflict between total current consumption, investment and growth. In order to maintain the governmental welfare policy, allocations for imports of productive inputs and investment goods were cut back to provide foreign exchange for consumer goods imports. In the end with its reserves nearly exhausted Ceylon seems to be on the road to long-term economic decline.

In the task of re-structuring the economy substantial progress had already been made between 1965 to 1969 as policies were reoriented towards pushing domestic production. However the management of financial affairs failed to provide the basis for sustaining this progress. In a country where total government outlays account for 30 p.c. of GDP, the rate of growth and the structure of public expenditure has a strong influence on the overall allocation of re-

sources. Although in the 1960s the thrust had been on raising consumption the present Government found itself unable to reverse this trend. Government current expenditures were outrunning the increases in GDP at constant prices, not counting the losses made by public enterprises and corporations as a result of selling their goods and services below economic cost. The result was not only a low rate of public savings but also very large expansionary deficits of the Government.

### **Government Policies**

The chief instrument of Government intervention in the economy for achieving its social objectives has been the rice subsidy. The subsidy bill rose to the colossal sum of Rupees 516.4 mn representing about 30 p.c. of current expenditures. The rice ration is only one of the measures which are likely to increase consumer expenditures.

Since taking office the Government has taken a number of actions in order to ensure the dominant role of the public sector in industrial life. This policy has not yet been finally formulated. Nevertheless the Government has already introduced the Business Acquisitions Bill which allows the take-over of any business enterprise. The bill itself contains no safeguards against arbitrary takeovers. Beside this a Capital Levy and a Compulsory Savings Levy have been introduced. Furthermore the Government is determined to impose a Rupees 2,000 ceiling on expendable income, a measure unknown in any other part of the world. The climate is therefore not one in which new private investment can be anticipated.

The Finance Minister declared in connection with the Five Year Plan, announced in November 1971, that national agencies will be created which will spell out obligations, coordinate activities between private and public sectors and generally follow a policy of purposeful intervention in the activities of the private sector. It may be asked to what sort of intervention the Finance Minister is referring as the activities of the private sector are already caught up in a narrow cobweb of state controls. The state fixes the prices of several consumer goods, decides on the foreign exchange allocations for raw materials, machinery spares and packing materials, controls industrial extensions and the set up of new industries through a system of licences and decides for certain industries what materials should be manufactured and to whom they should be sold. On top of this the Ministry of Labour has enforced certain labour contracts within the industrial sector. For existing plants the Government has taken steps to limit the possibilities for retrenchment. But it is doubtful whether an industrial

sector without autonomy but with the responsibility of gearing its limited and diminishing resources towards the fulfilment of the objectives laid down in the Five Year Plan, can be expected to put up almost 50 p.c. of the total investment of the Rupees 15,000 mn Five Year Development Plan.

All these measures will tend to reduce private savings and curtail private investment. As a consequence an extraordinary fall in private investment already took place in 1971 and continued in 1972. The fall is mainly taking place in private investment in manufacturing. As the activity of the public sector units is limited by their efficiency—many units are operating below 40 p.c. of their installed capacity and are depending upon operating subsidies—they are not yet ready to fill this created vacuum. Over the past twenty years the Government has invested nearly three billion rupees in state corporations but the investment has not realised a return of even one p.c.

### **Falling Private Investment**

Another direction in which the Government has acted is the nationalisation of much of the internal and external trade. With the establishment of the Sri Lanka Trading Corporation in 1971 the Government attempted to eliminate foreign exchange abuses. This was done in order to put the available resources to the best use, to guarantee speedy and regular supply, to enable fair distribution and—as an indispensable condition for planned economic development—to ensure the take-over of the import trade in all essential commodities, the expansion of the share of the state in the export trade and the handling of the entire whole-sale trade in all imported essential commodities.

The Minister of Foreign and Internal Trade had assured that the new machinery would be made to fit the needs of the consumer rather than trying to shape the consumer to suit the machine. Already in December 1970 it had been realised that the whole distribution network for essential consumer goods demands an entire overhaul. The major defects that had affected the progress of the country's distribution system are in the retail outlets used by the co-operative movement and the Co-operative Wholesale Establishment which is assisting the State Trading Corporation in the distribution of subsidiary food items. Although defects like the smallness of the distribution centres, unskilled managers, general apathy of the members, incompetence and dishonesty, fraud and other forms of corruption, insufficient educational and advisory services, insufficient supervision and control had been recognised, the situation has been aggravated after the governmental take-over.

For years there were plans for expanding production for export in a number of industries like plywood and ilmenite, but their execution suffered from innumerable delays. Ceylon has not taken any considerable steps for a massive programme to modernise the tea industry. The rubber industry lies far behind other producers of natural rubber in the introduction of new technology in the processing of rubber and the production of latex. In the production of coconuts there have consistently been shortfalls in the fertiliser and replanting programmes which resulted in declines in the export of coconuts.

Although promotion of exports has been given priority since the new Government took office, the necessary commitment is missing which will ensure that targets are becoming operational objectives. The Government is now actively considering a proposal for setting up a free-zone port at Trincomalee. A white paper on foreign investment is in the drafting process which is hoped to attract foreign investors in financing export oriented industries. The new Government has already decided to offer bonuses to exporters of non-traditional goods such as an eight year exemption from payment of taxes on earnings from non-traditional exports. This tax relief will also apply to the payments of dividends to shareholders. Similar arrangements will be granted to foreign investors in the non-traditional export sector.

Areas of private foreign investment are the tourist industry, the fisheries industry and the manufacturing sector. The major facilities granted to the foreign investor are: Remittance of profits after adequate provision has been made for maintenance and replacement of assets, interest due to non-residents on borrowings, repatriation of capital on sale or liquidation of investments after local liabilities have been met. Although the foreign investor is assured of the complete security of his investment and in the event of nationalization full and prompt compensation it is doubtful in view of the declared policy of the Government whether any foreign investor can be encouraged.

### **The Unemployment Problem**

The last area in which the new Government is trying to achieve a major change is that of employment. The unemployment problem is not a phenomenon of recent origin. Even in 1963 there was a considerable volume of unemployment in the rural sector. Ceylon's rate of growth during 1968 and 1969 was possibly responsible for the absorption of the increases in the labour force during the past few years although a surplus of perhaps 500,000 unemployed remains. The un-

employment problem is partly the result of free secondary and higher education which increased the demand of thousands of young men and women for white collar employment and partly of the chronic maladjustment between the educational process and the national economy. The success at an examination was considered a visible ladder to success. Wrong values and a misconception of the concept of the dignity of labour have created a fetish for white collar employment.

The other cause is embedded in the race between economic growth and population. Although Ceylon's population growth is extremely high, family planning campaigns have been left to well intentioned enthusiasts like the Family Planning Association. To remedy the situation the Ministry of Education is attempting to reorientate the educational system, the Government has initiated a programme to employ 100,000 of the unemployed mainly in agriculture, and a start has been made to formulate a comprehensive programme to meet the challenging consequences of population growth.

### **Feature of a General Strategy**

The prospects for economic and social development in Ceylon depend upon the structural transformation of the economy. Such a programme must emphasise a rapid growth of agricultural production, a short cut in industrial development, because of the large demands for imports connected with it, a more efficient use of the existing productive assets and a reduction in the growth of private and public consumption.

Therefore a general strategy for restructuring the framework of economic policies and for reversing the adverse trend in order to achieve accelerating growth calls for three main lines of action:

- ☐ Reduction in the growth of consumer demand in order to ease the pressure on imported and locally produced goods.
- ☐ Restrictions in the quantity of imported consumption goods and thus free the foreign exchange resources for reversing the decline of investment.
- ☐ Increase in the volume and quality of investment in order to increase the rate of growth.

But this general strategy has to be carried through by the aid of private initiative. The measures taken so far by the Government to implement its socialistic aims are wellnigh paralysing the country's economy. What is needed is a proper detailed credible policy, which must clearly define the place of the private sector.