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Sub-Fonds: Records of President Robert S. McNamara

Fonds: Records of the Office of the President

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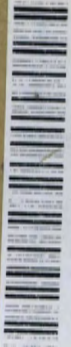


THE WORLD BANK
Washington, D.C.

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Travel briefs - Ceylon
Jan. 19 - Febr. 1954



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The World Bank Group
Archives

Travel briefs, Ceylon 01

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ITINERARY FOR VISIT TO CEYLON, INDIA, NEPAL,
AND PAKISTAN, JANUARY 19--FEBRUARY 1, 1972

Revised
January 19, 1972

| <u>DATE</u> | <u>TIME</u> | <u>GMT</u> | | <u>REMARKS</u> |
|-------------------|--|-------------------------|---|---|
| Jan. 19 Wed. | 1930 | 0030 | Depart Washington (Dulles) | PA 106 non-stop |
| Jan. 20 Thurs. | 0730 1530 1600 1700 1900 2100 | 0730 | Arrive London (Heathrow) Meeting with Chancellor of the Exchequer Meeting with Secretary of Foreign Affairs Meeting with Prime Minister Depart London (Heathrow) Arrive Paris (Orly) | Claridge's BE 024 non-stop Bristol |
| Jan. 21 Fri. | 1130 | 1030 | Depart Paris (Le Bourget) | UT 568 via Karachi GMT 1755-1855 |
| Jan. 22 Sat. | 0340 1115 1200 1300 1500 2000 | 2210 | Arrive Colombo Briefing with Cargill Meeting with Secretary for Planning, Dr. Gunasekera Meeting with Prime Minister Lunch hosted by Prime Minister Meeting with Finance Minister, Dr. N.M. Pereira Meeting with Governor of Central Bank, Mr. Tennekoon Dinner hosted by Finance Minister | Galle Face Hotel |
| Jan. 23 Sun. | A.M. 1500 2030 | 0930 | <i>Chief of Antenna</i> Trip along coast to Hikaduwa or by plane to Mahaweli project in interior Depart Colombo Arrive Delhi | Charter via Madras one-hour stop Rashtrapati Bavan |
| Jan. 24 Mon. | 0830 0945 1315 1500 1615 1645 1830 | <i>with minutes</i> | Briefing in Delhi office (till 0930) Meeting with Mr. Subramaniam at Planning Commission (till 1130) Lunch with Mr. Subramaniam (till 1445) Meeting with Ford Foundation (till 1600) Meeting with Foreign Minister (till 1645) Meeting with Messrs. P.N. Dhar and Haksar (till 1800) X Reception hosted by Mr. McDiarmid (till 2030) Evening free | |
| Jan. 25 Tues. | 0700 0915 1000 1030 1230 1400 | 0130 0345 | Depart Delhi Arrive Kathmandu Briefing with Kirk Meeting with Secretaries of Finance, Public Works, Agriculture, Commerce & Industry, Communications, Planning Commission Lunch with Ambassador Laise, hosted by Mr. McNamara Meeting with Prime Minister Bista | Charter Government Guesthouse or Soaltee Hotel at Singh Dunbar |

| | | | | |
|---------|------|------|--|----------------------------|
| Jan. 26 | 0900 | | Leave for Western Nepal (Karnali area, Bhadia, Nepalganj) | by plane |
| Wed. | 1200 | | Lunch at Pokhara | |
| | 1400 | | Leave Pokhara | by plane |
| | P.M. | | Audience with His Majesty at Chitwan | |
| | | | Return to Kathmandu | |
| | 1800 | X | Cocktail party hosted by Mr. Kirk | |
| | 1900 | | Dinner hosted by Prime Minister | |
| Jan. 27 | 0830 | | Meeting with UNDP ResRep and Deputy and FAO ResRep | at Bank office |
| Thurs. | 0930 | | Meeting with Gen. Manager of Nepal Industrial Development Corp. and private industrialists | " |
| | 1030 | | Meeting with Director, Center for Economic Development & Administration (CEDA) | " |
| | 1130 | | Meeting with Governor of Nepal Rastra Bank | " |
| | 1300 | | Lunch free | |
| | 1630 | 0100 | Depart Kathmandu | Charter |
| | 1845 | 0315 | Arrive Delhi | Rashtrapati Bavan |
| | 2000 | | Dinner with I.G. Patel | |
| Jan. 28 | 1000 | | Meeting with Finance Minister (till 1100) | |
| Fri. | 1100 | | Meeting with I.G. Patel (till 1145) | |
| | 1200 | | Meeting with Prime Minister (till 1300) | |
| | 1300 | | Lunch with Prime Minister (tentative) | |
| | 1500 | | Meeting with private group, including some industrialists (till 1630) | |
| | 2000 | | Dinner with Finance Minister | |
| Jan. 29 | 0800 | 0230 | Depart Delhi | Charter |
| Sat. | 0900 | 0400 | Arrive Rawalpindi | Mr. Bhutto's Guest House |
| | 1230 | | Meeting with Mr. Bhutto | |
| | 1330 | | Lunch hosted by Mr. Bhutto | |
| | | | Muzzafar Ahmad | |
| | | | Ford Foundation, Mr. Edwards | |
| Jan. 30 | | | | |
| Sun. | | | | |
| | 1600 | 1100 | Depart Rawalpindi | Charter |
| | 1800 | 1230 | Arrive Delhi | Rashtrapati Bavan |
| | | | Evening free | |
| Jan. 31 | | | <i>DEPART DELHI</i> | |
| | | | <i>ARR. SACCA</i> | |
| | | | <i>DEPART SACCA</i> | |
| | | | <i>ARR. DELHI</i> | |
| | 2300 | 1730 | Depart Delhi | LH 649 via Athens |
| | | | | GMT 0250-0350 |
| Feb. 1 | 0635 | 0535 | Arrive Frankfurt | |
| Tues. | 0930 | 0830 | Depart Frankfurt | PA107 via London 0955-1130 |
| | 1435 | 1935 | Arrive Washington (Dulles) | ALjungh |

Project for Mrs. McNamara

Saturday, 22nd January, 1972

Notes

- 3.00 p.m. ✓ Call on the Hon'ble Dr. N.M. Perera at the Ministry of Defence and External Affairs, Senate Building, Colombo 1. Raulet
OK
- 4.30 p.m. ✓ Call on Dr. H.A. de S. Gunasekera, Permanent Secretary, Ministry of Planning and Employment, Senate Building, Colombo 1. OK
Raulet
- Possibly late (5.30 or 6.00) → 5.50 p.m. ✓ Call on Hon'ble Maithripala Senanayake at the Ministry of Defence and External Affairs, Senate Building, Colombo 1. OK
Raulet
- 8.00 p.m. Dinner in honour of the President of the I.B.R.D. and Mrs. McNamara by the Hon'ble Dr. N.M. Perera at the Coconut Grove, Galle Face Hotel.

Sunday, 23rd January, 1972

- 9.30 a.m. ✓ Call by Dr. C. Hart Schaaf, Resident Representative of the U.N.D.P. Blah
- 10.00 a.m. ✓ Call on the Hon'ble Sirima R.D. Bandaranaike, Prime Minister of Ceylon at Temple Trees. Raulet
or Blah
OK
- 11.30 a.m. Call on Mr. H.E. Tennakoon, Governor of the Central Bank at Baudhaloka Mawatha. No one
- 12.30 a.m. ✓ Luncheon in honour of the President of the I.B.R.D. and Mrs. McNamara by the Governor of the Central Bank and Mrs. Tennakoon at the residence.
- about 2.15 pm
4.15 p.m. Leave Temple Trees.

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air control ↑

71438 Jayawardena file 8 PM at hotel

Sunday Lunch (by Central Bank Governor
and Mrs. Tennekoon)

Invitees

1. Dr. N.M. Perera, Minister of Finance
2. Dr. and Mrs. H.A. de S. Gunasekera, Permanent Secretary,
Ministry of Planning and Employment
3. Mr. And Mrs. C.A. Coorey, Acting Permanent Secretary,
Ministry of Finance
4. Mr. and Mrs. M.D.D. Pieris, Secretary to the Prime Minister
5. Dr. and Mrs. Mackie Ratwatte, Physician, Brother and Private
Secretary to the Prime Minister (Mrs. Ratwatte is the daughter
of the Governor General)
6. Mr. Peter Cargill
7. Mr. William Clark
8. Mr. Manfred Blobel
9. Mr. and Mrs. J.-D. Roulet
10. Mr. Ljungh

Pally

NAMES OF PEOPLE LIKELY TO MEET WITH MR. R. McNAMARA IN CEYLON

PRIME MINISTER: ✓ Mrs. Sirimavo R. D. Bandaranaike
Also, Minister of Defense and External Affairs,
and Planning & Employment.

MINISTERS:

✓ Dr. N. M. Perera
(Finance)

✓ Mr. Maithripala Senanayake
(Irrigation, Power & Highways)

Mr. T. ^{Kiri} B. Ilangaratne
(Internal & External Trade)

Mr. Badi-Ud-Din Mahmud
(Education)

Mr. P. B. G. Kalugalla ^{Wimala}
(Shipping & Tourism)

Mr. Felix Dias Bandaranaike
(Public Administration, Local Government and
Home Affairs)

Mr. T. B. Subasinghe
(Industries and Scientific Affairs)

Dr. Colvin R. de Silva
(Plantation Industry)

Mr. H. Kobbekaduwa
(Agriculture & Lands)

Mr. George Rajapakse
(Fisheries)

Mr. Chelliah Kumarasurier
(Post & Telecommunications)

GOVERNOR, CENTRAL
BANK OF CEYLON

Mr. Herbert Earnest Tennekoon

UNDP RESIDENT
REPRESENTATIVE

Mr. C. Hart Schaaf

I. BIOGRAPHICAL DATA

Mrs. Sirimavo Bandaranaike is Prime Minister as well as Minister of Defence and External Affairs and Minister of Planning and Employment. Born in 1916, of a prominent Singhalese land-owning family, she married Mr. Solomon W.R.D. Bandaranaike in 1940, who became a member of Ceylon's first Cabinet after independence in 1947. In 1951, her husband broke from the United National Party to form the Sri Lanka Freedom Party (SLFP), appealing broadly to the Singhalese Buddhist lower and middle classes, and became Prime Minister in 1956 following the SLFP victory in the general elections. The following years were marked by the Singhalese-Tamil riots of 1958 and a state of emergency. In 1959, Mr. Bandaranaike was assassinated and in the subsequent wave of emotion, his wife was asked by the party leaders to assume the leadership of the SLFP. Following her victory in the 1960 election, as leader of a leftist coalition, she became the first woman to assume the duties of Prime Minister in modern times. At this point, however, her lack of experience and the fact that she had been used as a vote-getter made it impossible for her to control effectively the disparate elements within her Cabinet even though she may have been the most pragmatically minded person in the Government and was actually described by some Ministers as "the only man in the Cabinet". Her Government fell in 1965 as a result of defections over an attempt to nationalize the press. In the general election of that year, the United National Party was returned to office and for the following five years she led the opposition. In May 1970, she returned to power with a sweeping majority in Parliament. Her first year in office however, was one of the most troubled in Ceylon's history. Although she seems aware of the need for drastic action and may be the only person with sufficient influence to take action, she seems reluctant to assume full control and reportedly wishes to proceed only with Cabinet unanimity on major issues.

Dr. N.M. Perera is a veteran politician. Founder and leader of the L.S.S.P. Party, he has served in Ceylon's Parliament since 1936 (except between 1940 and 1945 when his party was banned and he himself imprisoned), and was leader of the opposition in the House of Representatives in 1947-52. He was Minister of Finance in Mrs. Bandaranaike's government from June 1964 to March 1965 and in this capacity attended the Bank/IMF Annual Meeting in Tokyo. During that period relations with Ceylon began to improve and it was with Dr. Perera that the discussions which subsequently led to the establishment of the Aid Group were initiated. Among the present Cabinet members, he is a more conservative and moderate element.

Born in 1905, he was educated in Colombo and at the London School of Economics. He received doctorate degrees in both law and economics from London University.

CEYLON

Herbert Ernest TENNEKDON

Governor, State Bank

H. E. Tennekoon, a senior career civil servant, has been governor of the Central Bank since June 1971. Previously he had served as Ambassador to Japan and the Philippines from 1966 to late 1970.

Herbert Ernest Tennekoon was born on 30 September 1911. He received his higher education in the United Kingdom where he earned a B.A. degree. Tennekoon joined the Civil Service in 1935 and held numerous lower and middle-level positions until his appointment as acting permanent secretary of the Ministry of Defense and External Affairs (MDEA) in 1958. He became permanent secretary of the MDEA in 1960. For a short time Tennekoon served as additional permanent secretary of the Ministry of Commerce, Trade, Food and Shipping before becoming Permanent Secretary of the Ministry of Agriculture, Land, Irrigation and Power (in 1963). Later in the same year he became Permanent Secretary of the Ministry of Finance.

Tennekoon visited the United States in 1963 to attend a meeting of the International Monetary Fund. As a member of the Board of Governors, he attended the first annual meeting of the Asian Development Bank's Board of Governors held in Manila in 1968.

September 15 1971

UNITED NATIONS
DEVELOPMENT
PROGRAMME



UNDP

RESTRICTED
DP/CM/184
3 October 1969

*In Case J...
A
K H
S...
New File*

TO: Participating and Executing Agencies of the
United Nations Development Programme

FROM: *f. A. Vaidyanathan*
A. Vaidyanathan, Director
Bureau of Administrative Management and Budget

SUBJECT: Designation of Mr. C. Hart Schaaf as Resident Representative
of the United Nations Development Programme in Ceylon

Mr. C. Hart Schaaf (USA) has been appointed Resident Representative of the United Nations Development Programme in Ceylon. He succeeds Mr. Anatoly Gromov who has recently retired from UNDP service.

Mr. Schaaf, who has been associated with the United Nations since 1949, will be well known to the participating and executing agencies having served as Resident Representative in Israel (1954-1957) and the Philippines (1957-1959). For the past ten years, Mr. Schaaf has been serving with ECAFE as Executive Agent of the Committee for the Co-ordination of investigations of the lower Mekong Basin (Mekong Committee).

Pending the arrival of Mr. Schaaf in Colombo in the course of December 1969, Mr. Himalaya Rana, Deputy Resident Representative, continues to assume the duties of Resident Representative ad interim.

MINISTRY OF POSTS AND TELECOMMUNICATIONS

Mr. Chelliah Kumarasurier - Minister (Chairman, Inquiry Committee)

Mr. Kumarasurier is a newcomer to national politics, and is the Tamil representative in the Cabinet. He is a Chartered Engineer and Industrial Consultant, and partner of a firm of architects. It was mentioned recently that his presence in the Cabinet gave it access to the views of a technical man. Very little else is publicly known about him.

MINISTRY OF FISHERIES

Mr. George Rajapakse - Minister

Mr. Rajapakse is a lawyer, with a history of political affiliation to Mr. Philip Gunawardene. He was Parliamentary Secretary to the Ministry of Finance in the 1960 SLFP Government. He is one of the younger, brighter men in the SLFP and could develop into an able Minister.

MINISTRY OF AGRICULTURE AND LANDS

Mr. H.S.R. Banda Kobbekaduwa - Minister

Mr. Kobbekaduwa is a Kandyan. He served for a long time as Chairman of the Public Service Commission after being defeated as a SLFP nominee at a previous General Election. His portfolio is a reward for organizing the election campaign for the SLFP in the Central Province. Although a Doctor by profession, he has no reputation for cleverness (a drawback he shares with most of the Kandyan community). His appointment to the Public Service Commission in 1960 was widely criticized because he was a politician, and it offended the spirit of the Constitution.

CEYLON

Colvin R. de SILVA

Minister for Constitutional Affairs; Minister of Plantation Industry

Colvin R. de Silva, a veteran Ceylonese Trotskyite, became Minister for Constitutional Affairs and Minister of Plantation Industry in the coalition government that Prime Minister Sirimavo Bandaranaike formed on 31 May 1970. As Minister for Constitutional Affairs, de Silva will oversee the writing of a new constitution, which will include provisions for making Ceylon a republic. The newly established Ministry of Plantation Industry is responsible for controlling predominantly British-owned rubber and tea plantations and agency houses (primarily British-owned and managed banking and marketing centers acting as intermediate export agents)



(1966)

De Silva has long been regarded as the number-two man in the hierarchy of the Trotskyite Lanka Sama Samaja Party (LSSP) the oldest surviving political party in Ceylon. He has been active in LSSP-affiliated labor organizations and has served as a Member of Parliament.

Early Life and Career

Colvin R. de Silva was born on 16 February 1907, the son of a wealthy, low country Sinhalese trader and landowner. He attended St. John's College, Panadura, and Royal College, Colombo, distinguishing himself as both a student and an athlete. From 1924 to 1926 de Silva attended Ceylon University College on a scholarship. After graduation he traveled to London, where he entered Kings College. He received a Ph. D. degree in 1932 and in the same year was called to the bar at Lincoln's Inn.

On his return to Ceylon in the early 1930's, de Silva began a law practice and was one of the founding members of the LSSP. He and N.M. Perera, now the leader of the LSSP, were among the handful of Marxists active in Ceylon at that time. With the outbreak of World War II, LSSP leaders were arrested and the party banned because they did not support the war effort. In 1942 de Silva escaped from prison and went into exile in India. While there he was appointed secretary of the Bolshevik Leninist Party of India (BLPI). He became the leader of the BLPI faction in Ceylon when he returned from India in 1946.

Parliamentary Career

After his return from India, de Silva became a permanent fixture in the national elections. In 1947 he won a seat in Parliament on the BLPI ticket. He merged his BLPI with the LSSP in 1950 and ran for Parliament on the LSSP ticket in 1952. He lost the election but was returned to office in 1956. De Silva lost his seat in the March 1960 elections, won it back in July 1960 and lost it again in 1965. In a 1967 byelection de Silva again won a seat, which he retained in the 1970 elections.

Involvement with the LSSP

Since rejoining the LSSP, de Silva has been one of its leading figures. His organizational abilities, oratorical excellence and unblemished orthodoxy have been invaluable in bringing the party from its humble beginning to its present position as a member of the coalition government. De Silva has held a number of senior positions in the party, including those of organizing secretary (responsible for party organization and propaganda), member of the politburo, president of the Youth League and secretary general of the party. He has also been vice president of the Ceylon Federation of Labor, an LSSP affiliate.

For many years de Silva maintained a very active and lucrative law practice in conjunction with his political activities. One of the leading criminal lawyers in Ceylon, he gave up his practice in June 1964 to devote his full energies to party work. His main reason for temporarily withdrawing from the legal profession was to assume the leadership of the LSSP when N.M. Perera became Finance Minister in Mrs. Bandaranaike's coalition government formed in June 1964. De Silva led the LSSP until the government fell in December 1964 and Perera returned to lead the party.

Travel

De Silva has traveled to many countries. He has visited the USSR at least three times, most recently in 1967 for the 50th anniversary of the Russian revolution. In 1948 de Silva represented India at the World Congress of the Fourth International, held in Paris, and in 1960 he represented the LSSP at the Paris meeting of the International Secretariat of the Fourth International. He also visited Yugoslavia in 1953, the United Kingdom in 1961 and Morocco in 1963.

Personal Data

De Silva is a Buddhist of the Salagama caste. A historian, he specializes in the British period of Ceylonese history. He has written a number of books, including *Towards a Dictatorship*, *Whither the Soviet Union*, and *Socialism Reaffirmed*. De Silva is married to Suvinita Nita and has a daughter, Shireen Mohina, born in 1937, and a son, Nalina, born in 1941. His brother-in-law, K.C. de Silva, is a Member of Parliament. De Silva speaks English better than he does Sinhalese.

August 1971

CEYLON

Tikiri Banda SUBASINGHE

Minister of Industries
and Scientific Affairs

Tikiri Banda Subasinghe became Minister of Industries and Scientific Affairs on 31 May 1970. He belongs to a small group of Cabinet Ministers who often speak on behalf of the government and recommend action on the most pressing problems facing both the government and the country.

Early Life and Career

A member of a well-established, influential family from Bingiriya in the Northwest Province, Tikiri Banda Subasinghe was born in Sandalankawa on 14 August 1913. He attended Ananda College, the University of Ceylon and the London School of Economics. He also received training in banking in Bombay from 1934 to 1937. While at the London School of Economics Subasinghe was reputedly associated with the "anti-imperialist" element, represented at that time by V. K. Krishna Menon, Jomo Kenyetta and Kwame Nkrumah.

Subasinghe's active political career began in 1947, when he won election to Parliament from Bingiriya on the Trotskyite Lanka Sama Samaja Party (LSSP) ticket. He was reelected to Parliament on the LSSP ticket in 1952. In 1955 Subasinghe broke with the LSSP and declared himself an independent socialist. National elections were held in 1956, and he won election to Parliament as a member of S.W.R.D. Bandaranaike's Mahajana Eksath Peramuna Party (a coalition party formed to contest the elections). After the elections Subasinghe was appointed parliamentary secretary to the Minister of Defense and External Affairs.

In February 1959 he resigned his post and joined the opposition in Parliament.

In March 1960 Subasinghe won election from Katuganpola as an independent candidate and was elected speaker of the House. The government fell in June 1960, and Subasinghe lost his bid for reelection to Parliament. Turning to a diplomatic career, he represented Ceylon in the United Nations in 1961 and served as Ambassador to the USSR, Poland and Czechoslovakia from late 1961 to 1965. In the latter year he was again elected to Parliament.

Since his reentry into the political field, Subasinghe has been associated with the Sri Lanka Freedom Party (SLFP). He was secretary general of the SLFP in 1968, a member of the Finance Committee of the SLFP Advisory Board in 1969 and a vice president of the party in 1970.

Tikiri Banda SUBASINGHE (cont'd.)

Travel

Subasinghe has traveled extensively. In 1955 he attended the World Youth Festival in Warsaw, and in 1956 he traveled to the USSR and Communist China as a member of a delegation that discussed the establishment of diplomatic missions. He was a delegate to sessions of the UN General Assembly in 1957, 1958 and 1960. Subasinghe has also visited India (1967), North Korea (1968) and the USSR (1968). In 1969 he went to East Berlin for a meeting of the World Assembly for Peace.

Personal Data

Subasinghe is intelligent, gregarious and outspoken. He wears thick glasses. Married, he is the father of two daughters. In April, 1953, Subasinghe was one of three sponsors, and a member of the Board of Directors of the Sinhalese Weekly MAWATA (The Path). He is a member of the Ceylon Peace Council and the World Council of Peace and a vice president of the Ceylon National Committee for Solidarity with Vietnam. He speaks English well.

August 1971

CEYLON

Felix Reginald Dias BANDARANAIKE

Minister of Public
Administration, Local
Government and Home Affairs



(1961)

On 31 May 1970 Felix Dias Bandaranaike became Minister of Public Administration, Local Government and Home Affairs in the Cabinet formed by Prime Minister Sirimavo Bandaranaike (a distant relative by marriage). He is also a member of a Cabinet sub-committee established to advise and assist Colvin R. de Silva, Minister for Constitutional Affairs, in drafting a new constitution for Ceylon. Ambitious and forward-looking, Bandaranaike is one of the most able and industrious men in the Cabinet. He heads the conservative bloc in both the Cabinet and the Sri Lanka Freedom Party (SLFP), of which he is secretary. Since Bandaranaike entered politics in 1960 he has been a close friend of and adviser to Mrs. Bandaranaike. She was particularly dependent upon his advice during her first term as Prime Minister, during 1960-65.

Early Life and Career

Felix Reginald Dias Bandaranaike, a member of the Goigama caste, the highest in Ceylon, was born on 5 November 1930. He attended Royal College and received an LL.B. degree from Ceylon University. He later entered law school, graduated as an advocate and began law practice in Hultsdorf. While in school Bandaranaike won honors as a star debater and orator. He was admitted to the Colombo bar in 1953 and the London bar in 1959.

In March 1960, Bandaranaike won the election to Parliament from Dompe on the SLFP ticket. In the general election of July 1960 he was reelected. During both campaigns he proved very helpful to Mrs. Bandaranaike, particularly in drafting her public statements as she sought the post of Prime Minister. Mrs. Bandaranaike was named Prime Minister after the July elections, and she appointed Bandaranaike Minister of Finance (at 29, he was the youngest man ever to hold this position) and parliamentary secretary for defense and external affairs. Bandaranaike became the government's principal spokesman in the House not only for all financial, civil service and related matters but also for matters of defense, external affairs, internal security and general government policy.

As Finance Minister, Bandaranaike pursued moderate policies, based on a realistic view of Ceylon's financial position and the need for economic development. In his 1962 Budget Speech,

Felix Reginald Dias BANDARANAIKE
(cont.)

expecting that his party would support him, he proposed a reduction in the rice ration. His fellow party members did not back him, however, and he had to withdraw his proposal. In the face of strong opposition he was forced to amend the budget, and in August 1962 he resigned as Finance Minister, although he retained his parliamentary secretaryship.

In November 1962 Prime Minister Bandaranaike took Bandaranaike back into the government as Minister Without Portfolio. In a Cabinet reshuffle in 1963 he became Minister of Food, Agriculture and Cooperative Development, a position he held until the fall of the government in 1964. Bandaranaike was returned to the House in the March 1965 national elections and served as one of the opposition's most vigorous spokesmen until the May 1970 elections. In those elections he received the largest majority of any parliamentary contestant. His peers acknowledge that he is one of the best speakers in the House.

Travel

Bandaranaike has traveled abroad on numerous occasions. In 1961 he visited the USSR and the United Kingdom and accompanied Prime Minister Bandaranaike to the Conference of Nonaligned Nations in Belgrade. In the same year he attended the Commonwealth Finance Ministers Conference in Accra and the International Bank for Reconstruction and Development Conference in Vienna and addressed the UN General Assembly. Bandaranaike traveled to the United Kingdom for medical treatment in 1966 and on his return voyage visited East Berlin and the USSR. He went to Communist China and North Korea in 1967. He was part of the Ceylonese delegation to the Conference of Nonaligned Nations in Lusaka in September 1970 and attended the Commonwealth Conference in Singapore in January 1971.

Personal Data

Bandaranaike has been a champion of Sinhalese nationalism, although he is Westernized in speech, dress and manner. He is a large man who wears thick-lensed eyeglasses. He does not smoke and claims to have given up drinking for reasons of health. He enjoys reading detective and spy stories for relaxation. Bandaranaike is an Anglican. He speaks English and Sinhalese.

In 1952 Bandaranaike married Lakshmi Jayasundera, his sister's best friend. Mrs. Bandaranaike is also a lawyer. She has been her husband's private secretary since he entered politics.

August 1971

CEYLON

Punchi Banda Gunatilaka KALUGALLA

Minister of Transport
and Tourism

P.B.G. Kalugalla became Minister of Transport and Tourism in Prime Minister Sirimavo Bandaranaike's Cabinet on 31 May 1970. He has been involved in politics since 1956 and has held several other Cabinet portfolios, most recently that of Education and Cultural Affairs from 1963 to 1965. A member of the Sri Lanka Freedom Party (SLFP) since the mid-1950's, Kalugalla was president of the SLFP Youth League in 1959 and has been a vice president of the party since 1967.

Early Life and Education

Punchi Banda Gunatilaka Kalugalla was born on 20 March 1920 in Kegalle. His father was a well-known notary and a locally prominent ayurvedic physician--a doctor who uses the *Ayurveda*, a Hindu book on the science of health and medicine, as the basis for healing. Kalugalla is a Buddhist and a member of the Goigama caste, the highest in Ceylon.

Kalugalla received his early education at the Catholic-operated Maris Stella College in Negombo and at Ananda College in Colombo, the foremost private Buddhist school in Ceylon. He finished his education at the Ceylon Law College, where he was vice president of the Law Students Association. After graduation he practiced law as a proctor in Kegalle.

Political Career

After Ceylon attained independence (1947) Kalugalla became interested in politics, and by 1956 he was a member of the SLFP Youth League and a candidate for national office. He ran on S.W.R.D. Bandaranaike's ticket and won election to Parliament from Kegalle (he still holds that seat). In the same election Bandaranaike was elected Prime Minister, and he promptly appointed Kalugalla parliamentary secretary to the Minister of Health. In June 1959 he became Minister for Cultural Affairs and Social Services in Bandaranaike's coalition government.

In September 1959 Bandaranaike was assassinated, and in December 1959 the coalition government fell. W. Dahanayake formed an interim government but did not include Kalugalla in it. In the July 1960 national elections the SLFP, under the leadership of Sirimavo Bandaranaike, widow of the late Prime Minister, won a near majority of parliamentary seats, and Kalugalla was appointed Minister of Transport and Works. He also held the Finance portfolio for a short time before becoming Minister of Education and Cultural Affairs in 1963.

There are a number of keys to Kalugalla's political success. First is the political apparatus he has developed in his home constituency. He has a solid party organization, which includes an excellent secretary who keeps in touch with the electorate and a wife who is a prominent lawyer in Kegalle and handles, without charge, cases of party supporters. Second is his longstanding friendship with the Bandaranaikes. Finally, by virtue of being born in the area of Kandy and belonging to the highest Buddhist caste, Kalugalla belongs to the social elite that traditionally has ruled Ceylon for many years.

Travel

Kalugalla has made numerous trips abroad. He has visited the Netherlands, Italy, Switzerland, North Korea, Mongolia and the USSR. In 1962 he went to the United States on a partial Leader Grant. He traveled to Bombay as the Ceylonese representative to the Conference of Young Asian Socialist Leaders in 1965.

CEYLON

Badiuddin MAHMUD

Minister of Education

Badiuddin Mahmud became Minister of Education in Prime Minister Sirimavo Bandaranaike's Cabinet on 31 May 1970. He was also appointed to a subcommittee tasked with assisting the Minister of Constitutional Affairs, C.R. de Silva, in writing a new Ceylonese constitution. Mahmud served in Mrs. Bandaranaike's previous government as Minister of Education and Broadcasting (1960-63) and Minister of Health and Housing (1963-64).



(1964)

Mahmud, the only Muslim Cabinet member, has identified himself with the Sinhalese majority and has been an advocate of "Sinhala only" (the use of Sinhala as the only official language in Ceylon) since 1938.

Early Life and Career

Badiuddin Mahmud was born in Matara on 23 June 1904. His father was a planter, landowner and Muslim leader. Mahmud attended St. Thomas College, Matara; Wesley College, Colombo; and Zahira College, Colombo. In 1931 he went to India to study geography at Aligarh University. Mahmud remained in India for the next 6 years, during which time he became involved in organizing students. In 1936 he was named president of the All-India Students' Federation Conference. Mahmud placed first in his class at Aligarh and received an M.A. degree. From 1944 to 1960 he was principal of Zahira College, Gampola.

After his return to Ceylon in 1937, Mahmud developed an interest in politics, particularly Muslim politics. He was vice president of the Ceylon Muslim Political Conference from 1939 to 1945.

Badiuddin MAHMUD
(cont.)

In about 1940 Mahmud began a long and close association with S.W.R.D. Bandaranaike, one of the leading political figures of Ceylon and Prime Minister from 1956 to 1959. In 1951 Mahmud and Bandaranaike left the United National Party and founded the Sri Lanka Freedom Party (SLFP). Mahmud was secretary general of the SLFP from 1951 to 1953 and then became a vice president, a position he still retains. In 1956 he was appointed to the National Planning Council in Ceylon.

After the assassination of Bandaranaike in 1959, Mahmud became an active campaigner for the SLFP prior to the 1960 elections. Sirimavo Bandaranaike, Bandaranaike's widow, won election as Prime Minister and named Mahmud Minister of Education and Broadcasting. After assuming office, Mahmud created considerable controversy by authoring the plan that led to the government's takeover of state-assisted denominational schools.

Travel

Between 1956 and 1959 Mahmud attended the 11th through the 14th Sessions of the UN General Assembly. At the 14th Session he was Vice Chairman of the Third Committee (Social, Humanitarian and Cultural). In the early 1960's Mahmud attended a UN Economic and Social Council meeting in Japan. He visited East Germany, the USSR and Pakistan in 1968.

Personal Data

Mahmud is an affable and likable man. Married since 1937, he has two sons and two daughters.

August 1971

CEYLON

Tikiri Bandara ILANGARATNE

Minister of Foreign
and Internal Trade

On 31 May 1970 Prime Minister Sirimavo Bandaranaike appointed T. B. Ilangaratne Minister of Foreign and Internal Trade. He had also held that post during 1964-65, in Mrs. Bandaranaike's first administration. Ilangaratne strongly supports the coalition government, composed of the Sri Lanka Freedom Party (SLFP), the Trotskyite Lanka Sama Samaja Party and the Ceylon Communist Party/Moscow. He has been a vice president of the SLFP since at least 1962.



(1964)

In Ceylon Ilangaratne has consistently advocated the extension of the public sector at the expense of the private sector. In a previous Cabinet stint, as Minister of Commerce, Trade, Food and Shipping during 1960-63, he successfully piloted a number of revolutionary bills through Parliament. These included nationalization of the insurance and oil industries. He also helped ensure the passage of a bill inaugurating the People's Bank, expanded the Cooperative Wholesale Establishment, and was instrumental in establishing the Employees Provident Fund.

Early Life and Career

The son of a farmer, Tikiri Bandara Ilangaratne was born on 27 February 1913. He attended Saint Anthony's College in Kandy. In 1943 Ilangaratne entered government service as a clerk in the Income Tax Department. He became a leader among his fellow clerks and by the mid-1940's was president of the leftist-controlled General Clerical Service Union. In 1947 Ilangaratne was dismissed from government service because of his participation in an unauthorized strike by government clerks.

After his dismissal, Ilangaratne decided to enter politics, and in 1947 he ran for the Kandy seat in the first parliamentary elections held in Ceylon. He lost the election by a narrow margin, but the winner, George E. de Silva, was unseated in 1948 because of election irregularities, and Ilangaratne won the May 1948 by-election for the seat. An election petition was filed against him, however, and he, in turn, lost the seat. Moreover, he was enjoined from running for public office for 7 years. He thereupon urged his wife to run for the vacant seat, and she won the by-election.

In the 1956 national elections Ilangaratne made a triumphant return to public life by winning a seat in Parliament from Galaha. S.W.R.D. Bandaranaike was named Prime Minister and rewarded Ilangaratne's service to the SLFP--Ilangaratne

Tikiri Bandara ILANGARATNE
(cont.)

was a founder and strong supporter of the party-- by naming him Minister of Labor, Housing and Social Service in his coalition government. In June 1959 Bandaranaike formed an all-SLFP Cabinet and appointed Ilangaratne Minister of Home Affairs. After Bandarnaike's assassination in September 1959, Ilangaratne retained his position until Interim Prime Minister W. Dahanayake removed him on 8 December 1959.

In both the March and July 1960 national elections Ilangaratne was a victorious SLFP candidate for Parliament from Hewaheta. Sirimavo Bandaranaike, S.W.R.D. Bandaranaike's widow, became Prime Minister in 1960 and named Ilangaratne Minister of Commerce, Trade, Food and Shipping. In May 1963 he became Minister of Finance and in June 1964 Minister of Foreign and Internal Trade. With the sweeping victory of the United National Party in the 1965 elections Ilangaratne lost both his Cabinet post and his seat in Parliament. In 1967 he was reelected to Parliament from Kolonnawa.

Travel

Ilangaratne has traveled widely on both official and private business. He has visited the USSR and Eastern Europe on a number of occasions, most recently in October 1970, when he went to the USSR, East Germany and Yugoslavia. He headed an economic delegation to Communist China and North Korea in September 1970. In 1963 Ilangaratne was invited to visit the United States, but he fell ill in London and could not complete the trip. He has attended a number of international conferences, including the Second International Conference in Support of the Arab People, held in Cairo in 1969, and the fourth conference of the International Confederation of Arab Trade Unions, also in 1969.

Personal Data

Ilangaratne is a writer and scholar. While he was away from politics in the early 1950's he wrote three novels, six plays, two collections of short stories and two scripts for films, which he also directed. In 1965 Ilangaratne was appointed managing director of *Janadena*, an LSSP newspaper, and in 1967 he was in charge of publishing the SLFP newspaper, *Sinhala*. He is president of the Ceylon Peace Council, the Ceylon branch of the World Council of Peace. He is a patron of the Ceylon-North Korea Friendship Association.

Family

Ilangaratne is married and has at least three children. His wife, Tamara, is a vice chairman of the SLFP women's organization and in that capacity led a women's delegation to Communist China in 1964. In 1968 she was a leader of a demonstration in front of the US Embassy protesting US involvement in Vietnam. In the May 1970 elections Mrs. Ilangaratne won the Galagedera parliamentary seat.

August 1971

CEYLON

Maithripala SENANAYAKE

Minister of Irrigation,
Power and Highways

Maithripala Senanayake became Minister of Irrigation, Power and Highways on 31 May 1970. He is also the leader of the House of Representatives and a member of a Cabinet sub-committee established to advise and assist the Minister of Constitutional Affairs, Colvin R. de Silva, in writing a new constitution. Senanayake was a leader of the opposition in Parliament from 1965 to 1970. He belongs to a select group of Cabinet Ministers who often speak on behalf of the government and recommend action on the most pressing problems facing the government.



(1961)

A member of the Sri Lanka Freedom Party (SLFP) since 1956, Senanayake is currently one of its vice presidents.

Early Life and Career

The son of a court clerk, Maithripala Senanayake was born on 20 August 1916 in Kuilekala. He is a member of the Goigama caste, the highest in Ceylon. A Buddhist, Senanayake received most of his education in Christian schools. He attended St. Joseph's College, Anuradhapura; St. John's College, Jaffna; and Nalanda Vidyalaya, Colombo. After finishing school he entered government service as a cultivation officer in 1940.

In 1947 Senanayake resigned his position as a cultivation officer and ran for the Medawachchiya seat in Parliament. He won the election on the

Maithripala SENANAYAKE (cont.)

United National Party (UNP) ticket. He was reelected in 1952, and Prime Minister Dudley Senanayake (no relation) appointed him parliamentary secretary to the Minister of Home Affairs. In 1953 Maithripala Senanayake resigned as parliamentary secretary and also left the UNP. His reason for resigning was his opposition to the government's decision to remove the subsidy on rice. (The removal had increased the cost of rice.) Senanayake remained in Parliament as an independent but by 1956 had joined the SLFP.

Senanayake was again reelected in 1956, and in the same year Prime Minister S.W.R.D. Bandaranaike appointed him Minister of Transport and Work. After the assassination of Bandaranaike in 1959, Interim Prime Minister W. Dahanayake retained Senanayake for a short time. In December 1959 Senanayake was dismissed from office. He won election to Parliament in the March 1960 elections and was chief opposition whip until the June 1960 elections. He retained his seat, and Prime Minister Sirimavo Bandaranaike, widow of the late Prime Minister, named him Minister of Industries, Home and Cultural Affairs. In May 1963 Senanayake became Minister of Commerce and Industry and in June 1964, Minister of Rural and Industrial Development, a post he held until the government fell in 1965.

Travel

Senanayake has traveled extensively during his government career. He has visited Europe on numerous occasions, Communist China in 1959 and 1961 and North Korea in 1967. He has represented Ceylon at trade conferences in Europe and went to India in 1961 and to the Philippines in 1963 for meetings of the UN Economic Commission for Asia and the Far East. He attended the October revolution celebrations in the USSR in 1967.

Personal Data

A tall, handsome man Senanayake is reserved and dignified, but simple and direct, and manages to exude a friendly warmth even when speaking in public. He is very popular in his electorate.

He speaks Tamil, Sinhalese and English.

Senanayake married Ranji Handy in 1963. The daughter of a prominent Tamil Anglican Minister, she was born and educated in Malaya. For many years she was a reporter on the CEYLON DAILY OBSERVER.

August 1971

CEYLON

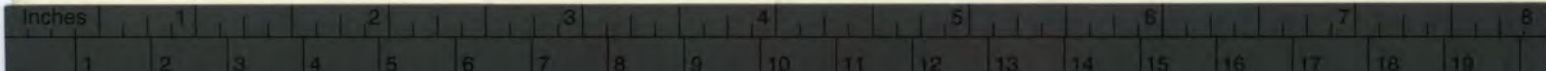


Legend

- Roads ————
- Railways ————
- Provincial Boundaries ————

0 Miles 12 24

- Ruins ————
- Govt. Factories ————
- Botanic Gds. ————
- Water Falls ————
- Rest Houses ————
- Population ————
- Aerodromes ————
- Zoological Gardens ————
- Hydro-Electric Scheme ————
- University (Peradeniya) ————
- Irrigation & Colonisation Scheme ————
- Farm Schools ————
- Basket & Hat Making ————



TIFFEN Color Control Patches © The Tiffen Company, 2007

| | | | | | | | | |
|------|------|-------|--------|-----|---------|-------|---------|-------|
| Blue | Cyan | Green | Yellow | Red | Magenta | White | 3/Color | Black |
| | | | | | | | | |

Friedman

interest in the question of the "link" between SDR's and development finance but do believe that this is more a question of how to finance development assistance rather than having an international monetary system which provides the appropriate international environment for achieving goals of economic and social development.

While I was in Ceylon I had some conversations with the Governor of the Central Bank as well as the Minister of Finance. I greatly benefitted from conversations with Messrs. Baneth and Roulet. In accordance with my conversations with them, I emphasized with the Governor and the Minister the need for a surplus in the budget's current account to help finance investment. The Minister said his aim was to increase savings as a percentage of GNP from 12 to 25 per cent.

The Governor, the Minister of Finance and others were principally preoccupied at the moment with the exchange rate question. It seemed to be an open secret that there would be a general exchange rate adjustment by various countries at the end of the week that I was there. I was asked by the Governor of the Central Bank to express my personal views on the exchange rate question to the Minister of Finance, including the desirability of using the occasion of a general adjustment of exchange rates to bring about a more rational exchange rate system in Ceylon. For obvious reasons I was quite cautious in speaking on this matter to the Minister, particularly in avoiding the mentioning of any specific rate for the Ceylon rupee. I did, however, stress the importance of a realistic exchange rate and efficient exchange system for the success of a sound development program.

I found the business community, with very few exceptions, very alarmed about the new government, particularly its views on nationalization, income ceilings, compulsory savings which are not expected to be returned, taxation, subsidization of consumption, confiscation of land with promises of compensation which are regarded as being of dubious value, the continuation of an unsatisfactory exchange control system, etc. A number expressed the view that Ceylon was becoming another Burma. Everywhere there was concern with falling tea prices. The rise which was being experienced was regarded as temporary and expected to be reversed when the Pakistan-India hostilities came to an end. All seemed to expect that the anticipated devaluation of the Ceylon rupee would bring down tea prices in sterling. Some saw this as especially difficult because they saw wage increases on tea plantations as being inevitable.

I mentioned to the Minister of Finance that the business community seemed worried about the policies of the government. He replied that the private sector would continue to have a major role and that its fears with respect to ceilings on income and compulsory savings were not well founded. The government did intend to return the compulsory savings.

As for the student insurgents, the Minister said that they were supporters of the government. They had hoped to find jobs after the new government came into power but their expectations of quick results were unrealistic. The government, he said, was trying to create employment opportunities for these insurgents now held in detention. (One of the more depressing aspects of the situation in Ceylon was the repeated comment that many educated and experienced people were trying to leave Ceylon. This was true not only of people in the private sector but also in government which hitherto had been an attractive career in Ceylon. Confidence had been shaken in the career service tradition by recent actions of the government).

Talking to the scientists with different disciplines at the annual meeting reinforced a conviction of mine that there continues to be a need for some fairly readily available source of foreign exchange to help finance very small foreign exchange needs to cover the foreign exchange costs of research, e.g., rental of equipment, trips abroad, processing of data abroad, etc., in many different fields of importance for development, say multiples of thousands or even hundreds of dollars, rather than multiples of tens of thousands or higher.

3. After Ceylon I visited Manila for a day and a half. I had promised Mr. Watanabe that I would take the occasion of visiting with him and his Bank when I was in the area. He was kind enough to invite me to be his house guest the two nights I spent in Manila. As you well know, he is eager to cooperate with the World Bank but also eager to find a special role for his own Bank. As he probably told you, Mr. Watanabe believes that his relations with the Philippine Government has appreciably improved. Mr. Watanabe expressed appreciation for his chats with you.

While I was there Messrs. Watanabe and Krishna Moorthi made some suggestions with respect to the establishment of a study group to prepare a report and recommendations on the future of the Asian Institute for Economic Development and Planning and the possible role of the Asian Development Bank in supporting this Institute in the future. Since this is a rather separate subject, I am sending you a separate memorandum on it.

When I was in Manila I had the opportunity to call on the Secretary of Finance, Mr. Virata, whom I have known for some years before he entered the government. His uncle, who is now the chairman of the Philippine Development Bank (highly politicalized I am told), was an old acquaintance of mine from the days when he was the one-man professional staff for the Philippine Secretary of Finance. It was he who introduced me to the present Minister of Finance. Secretary Virata was worried about Philippine exports, particularly copper, plywood and copra that were being hit by the economic situation in Japan and the United States. He was rather optimistic about '72, relying essentially on an optimistic forecast for the U.S. economy particularly the construction industry. I was rather struck by the fact that in reply to a query he indicated that his forecasts for the

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CEYLON COUNTRY PROGRAM PAPER

Postscript

41. The Ceylon Country Program Paper was reviewed at a meeting in Mr. McNamara's office on March 24, 1971. The following conclusions were reached:

(a) Ceylon faces extraordinarily difficult economic problems. Although these derive essentially from the decline of prices in its major export products, they also reflect the failure of Ceylon to adapt its economic and social policies to the fundamental change of its export position. As stated in paragraph 28 of the paper, the current liquidity crisis as well as the difficult longer term outlook, call for a far-reaching action of economic and social policies. This view is widely accepted among government officials but there is no indication as yet that the nature of the problems facing Ceylon is understood by the Cabinet, let alone that the Government is moving towards a program of action of the kind required. An acute crisis is likely to occur within the next few months. Such a crisis, and a consequential change in political alignments, may well have to precede the preparation of a meaningful program of action by the Government.

(b) As regards the Aid Group, its major members have said that they will attend the meeting at the end of April and appear generally inclined to help Ceylon. However, the continuing existence of the Group and perhaps even the willingness of members to pledge at the next meeting will depend on the Government preparing a program of action - and demonstrating its ability to carry it out - that promises to see Ceylon through the present difficulties and back on to the path of development.

(c) As regards future Bank Group activities: (i) future lending will be limited to IDA as Ceylon can no longer be considered creditworthy for Bank loans; (ii) in the present circumstances IDA lending should be directed towards program type operations. Agriculture has top priority and steps should be taken immediately to identify possibilities for IDA to assist in expanding production for export and for import substitution. Should the Government request IDA assistance in the form of industrial import or similar program financing, the matter should be considered further, but IDA should take no initiative in this direction; (iii) pending clarification of Ceylon's economic policies and investment priorities further work on the other projects listed in the FY 1972 program, including the proposed education project, should be suspended; (iv) as pro-

posed in paragraph 35 of the paper, conditions for IDA lending, in terms of Government action, should initially be set considerably below the ideal; (v) once these conditions are met, IDA may be able to lend to Ceylon more than its present tentative allocation in the order of \$10 to 15 million annually.

(d) The Bank's approach to Ceylon should be reviewed in a few months, or earlier if warranted by a significant change in the situation.

South Asia Department
March 31, 1971

CEYLON - COUNTRY PROGRAM PAPER

| | | <u>Bank/IDA Lending (\$ millions)</u> | | |
|---|---------------------|---------------------------------------|---------------------------|----------------------------|
| | | <u>1964-68</u> | <u>1969-73</u> | <u>1972-76</u> |
| 1970 Population: | | | | |
| 12.6 million | IBRD ^{/1} | 2.8 | 32.5 | - |
| 1969 per. cap. GNP (in \$): 157 ^{/2} | IDA ^{/1} | <u>2.0</u> | <u>47.6</u> | <u>75.0</u> |
| Current Population Growth Rate: | Total | <u>4.8</u> | <u>80.1</u> | <u>75.0</u> |
| 2.3% | Operations Program: | | <u>87.1</u> ^{3/} | <u>122.0</u> ^{3/} |
| Current Exchange Rate: US\$1 | | <u>Annual Average per capita (\$)</u> | | |
| = Rs. 5.95 (parity rate) | IBRD/IDA | 0.08 | 1.27 | 1.19 |
| = Rs. 9.2 (rate covering 50-60% of payments) | IDA | 0.03 | 0.75 | 1.19 |

/1 Net of cancellations

/2 \$196 according to the concept used in the World Bank Atlas

/3 Operations program approved last year for 1969-73 was \$174.3 million. Operations program for 1972-76 is notional.

A. INTRODUCTION

1. The major recent event on Ceylon's political scene has been the victory of the coalition led by Mrs. Bandaranaike in the general elections last May which gave it control over more than three-quarters of the seats, with Mrs. Bandaranaike's own party, the Sri Lanka Freedom Party (SLFP) holding nearly two-thirds. The United National Party (UNP) led by Mr. Dudley Senanayake, which had been in power since 1965, was left with 18 seats out of 157.

2. During the campaign, the coalition had announced its intention to bring about fundamental changes in economic organization designed to lay the foundation of a socialist society. To do this, it promised to give the leading role to the public sector and to bring the private sector under control, including in some cases through nationalization. Furthermore, it accused the previous administration of having pursued growth without regard for distributive justice and undertook, if elected, to implement a welfare-oriented program in which the most

popular measure was the re-establishment of the full rice ration which had been halved by the Senanayake government in 1966. On the external front, the coalition accused the Senanayake regime of having sold out to the West and claimed that Ceylon's sovereignty was being impaired by improper deference to the wishes of the West. The IMF and IBRD were branded as prime culprits and the Aid Group as an instrument of western imperialism. The coalition promised to reassert Ceylon's independence.

3. Shortly after coming to power, the new Government took various steps to fulfil its electoral promises. To begin with, it extended diplomatic recognition to certain eastern regimes (Hanoi, East Germany, etc.); this was done in such a way that it had the effect of annoying the main aid givers. With respect to the Bank, it established enquiry committees to review the three major Bank-financed projects (highways, power, and Mahaweli), while debate continued between those who wished to cancel all pending projects and those who advocated a more moderate course.

4. The Prime Minister and some of her advisers soon realized, however, that their expectations of securing from the eastern bloc or from mainland China the kind and amount of aid which Ceylon had been receiving from the Aid Group were unrealistic. They also realized that Ceylon could not do without foreign assistance. Less than a week after having assumed office, Dr. N.M. Perera, the new Minister of Finance and leader of one of the coalition parties, announced to the nation that he had inherited a financially nearly bankrupt country. Although the gravity of the situation became more generally understood only later - particularly in December 1970 when Ceylon defaulted on a loan from German banks - this discovery dampened somewhat the euphoria of the electoral victory and marked the beginning of a sobering process. To be fair, one has to recognize that to a large extent the difficulty had been the result of action by the previous Government. In addition, the previous Government, which knew the facts, had carefully concealed them in an attempt to win the election. In these circumstances it is not surprising that when the new Government was faced with the facts a good deal of confusion followed - which to a large extent still prevails today - as to what action it should and could take.

5. During the review of Ceylon's CPP in February of last year, there was no doubt that Ceylon's balance of payments was one of the major causes for concern. It was recognized, however, that while the situation called for far-reaching political decisions, little was likely to be done before the elections. It was agreed that the question should be taken up with the new Government soon after the elections, and that the Bank's lending program should be reviewed in the light of these discussions. In fact, the situation continued to deteriorate throughout 1970. A good deal of short-term borrowing was incurred in the months preceding the elections despite our warnings and without our knowledge. Today, Ceylon's liquidity crisis is the overwhelming factor and all other issues, however important they may be, are secondary. It is therefore to this problem and to what the Bank should do in the circumstances, that the main thrust of this paper will be devoted. Since several constraints, however, are largely

the product of policies pursued by previous governments, it may be useful first to put Ceylon's problem in historical perspective by recalling some of the major events of Ceylon's recent economic history. This will be the object of the next section.

B. A BRIEF ECONOMIC HISTORY (1956 - 1970)

6. Since the mid-1950's Ceylon has been going through a painful process of profound social, political, and economic change. Its beginning was marked by the victory in the 1956 general elections of the Sri Lanka Freedom Party (SLFP) - then led by Mr. Bandaranaike and subsequently by his wife after his assassination in 1959. This constituted the first step towards eliminating the social, cultural, political and economic features of colonial rule which the United National Party (UNP) - representing the thoroughly westernized, English-speaking elite and middle class - had left largely untouched in its nine years in office since independence. The mid-1950's also saw the start of the decline in the prices of Ceylon's major export crops - tea, rubber and coconut products - which dominated the economy and had traditionally provided the Ceylonese with a per-capita income far above that of the rest of the Indian sub-continent. At the same time, Ceylon's population began growing rapidly largely as a result of successful efforts to eradicate malaria.

7. Social and political reform dominated the first ten years of this period. It led to the introduction of Sinhala as the official language to ensure that administrators could communicate with those they administered, and changes in the education system to place greater emphasis to Sinhalese culture. It entailed the conclusion of an agreement with India on the repatriation of about half of the Indian labor force on the tea estates. But above all, it involved an acceleration of the program to reduce inequality of income and provide every Ceylonese with a minimum standard of living. Specifically, it meant increases in taxes, particularly on exports and the higher income groups, a continuance of the rice subsidy and the rapid expansion of a wide array of other consumer subsidies on a steadily widening range of other basic consumer goods and increased expenditures on free or heavily subsidized government services (not only free education but also health services and subsidized public transport). Finally, it meant sharp curtailment of the scope for private economic activity and corresponding expansion of the public sector (particularly in manufacturing), partly because of the Government's socialist orientation, but also because the private sector has traditionally been dominated by non-Sinhalese.

8. Undoubtedly, reforms were needed to create a society with an identity of its own, rather than an amalgam of communal groups governed by a Westernized elite. However, in the short run a heavy price was paid. Ethnic tensions ran high. The quality of the education system and of administration deteriorated. The Government's social program resulted in large budget deficits which fuelled rapid expansion of purchasing power. At the same time, real income grew only

very slowly - partly, because public investment, which increased substantially, yielded little productive return as here, too, welfare objectives dominated over economic considerations; partly, because with declining export prices, particularly of tea, real income from export agriculture stagnated; and partly, because out of welfare considerations the Government kept the supply of imported consumer goods, especially foodstuffs, relatively plentiful and at low prices which offered little incentive to domestic production. Thus, a wide gap opened between exchange earnings and payments. External assistance was negligible because Government policies had alienated Western aid givers and aid from Communist countries, although sizeable in terms of commitments, was very slow in being disbursed. Thus, financing of the deficit fell largely on Ceylon's exchange reserves which, though substantial in the mid-1950's, (\$236 million equivalent in 1956) dwindled rapidly and were virtually exhausted by 1961.

9. Although the Government then began to recognize the need to expand domestic production, its actions were very largely confined to palliative measures, in particular increasingly comprehensive and severe exchange in import controls. However, even these measures proved inadequate to prevent the exchange situation from deteriorating to the point where, in order to maintain imports of foodstuffs which the Government considered essential, imports of intermediate and capital goods had to be cut, thus further circumscribing the scope for developing domestic production. It was in this atmosphere of economic crisis that general elections were held in March 1965, following a Government defeat in Parliament over an attempt to nationalize the press which had become strongly critical of Government policy.

10. The government elected in 1965, led by Mr. Dudley Senanayake, was faced with the task of bringing about major structural changes. However, it was also clear by that time that Ceylon's exchange situation had reached a point where sizeable external assistance was a precondition of any attempt to tackle the problems. The Bank had begun discussions in the last months of the previous Government on how this assistance might be mobilized. This led to the creation of the Ceylon Aid Group - presently consisting of Australia, Canada, France, Germany, Japan, United Kingdom and the United States, with observers from Denmark, India and Italy and representatives from the IMF, the Asian Development Bank, UNDP and OECD - which held its first meeting under the chairmanship of the Bank, shortly after the UNP came to power. It was hoped that an inflow of quick-disbursing commodity aid would allow the Government sufficient room for maneuver to permit some liberalization of imports for investment purposes and to restructure the framework of economic policies and thus begin the task of reversing the adverse trend. The situation appeared to call for three main lines of action: (a) curtailment of the growth of consumer demand so as to relieve the pressure on imported and locally produced goods; (b) reduction of the quantity of imported consumption goods, and thus release the foreign exchange resources required to reverse the decline of investment; (c) an increase in the volume and, particularly, the quality of investment so as to increase the rate of growth. From the aid donors it was hoped that a sufficient level of assistance would be provided over a period of several years to provide the Government with the room for maneuver for

implementing, without an absolute cut in consumption standards, the production, consumption and fiscal policies needed to achieve more rapid growth.

11. In this task of restructuring the economy, substantial progress was made between 1965 and 1969, as policy changes over a fairly wide front - in which the Bank took an active advisory role - provided an important stimulus to increased domestic production. Most notable among these changes were the halving of the rice ration in December 1966 and the reform of the exchange system. The former led to a sharp increase in the domestic price of rice and a substantial widening of the free market which were important factors in the rapid increase in production which took place. The rupee was devalued in November 1967 from 4.76 to 5.95 to the dollar. Further partial devaluation resulted from the introduction, in May 1968, of Foreign Exchange Entitlement Certificates (FEEC's). Their price was eventually fixed at a premium of 55 percent of the official rate, for an effective rate of exchange of Rs. 9.20 to the dollar, and the categories of payments subject to FEEC's were gradually extended. A category of Open General License imports was introduced, covering in particular industrial materials. These reforms had marked beneficial effects on economic activities, especially in manufacturing, and improvements in policies, combined with efforts to make existing investments more productive, brought about considerable acceleration of economic growth. In 1968 GDP at constant prices increased by about 8 percent and continued gains in agricultural and industrial production were recorded in 1969 when GDP increased by a further 6 percent, as compared to an average of 3.6 percent in the first half of the 1960's. In addition, after years of stagnation fixed investment increased considerably, from below 15 percent of GDP to 19 percent in 1969.

12. In contrast to the progress made in restructuring the productive side of the economy, the management of financial affairs failed to provide the basis for sustaining this progress. At the outset, it should be noted that this task turned out to be much more difficult than had been expected when plans for economic improvement were mapped out in 1965. It was then expected that over the next five years export earnings would at least be maintained at their 1965 level. Consequently, aid would be translated into increased imports. In this context, the task of financial management was seen as ensuring that, initially, these increases in total imports and, subsequently, the fruits of rising domestic production, especially of food, went into additional imports of productive goods so as to initiate and then sustain the growth and restructuring of the economy. As it turned out, prices of Ceylon's major exports, particularly tea, fell much more rapidly than had been expected. Actual export earnings in 1966-1970 were in the aggregate \$345 million less than they would have been had they remained at their 1965 level. In contrast, total disbursements by the Aid Group came to less than \$250 million. Moreover, the rise in freight rates following the closure of the Suez canal and sharp increases in world prices of rice further eroded Ceylon's import capacity. In short, the foreign exchange constraint was immeasurably greater than had been expected.

13. The Government was not able to cope with the situation. Rising incomes went largely into increased consumption. Thus the increase in investment was financed largely by capital inflows. Interest rates remained low and, despite substantial increase in Government revenues, the Government's current expenditures rose just as rapidly, since the maintenance of social and welfare

programs required increasing resources. Rising money incomes, in the absence of adequate tax and savings policies, put added pressure on the balance of payments.

14. By 1968 the strain of attempting to maintain import capacity for both investment and consumer goods in this context had begun to show. In that year large drawings on the IMF and sizeable supplier's credits were required to finance a level of total imports only equal to that of 1959. In 1969, however, further drawings on the IMF were not possible and Ceylon's import capacity declined below the level of 1968. Despite this, imports were allowed to increase substantially. The principal reason was that, in anticipation of the general elections, the Government failed to translate increases in domestic production, particularly of food, into reductions in imports. Furthermore, at a fixed FEEC rate, demand for imports under open general licences began to outrun available foreign exchange. To finance the increase in imports external reserves were exhausted and large amounts of short-term high-interest foreign commercial bank credit were drawn to meet exchange payments. Ceylon thus entered 1970 with a severely weakened liquidity position.

15. Unfortunately, further deterioration did occur. The 1970 import budget which was well in excess of import capacity was not cut back before the elections in late May. Exports in the first half of 1970 remained at the 1969 level instead of increasing as expected and short-term indebtedness to foreign commercial banks increased still further. Domestic financial policies also served to keep import demand at a high level. Expansionary financing reached high levels in 1969/70 and rising prices produced political pressure for reducing the cost of living. Thus when the present Government came to power in mid-1970; it was faced with the worst foreign exchange crisis since the war, and a potential internal financial situation of similar gravity. On coming to power in May 1970 the new government under Mrs. Bandaranaike articulated a number of political objectives, in particular to redistribute income, reduce the cost of living and increase employment. A variety of actions have been taken in pursuit of these objectives. These include the restoration of the second measure of rice to the ration; the extension of price controls to a growing list of manufactures; the limitation of the area of private sector industrial activity; progressive nationalization of wholesale and foreign trade; and the formulation of an employment program.

16. Ceylon is faced with a situation where the total supply of goods from overseas must be curtailed in the short-term and where, over the longer term, the government must seek to achieve its economic objectives within a more or less constant level of imports. If the economy is to continue to invest so as to achieve growth of domestic production and employment, with roughly stable prices, then the primary policy objectives must be to limit the growth of consumer expenditures and to increase public and private savings. Total savings in Ceylon have fallen from almost 16 percent of GNP in 1961 to about 12-1/2 percent in 1969, and, if preliminary estimates are accurate, to under 11 percent in 1970. In the present political climate private savings must be expected to decline. The weight of action therefore falls to the government, which must increase savings by increasing its tax revenues relative to its consumption.

17. Seen against this background of the urgent need to increase public savings, the 1970/71 budget is a disappointing document. Even the original budget estimates show a fall in the surplus of revenues over current expenditures from Rs. 161 million to Rs. 77 million. These earlier estimates have been overtaken by events, however, which strongly suggest that this budget will not only fail to provide a way out of the present difficulty, but will in fact lead to further deterioration. A series of revisions to the original budget estimate have had to be made for a variety of reasons, which in sum represent a serious worsening of the budgetary situation even as compared to the very unsatisfactory outturn last year. It is difficult to see how the deficit could be significantly reduced without virtually eliminating public investment.

18. In his budget speech, the Minister of Finance talked of the government's objectives. "It is committed", he said, "to maintain those social welfare measures which are an integral part of our fabric and to take all such steps as the situation demands to provide the necessities of life at reasonable prices to the mass of our people. It is committed to a program of rapid economic growth of sufficient magnitude to absorb a sizeable proportion of the unemployed and to bring the solution of this problem within sight during its term of office". He added, "The magnitude of our development effort, the rapidity with which we can increase the production of these goods and services upon which our general welfare depends and the speed at which we can effect the transformation to socialistic forms are determined by the extent to which we are willing to make a sacrifice now and the extent to which we are willing to increase our productive work." Insofar as new directions have been set these have not been towards growth. None of the measures taken so far can be represented as a sacrifice of present consumption for future benefits. Consumption in 1970 grew at a faster rate than GNP and the prospects are for a similar divergence in 1971.

C. THE FOREIGN EXCHANGE CRISIS

19. Ceylon is presently facing the most severe external payments problem since the war. At the beginning of the last decade, the country still held US\$100 million in official exchange assets, unencumbered by short-term liabilities. By the end of 1970, these assets had shrunk to US\$42 million, of which more than half is either in bilateral balances that cannot be used readily or in securities that have a market value considerably below book value and in any event are pledged against borrowings. At the same time, US\$67 million of short-term debt was owed to commercial banks abroad and short-term trade credits stood at about US\$60 million. Outstanding drawings on the IMF amounted to a further US\$88 million, making the Fund's holding of currency in Ceylon the largest among its members in relation to quota.

20. The Central Bank's liquidity position is extremely weak. Its liquid assets are below US\$5 million. Among the various lines of credit with commercial banks abroad, which during the previous two years had in effect served

as the Central Bank's working balances, little is left to be drawn. Altogether, therefore, the Central Bank has less than US\$10 million in liquid resources with which to conduct the external finances of a country with an annual volume of exchange payments in the order of \$400 million. In the circumstances, even small unexpected payments present problems; large ones can cause a major crisis.

21. Looking ahead, one can only conclude that in 1971 Ceylon's external payments difficulties will become more rather than less intense. Most agreements with the commercial banks abroad expire in the first seven months of the year; unless they are renewed, sizeable net repayments will have to be made in the course of the year. In addition, short-term trade credits of US\$60 million will fall due, and the repayments of US\$24.5 million will have to be made to the IMF during the calendar year. Together, those obligations come to about US\$150 million. Payments on trade credits presumably can be offset by new borrowing. Under a new stand-by for US\$24.5 million from the IMF, approved by the IMF Board on March 17, Ceylon will receive \$19.5 million in 1971. However, financing will have to be found for nearly \$70 million - an amount equivalent to a fifth of a year's estimated earnings from merchandise exports and about twice Ceylon's official external assets. It is obvious that Ceylon's external financial position in 1971 will be unmanageable unless an accommodation is reached with the creditors that would substantially reduce payments falling due that year. The agreement with the IMF may well facilitate negotiations with commercial banks abroad. It is understood that the Ceylonese authorities have initiated discussions with some of the banks concerned to seek conversion of short-term loans into medium-term ones (5-8 years).

22. Accommodation with all the short-term creditors would render more manageable the task facing the authorities in avoiding a crisis. However, it would still leave Ceylon in a critically weak liquidity position. There is no question that the Central Bank's liquid assets must be increased. To this end, an amount at least equivalent to this year's allocation in SDR's of US\$11 million should probably be set aside. In addition, the commercial banks may well insist on Ceylon reducing its obligations to them somewhat - say, by US\$10 million. If, finally, Ceylon decided not to incur any net additions to the short-term trade credits outstanding at the end of 1970, net movements in short-term liabilities and assets would this year absorb nearly US\$10 million in exchange resources. This would be in contrast to Ceylon drawing on this source to the extent of US\$31 million in 1970 and US\$58 million in 1969 for financing merchandise imports.

23. There is no prospect of any significant increase in exchange earnings in 1971. Judging by undisbursed commitments of external assistance in the pipeline, disbursements this year are unlikely to exceed US\$80 million - US\$25 million in project aid and US\$55 million in commodity aid. At this level, they would exceed last year's receipts by about US\$15 million. Unless it can be increased by additional assistance, a balance of payments policy directed towards rebuilding Ceylon's liquidity position will have grave consequences for the amount of imports Ceylon can afford in 1971. Rough estimates suggest that, with the resources in sight, merchandise imports this year will have to be kept down to roughly US\$375 million, US\$30 million less than in 1970 and as much as US\$70 million below the level of 1969.

24. The fact that at US\$375 million imports would be at their lowest level since the late 1950's underscores the sharpness of the conflict between the need for improving the liquidity position, the import demand associated with current levels of consumption and the import requirements of economic growth with which the Ceylonese authorities will have to struggle in 1971. Clearly, the present liquidity crisis is merely the most glaring symptom of a much deeper malady.

25. More than a decade after the prices of Ceylon's major exports (tea, rubber and coconut) began to weaken and, consequently, total exchange earnings first became stagnant and then declined, (about \$370 million annually between 1954 and 1965, against about \$340 million for the period 1966-1970), Ceylon's imports, as is particularly evident in the continuing dominance of food imports, still have the basic structural characteristics of an export economy. Fundamentally, this situation reflects the inability of successive Governments to reconcile the longer term needs of the economy for structural adaption, through growth of domestic production, to the basic change in the export position, with strong pressures for current consumption. To effect such a reconciliation, within a level of imports Ceylon can afford and on terms that will dispel the prospect of long-term economic decline, is the fundamental challenge facing the present Government. This task by itself would have been a difficult one. As it is, it also has to deal with a liquidity crisis that is not of its own making.

26. It is evident from the discussion that at present a wide discrepancy exists between the direction which Government economic policy appears to be taking and that which it should be taking if Ceylon's economic affairs were to be managed effectively in the current difficult situation. In the circumstances it is obviously not possible now to reach any substantive conclusions about the prospects for economic and social development in Ceylon, except the negative one that without a major redirection of policy all indications point to long-term economic decline. However, instead of dwelling on the dire consequences of inaction on the part of the Government, it may be more appropriate briefly to summarize what appear to be the two critical elements in any effort to overcome Ceylon's severe difficulties and set it on the path to economic improvement.

27. One such element is external assistance. There is no question of the Government being able to cope with the present difficulties on its own, without continuing support from abroad on a substantial scale. Any appreciable shortfall, for any length of time, in imports below US\$400 million will threaten to strain beyond tolerable limits the Government's capacity for curtailing domestic consumption. Yet, without fresh commitments of aid, Ceylon's import capacity will fall to about US\$330 million in 1972 and thereafter level off around US\$300 million. Thus, it is essential that disbursements of aid be at least maintained at their estimated level of US\$80 million in 1971. Moreover, they will have to continue at this level not just for a couple of years, but for some time to come. These may seem large numbers for a country with a population of 12-13 million and it will certainly be difficult to mobilize external

assistance in such amounts, although it is a sobering thought that all the aid Ceylon received during the past five years did not make for the loss of exchange earnings that resulted largely from the decline in prices of its major export products.

28. However, for all its easily demonstrable need for external assistance, Ceylon would be unrealistic in expecting to obtain aid in amounts anywhere near those mentioned above, unless the Government establishes a policy framework to support a structural transformation of the economy to setting Ceylon on the path to development. The establishment of such a framework is, therefore, an equally important element in a renewed effort to overcome the structural difficulties of Ceylon's economy. Such a framework must provide for strong emphasis on promoting rapid growth of agricultural production, while industrial development, because of the large demands for imports associated with it, must probably for the time being be kept to a minor role. It must point the way to more efficient use of existing productive assets, particularly in the public sector which will require, inter alia, higher productivity of labor and more effective management. Finally, it must enable the Government to curtail the growth of consumption, private and public together, to the point where the major share in the additional income generated over the next several years is channeled into savings and reductions in imports of consumer goods, including food. Altogether, these various elements of a viable framework of domestic economic policies amount to a formidable challenge to the perseverance and ingenuity of the Government whose magnitude it is difficult to exaggerate. ?

29. If it were to meet this challenge, the Government would, in essence, not only have to go back on its principal campaign pledge of improving the standard of living of the masses, but would also have to break with the country's long-standing tradition of the State subsidizing many essential consumer goods and providing a wide array of free or heavily subsidized public services. It is far from certain that it will be able to muster the will and have the strength for carrying such a program through. In our concluding discussions, at the end of the economic mission last December, with the Prime Minister, our analysis of the facts of the situation was received with a good deal of disbelief, although officials generally agreed with the position we were taking. We therefore sent a note summarizing our findings and conclusions to the Government, preparatory to a further round of discussions towards the end of February. During the second visit, it appeared that in the intervening months realization of the difficulties in which Ceylon found itself had grown, aided no doubt by the fact that shortages of essential imported consumer goods had begun to appear in the market. However, there was as yet no semblance of a plan for action, either with respect to this year's exchange budget and import program or the Government budget, let alone a broad strategy for development. Indeed, there was no indication that any of these matters had come before the Cabinet. The Prime Minister, while recognizing the need for action, gave no indication that she intends to press the matter, possibly because she is uncertain whether she will be able to carry with her the left-wing elements in her coalition, including those of her own party. We impressed upon the Government the need for their being able in broad terms to

indicate to the Aid Group at their meeting at the end of April how they proposed to extricate the economy from its current severe difficulties and to present some evidence of concrete action, but it remains to be seen whether any decisions will have been taken by that time.

D. THE BANK/IDA PLAN

30. For the time being, the role, which the Bank Group will be able to play in Ceylon, must be regarded as quite uncertain. Most predominantly, it will depend upon the evolution of the political situation in the country. While the Government, as presently constituted, recognizes that circumstances argue strongly for further collaboration with the Bank, some groups among the coalition parties would like to see Ceylon cut its links with the western world and with institutions like the Bank which has often been identified with western capitalism. Should these take over the Government, the role of the Bank Group would presumably dwindle to that of an unpopular creditor. On the economic and financial front, much will depend upon the measures which the Government will take to tackle the country's external and internal liquidity crisis and to achieve some degree of development.

31. Last year's Country Program Paper commented that if a government led by Mrs. Bandaranaike were to come to power, there would be a period of confusion while officials tried to convince the new Ministers that Ceylon has little room for manoeuvre. This prediction has now come true. At present, there is still a good deal of confusion and the process of education of the new leaders is far from complete. Although the euphoria and flamboyant attitudes of last summer have been replaced by a somewhat more sober posture, no meaningful action has yet been taken. Appropriate fiscal and economic policies still have to be devised.

32. Since last June we have had several rounds of discussions with government officials and in this process opinions and attitudes toward the Bank have changed somewhat. The mere fact that the Bank has been willing to listen to objections to its three major projects, however justified or unjustified they may have been, came to many as a surprise, as was the discovery by some of the new officials that the Bank had also been critical of the previous regime. In view of the divergent attitudes towards the Bank among the different partners in the coalition, however, the vaudeville episode of the letters cancelling and then uncancelling our loans last July, may be repeated in one form or another. Nonetheless it is hoped that some degree of improvement will in the end be achieved. One of the Bank's objectives should therefore be to keep in contact with Government to assist in devising sensible economic policies, although given the magnitude of the problems, it is impossible to say what the outcome of a continuing dialogue will be.

33. The second field in which the Bank should remain active is that of the Aid Group which the Bank has shared since the Group was created in 1965. Obviously the continuance of the Aid Group does not depend upon the Bank but

upon each of the participants and in this respect the initiative rests primarily with Ceylon. So far, the major contributors have indicated that provided Ceylon does not take further diplomatic initiatives embarrassing to them, ceases threatening foreign interests and adopts policies aimed at achieving a reasonable degree of growth, they would be prepared to continue participating in the Aid Group. On the first two points there is of course little, if anything, that the Bank can do, but with respect to economic policy the Aid Group will be looking to the Bank for an objective appraisal of the situation. In the absence of new policy initiatives, we are now obviously not in a position to present a case for continuing assistance on the basis of economic performance. Nevertheless, we propose to have the Aid Group meet at the end of April, and expect that it will be responsive, on the grounds that a suspension of assistance (which finances over 20 percent of Ceylon's imports) would plunge Ceylon into a crisis of disastrous proportions and that for political reasons most members would probably want to avoid the impression that creation of the Aid Group was solely the reward for the election of a "friendly" Government.

34. The third area of importance is the Bank Group's own lending program. Here, the first question is obviously: should the Bank Group lend at all to Ceylon? Last year's Country Program Paper sounded a strong note of caution particularly with regard to Ceylon's ability to continue borrowing from the Bank. While the paper stressed that the bulk of assistance should come from IDA, it argued that under certain optimistic assumptions, a substantial amount could still be borrowed from the Bank over the next five years. It concluded, however, that if any of these assumptions did not prove true, it would be necessary to scale down Bank lending. None of the optimistic assumptions have become a reality, and many of the pessimistic ones have become true. Today, Ceylon can no longer be regarded as creditworthy for new Bank loans. Indeed, a certain reduction in the Bank's exposure would be desirable and in this respect the cancellations of the highway loan (569-CE) of \$4.9 million, of \$4 million under the last power loan (636-CE), and of about \$1.2 million from the first DFCC loan (520-CE) are welcome. A further cancellation of up to \$7 million is expected from the second DFCC loan (634-CE). Altogether, this will have the effect of reducing the Bank's present commitments from \$76.3 million to \$59.2 million. Assuming no further Bank lending and taking into account the pace of future disbursements and repayments, the Bank's exposure which today amounts to \$25.3 million will not exceed \$45.4 million (by 1975).

35. Fresh Bank Group assistance will thus have to come entirely from IDA. The question here is under what circumstances would we consider Ceylon eligible for IDA financing. As explained earlier, unless the Government is prepared to establish a policy framework designed to set Ceylon back on the path of development, all indications point to economic decline. In such a situation, there would probably be no justification for lending both on general performance grounds and also because Ceylon would then most likely not have any rupee resources to cover even a modest share of project costs. On the other hand, if we were to make IDA lending contingent upon the Government having introduced the kind of comprehensive policy package which ideally it should undertake to overcome the present difficulties, there would most

likely be no IDA lending for the next several years. It is proposed that, initially at least, we set the conditions for IDA lending considerably below this ideal and indicate to the Government our willingness to lend when there is evidence that the Government has faced up to the facts of the situation, agreement has been reached within the Government on a broad strategy for setting the economy back on the path of development, and some significant concrete steps have been taken towards putting the strategy into effect (for example, formulation of a supplementary budget and of a realistic import program that does not place the entire burden of adjustment on investments. In our discussions in February, we urged the Government to take action along those lines before the meeting of the Aid Group at the end of April. It remains to be seen whether they will do so.

36. Assuming we can continue lending, we should in present circumstances - and taking among other things account of the fact that Bank Group net transfers with Ceylon have been negative for several years - essentially look for projects which would:

- (a) lead to quick disbursements;
- (b) finance essential items expected to be imported even *without* without financial assistance; and
- (c) provide support for the required redirection of economic activity and Government policies.

All this points towards some form of program lending as the most suitable action. The major problem is, however, that the Government's overall policies might make it difficult to justify a program loan. Also, much of the Aid Group assistance takes the "non-project" form and may thus pre-empt areas which could otherwise be considered for IDA assistance. On the other hand, under certain circumstances it might be possible to devise sectoral loans which would meet urgent requirements in Ceylon's development program.

37. The first sector to be explored is agriculture. Given Ceylon's balance of payments situation, there is no doubt that high priority must be given to agriculture where there is still considerable room for increasing production for export as well as for import substitution. Bank Group lending to Ceylon in the past few years has reflected this priority. In addition to the Mahaweli project, two smaller projects, for irrigation and land reclamation, which were the results of an identification mission organized in 1966, are now being carried out. In the years ahead, a good deal of attention will have to be devoted to their supervision, which may lead to preparation of further similar projects. However, we should now look into the possibility of devising a scheme to increase production of export crops such as rubber, coconut, cashew, pepper, and/or cocoa. Such a program could have a quick impact on Ceylon's foreign exchange position and might well include financing current inputs (such as fertilizer) over a given period of time. Similar assistance may be possible in support of the Government's program to expand production of rice and other foodstuffs to reduce imports. The difficulty of such a scheme is that while we have some broad knowledge of Ceylon's requirements, it is not specific enough. Therefore as a first step we are planning

to organize an identification mission, hopefully within the next few months, in order to select elements that appear feasible and to outline whatever further steps should be taken. Another sectoral credit could possibly be devised in the field of transportation. For example, should the Government finally decide to raise bus fares, especially in Colombo; so as to make its Transport Board a viable enterprise, one could consider financing the modernization of Ceylon's bus fleet for which the Government is annually spending substantial amounts of foreign exchange to keep obsolete equipment running. Such a credit could also possibly include some assistance for the railways' maintenance and improvement program, including track renewal. Here again, the first step will be to send a mission to Ceylon to identify items suitable for financing.

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38. Although these projects should be given high priority, their preparation may run into difficulties and may turn out to be time consuming. Consequently, preparation of the more conventional projects that are already in the program will continue. This means essentially Education where much work has already gone into project preparation since 1968. Last month a UNESCO preparation mission, under the Cooperative Programme, visited Ceylon to assist the Government in preparing a request for financing. This mission has now completed its task and an advance copy of the request was received a few days ago. Appraisal is presently scheduled for mid-April. Because of the Government's budgetary difficulty, there is a need to reduce the program which, as proposed, is too large. The request will have to be considered carefully to keep only elements which would have sufficient priority to warrant financing now. This should be possible, particularly in such fields as agricultural, technical, and vocational education. There is also a Highway project resulting from the Government's intention to devise an alternative to the project recently cancelled. With respect to Power, the Government had originally hoped to use savings under Loan 636-CE to finance its transmission needs. We understand that a request for financing is under preparation, which may be suitable for IDA and/or bilateral financing.

39. In view of the above, the program outlined in Attachment I should be regarded as notional. In present circumstances we shall first of all endeavour to identify new projects which would meet the criteria in paragraph 36 while continuing preparation of those already identified. For planning purposes, we propose to treat the next two fiscal years as a single period and, while making all the necessary reservations, intend to inform the Government representatives at the time of the Aid Group meeting, that IDA would be prepared to consider making credits totalling about \$25 - \$30 million over the next two fiscal years and that in our opinion all attempts should be made to have these channelled through sector-type operations. Assuming a favorable answer, the missions mentioned above should be sent shortly thereafter to identify the projects. Given the advanced stage of preparation of the education project, the timing of the appraisal mission should, if at all possible, be kept unchanged.

40. Regarding assistance beyond FY 73, the situation will have to be kept under review and as it evolves specific proposals will be made. One may expect, however, that agriculture and possibly industry will require further assistance. Regarding Agriculture, arrangements are presently being made - as suggested last year - to organize a sector mission to review Ceylon's

longer-term prospects and needs. In reply to a request from ILO to participate in a mission to be led by Professor Seers from March 25 through the end of May to assist Ceylon in devising an employment strategy, the Bank has agreed to make available two staff members to look into the industrial sector. Although the report itself will be the responsibility of Professor Seers, information collected during the mission might suggest ways for subsequent Bank Group assistance.

South Asia Department

March 19, 1971

Population: 12.6 m
Per Cap Inc: \$157

CEYLON - ACTUAL AND PROPOSED LENDING THROUGH FY1976
(\$ millions)

Attachment 1

| | | Fiscal Years | | | | | | | | | | | | | | Total 1964-68 | Total 1969-73 | Total 1972-76 | |
|----------------------------------|-------|-----------------|------|------|------|------|------|------|-------|------|------|------|--------|------|------|------------------|------------------|------------------|-------|
| | | Through 1963 | 1964 | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | | | | |
| Lift Irrigation | IDA | | | | | | 2.0 | | | | | | | | | | | | |
| Drainage & Land Reclamation | IDA | | | | | | | | 2.5 | | | | | | | | | | |
| Mahaweli Irrigation I | IBRD | | | | | | | | 14.5 | | | | | | | | | | |
| Mahaweli Irrigation I | IDA | | | | | | | | 14.5 | | | | | | | | | | |
| Mahaweli Irrigation II | IDA | | | | | | | | | | | | | 25.0 | | | | | |
| Agriculture (Sectoral Credit) | IDA | | | | | | | | | | | 15.0 | | | | | | | |
| Livestock | IDA | | | | | | | | | | | | | 5.0 | | | | | |
| Agriculture - Unidentified | IDA | | | | | | | | | | | | | 10.0 | | | | | |
| DFCC I | IBRD | | | | | | 2.8* | | | | | | | | | | | | |
| DFCC II | IBRD | | | | | | | | 1.02/ | | | | | | | | | | |
| Education I | IDA | | | | | | | | | | 5.0 | | | | | | | | |
| Education II | IDA | | | | | | | | | | | | | 5.0 | | | | | |
| Power I | IBRD | 19.1 | | | | | | | | | | | | | | | | | |
| Power II | IBRD | 7.4 | | | | | | | | | | | | | | | | | |
| Power III | IBRD | 15.0 | | | | | | | | | | | | | | | | | |
| Power IV Maskeliya Oya | IBRD | | | | | | | | 17.0* | | | | | | | | | | |
| Power Transmission I | IDA | | | | | | | | | | 7.0 | | | | | | | | |
| Power Generation | IDA | | | | | | | | | | | | 10.02/ | | | | | | |
| Highways I | IDA | | | | | | 0.6* | | | | | | | | | | | | |
| Highways II | IDA | | | | | | | | | 10.0 | | | | | | | | | |
| Highways III | IDA | | | | | | | | | | | | 10.0 | | | | | | |
| Transportation - Unidentified | IDA | | | | | | | | | | | | | 10.0 | | | | | |
| Industry - Unidentified | IDA | | | | | | | | | | | | 5.0 | | | | | | |
| Industry - Unidentified | IDA | | | | | | | | | | | | | 5.0 | | | | | |
| Operations Program | IBRD | | | | | | | | | | | | | | | | | 32.5 | - |
| | IDA | | | | | | | | | | | | | | | | | 54.6 | 122.0 |
| | Total | | | | | | | | | | | | | | | | | 87.1 | 122.0 |
| | No. | | | | | | | | | | | | | | | | | 9 | 14 |
| | | | | | | | | | | | | | | | | | | | |
| Lending Program | IBRD | 41.5 | | | | | 2.8 | - | 32.5 | - | | | | | | | | 2.8 | 32.5 |
| | IDA | - | | | | | 2.0 | .6 | 17.0 | - | | 30.0 | 15.0 | 15.0 | 15.0 | | 2.0 | 47.6 | 75.0 |
| | Total | 41.5 | | | | | 4.8 | .6 | 49.5 | - | | 30.0 | 15.0 | 15.0 | 15.0 | | 4.8 | 80.1 | 75.0 |
| | No. | 3 | | | | | 2 | 1 | 4 | - | | 3 | 2 | 2 | 2 | | 5 | 8 | 9 |
| IBRD o/s inc. undisbursed | | 34.7 | 33.7 | 32.2 | 30.8 | 28.6 | 29.9 | 28.4 | 59.2 | 57.3 | 55.3 | 53.2 | 50.6 | 47.7 | 44.4 | | | | |
| exc. undisbursed | | 23.4 | 26.2 | 27.6 | 28.3 | 28.3 | 27.1 | 26.2 | 25.9 | 25.7 | 27.3 | 30.8 | 39.8 | 45.4 | 44.4 | | | | |
| IBRD - gross disbursements | | | 3.8 | 2.3 | 2.1 | 1.3 | .2 | .7 | 1.4 | 1.7 | 3.6 | 5.6 | 11.5 | 8.5 | 2.3 | | | | |
| - net disbursements | | | 2.9 | .9 | .7 | -.1 | -1.2 | -.8 | -.3 | -.2 | 1.6 | 3.4 | 9.0 | 5.6 | -1.0 | | | | |
| - net transfer | | | 1.3 | -1.0 | -1.5 | -2.0 | -3.0 | -2.2 | -1.8 | -1.9 | .1 | 1.4 | 6.6 | 2.3 | -4.7 | | | | |
| IBRD/IDA - gross disbursements | | | 3.8 | 2.3 | 2.1 | 1.3 | .2 | .7 | 1.8 | 3.2 | 6.7 | 13.4 | 27.6 | 30.1 | 21.9 | | | | |
| - net disbursements | | | 2.9 | .9 | .7 | -.1 | -1.2 | -.8 | .1 | 1.3 | 4.7 | 11.3 | 25.1 | 27.2 | 18.6 | | | | |
| - net transfer | | | 1.3 | -1.0 | -1.5 | -2.0 | -3.0 | -2.2 | -1.4 | -.7 | 3.2 | 9.1 | 22.5 | 23.6 | 14.3 | | | | |

1/ If at all possible, should be moved ahead.

2/ Loan amount is \$8.0 million. DFCC has advised, however, that not more than \$1.0 million is likely to be required. \$7.0 million is expected to be cancelled shortly.

3/ Jointly with other lenders.

* Net of cancellations.

INDICATORS OF DEVELOPMENT

| I. <u>ECONOMIC & STRUCTURAL INDICATORS</u> | Unit | Annual Average | | | d/ |
|--|---------------------|--|-------------------------------|-----------------|-----------------|
| | | 1961-1965 | 1966-1969 | 1970-1975 | |
| 1. GDP (in constant prices) | % Change | 3.6% | 5.7% | 4.8% | |
| 2. Manufacturing Output | % Change | 5.2% | 6.8% | 5.3% | |
| 3. Agricultural Output | % Change | 2.6% | 4.6% | 4.6% | |
| 4. Imports of Goods and NFS | % Change | -1.4% | 8.4% | 0.0% | |
| 5. Exports of Goods and NFS | % Change | 0.8% | 0.7% | 0.0% | |
| 6. Domestic Price Level | % Change | 1.7% | 3.8% | 2% | |
| | | <u>1960</u> | <u>1965</u> | <u>1969</u> | <u>1975</u> |
| 7. Gross National Savings | % GDP | 11.4% | 12.1% | 13.2% | 12.8% |
| 8. Resource Gap | % GDP | 3.0% | -0.4% | 5.9% | 1.7% |
| 9. Net Factor Payments Abroad | % GDP | 0.3% | 0.5% | 0.0% | 0.9% |
| 10. Gross Domestic Investment | % GDP | 14.6% | 12.5% | 19.0% | 15.4% |
| 11. Debt Service | % Exports | - | 2.0% | 8.5% | ? |
| 12. Central Govt. Current Revenue | % GDP | 20.7% | 24.3% | 23.4% <u>a/</u> | |
| 13. Central Govt. Current Surplus (Deficit) | % GDP | 0.3% | 1.0% | 1.2% <u>a/</u> | |
| 14. Public Exp. on Social Services | % GDP | 7.1% | 7.0% | 6.5% <u>a/</u> | |
| 15. Military Expenditure | % GDP | 0.9% | 0.8% | 0.7% <u>a/</u> | |
| 16. Manufacturing Output <u>b/</u> | % GDP | 11.2% | 12.2% | 11.7% | 12.0% |
| 17. Energy Consumption | MW | 1965:89; 1970:175 <u>c/</u> ; 1974:274 <u>c/</u> | | | |
| 18. Fertilizer Consumption | '000 tons | 1965:388.8; 1968:470 | | | |
| II. <u>SOCIAL INDICATORS</u> | | <u>1950</u> | <u>1960</u> | <u>1965</u> | <u>1969</u> |
| 19. Population Growth Rate | % | 3.2% | 2.7% | 2.5% | 2.5% <u>c/</u> |
| 20. Urban Population Growth Rate | % | 2.6% | (Average 1960-1966) <u>c/</u> | | |
| 21. Birth Rate | Per 1,000 popln. | 40.4 | 36.0 | 33.2 | 31.7% <u>a/</u> |
| 22. Family Planning | Acceptors '000s. | 1968:64; 1969:60 | | | |
| 23. Income of: Highest quintile | % total income | 1963:50.3%; 1969:45.2% | | | |
| 24. : Lowest quintile | % total income | 1963:10.7%; 1969:9.4% ! | | | |
| 25. School enrollment: | | | | | |
| Primary & Secondary | % school-age popln. | 68.0% | 80.0% | | |
| 26. Literacy rate | % adult population | 63.0% | | 80 % | |
| 27. Unemployment rate | % labor force | 1968:10.7% | | | |
| 28. Population per hospital bed | Number | | | | |

a/ Provisional.

b/ As percent of GDP at Current Factor Cost Prices.

c/ Estimate.

d/ Estimates represent targets which might be achieved within the assumed constraints of no growth of exports and imports.

South Asia Department
March 12, 1971

CEYLON: LONG-TERM PUBLIC DEBT PROJECTION
(Calendar Years; US \$ Million)

Attachment 3

| | 1964 | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 |
|--|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| National Income Accounts a/ | | | | | | | | | | | | | |
| GNP | 1633 | 1683 | 1751 | 1902 | 1781 | 1978 | 2077 | 2182 | 2290 | 2415 | 2525 | 2641 | 2784 |
| Plus: Net Factor Income Payments | 8 | 3 | 7 | 12 | 9 | 17 | 24 | 25 | 26 | 25 | 26 | 26 | 26 |
| Plus: Statistical Adjustment | - 2 | 11 | - 7 | - 10 | - 56 | - 24 | 3 | - | - | - | - | - | - |
| Equals: Gross Domestic Product | 1639 | 1697 | 1751 | 1904 | 1734 | 1971 | 2104 | 2207 | 2316 | 2440 | 2551 | 2667 | 2810 |
| Consumption | 1438 | 1478 | 1561 | 1668 | 1506 | 1718 | 1843 | 1914 | 2006 | 2112 | 2205 | 2301 | 2423 |
| Gross Investment | 234 | 213 | 251 | 289 | 280 | 375 | 322 | 338 | 355 | 373 | 391 | 411 | 432 |
| Gross National Savings | 195 | 205 | 190 | 234 | 275 | 260 | 234 | 268 | 288 | 306 | 322 | 341 | 361 |
| Imports of Goods and NFS | 441 | 433 | 453 | 442 | 424 | 480 | 436 | 420 | 420 | 420 | 420 | 420 | 420 |
| Less: Exports of Goods and NFS | 408 | 439 | 392 | 389 | 372 | 358 | 375 | 375 | 375 | 375 | 375 | 375 | 375 |
| Equals: Resource Gap - Amount | -33 | 6 | -61 | -53 | -52 | -122 | -61 | -45 | -45 | -45 | -45 | -45 | -45 |
| - as % of GDP | 2.0% | .35% | .35% | 2.8% | 3.0% | 6.2% | 2.9% | 2.0% | 1.9% | 1.8% | 1.8% | 1.7% | 1.6% |
| Finance of Resource Gap | | | | | | | | | | | | | |
| Bilateral: U.S. | 29 | 12 | 15 | 14 | 15 | 6 | - | 70 | 76 | 70 | 55 | 56 | 68 |
| Other | - | 16 | 34 | 39 | 39 | 61 | 61 | - | - | - | - | - | - |
| Multilateral: IBRD | 4 | 2 | 2 | 1 | - | 1 | 1 | 2 | 3 | 5 | 12 | 9 | 2 |
| IDA | - | - | - | - | - | - | 1 | 2 | 3 | 9 | 16 | 22 | 20 |
| ADB | - | - | - | - | - | - | 4 | 4 | 5 | 5 | 6 | 6 | 6 |
| Private: Suppliers' Credits ^{b/} | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | 16 | 17 | 10 | 10 | 10 | 10 | 10 |
| Total: Gross Disbursements | 33 | 30 | 51 | 54 | 54 | 68 | 83 | 95 | 97 | 99 | 99 | 103 | 106 |
| Less: Amortization | 15 | 9 | 6 | 9 | 10 | 13 | 25 | 31 | 26 | 29 | 28 | 32 | 35 |
| Net Inflow | 18 | 21 | 45 | 45 | 44 | 55 | 58 | 64 | 71 | 70 | 71 | 71 | 71 |
| Other Inflow (Net) ^{b/ c/} | 23 | -24 | 23 | 20 | 17 | 84 | 27 | 6 | - | - | - | - | - |
| Less: Net Factor Income Payments | -8 | -3 | -7 | -12 | -9 | -17 | -24 | -25 | -26 | -25 | -26 | -26 | -26 |
| Equals: Resource Gap | 33 | -6 | 61 | 53 | 52 | 122 | 61 | 45 | 45 | 45 | 45 | 45 | 45 |
| Memorandum Items | | | | | | | | | | | | | |
| Interest on Debt | | 3 | 3 | 4 | 7 | 8 | 13 | 17 | 18 | 17 | 18 | 18 | 18 |
| Total Debt Service | | 12 | 9 | 13 | 17 | 21 | 38 | 48 | 44 | 46 | 46 | 50 | 53 |
| Average Interest Rate | | | | | | | | | | | | | |
| Debt Service Ratio | | 2.7% | 2.3% | 3.3% | 4.6% | 5.9% | 10.1% | 12.8% | 11.7% | 12.3% | 12.3% | 13.3% | 14.1% |
| Total Debt Outstanding ^{d/} | | 76 | 97 | 142 | 187 | 231 | 286 | 344 | 408 | 479 | 549 | 620 | 691 |
| IBRD Debt Outstanding: Excluding undisbursed | | 28 | 28 | 28 | 27 | 26 | 26 | 26 | 27 | 31 | 40 | 45 | 44 |
| Including undisbursed | | 32 | 31 | 29 | 30 | 28 | 59 | 57 | 55 | 53 | 51 | 48 | 44 |
| IDA Debt Outstanding | | - | - | - | - | - | 1 | 3 | 6 | 15 | 31 | 53 | 73 |
| IBRD Debt Service | | 3 | 3 | 3 | 3 | 3 | 3 | 4 | 4 | 4 | 5 | 6 | 7 |
| IBRD /IDA % of Gross Inflow | | 7.0% | 4.0% | 2.0% | - | 1.0% | 2.0% | 4.0% | 6.0% | 14.0% | 28.0% | 30.0% | 21.0% |
| % of Debt Service | | 25.0% | 33.0% | 23.0% | - | 14.0% | 8.0% | 8.0% | 9.0% | 9.0% | 11.0% | 12.0% | 13.0% |
| IBRD % of Debt Outstanding | | 37.0% | 29.0% | 20.0% | 14.0% | 11.0% | 9.0% | 8.0% | 7.0% | 6.5% | 7.0% | 7.0% | 6.5% |

a/ At current prices. Up to the end of 1967 all figures have been converted into dollars at the rate of \$1 = Rs. 4.76. For 1960 and 1970, the current exchange rate of \$1 = Rs. 5.95 have been used.

b/ Prior to 1970 suppliers' credits are included in "other inflow".

c/ Includes direct investment, transfers, changes in net external assets, net change in short term credits, errors and omissions, etc.

d/ Excluding undisbursed.

Projection Basis (1970-76)

GNP Growth : 5.0% p.a.
 Investment : 15.5% of GNP each year
 Exports of Goods and NFS: No change since 1970
 Imports of Goods and NFS: No change since 1970

South Asia Department
3/18/1971



CEYLON

BACKGROUND NOTES

Population: 12.5 million (1969 est.)
 Capital: Colombo

Ceylon is a pear-shaped island located in the Indian Ocean southeast of India, from which it is separated at the closest point by only 18 miles. It has an area of 25,332 square miles, about the size of West Virginia. A plain only slightly above sea level makes up the entire northern half of the island and continues around the coast of the southern half. The south-central part is hilly and mountainous, ranging from 3,000 to more than 7,000 feet above sea level in the Central and Uva Provinces, where Ceylon's best quality high-grown tea is produced.

Ceylon has a generally uniform tropical climate. The south-central mountains offer some relief from the tropical heat. Throughout the year the humidity is rather high—more than 75 percent—and the temperature averages 80° F., with little variation daily or seasonally. Average annual rainfall ranges from about 50 inches in the northeast section to about 200 inches in the southwest, the distribution being determined largely by the monsoon and the island's topographical features. The heaviest rainfall occurs during the southwest monsoon period in the early summer.

The Ceylonese flag consists of two narrow green and orange vertical stripes on the left side, with a yellow lion carrying a sword in one upraised paw against a red background occupying the rest of the flag. The flag is bordered by a yellow band with a vertical yellow band separating the green and orange stripes from the red background. Ceylon's flag was adopted from the Lion Flag of the ancient kings of Kandy. The stripes, added in 1950, honor regions of the country.

THE PEOPLE

Ceylon's population in 1969 was about 12.5 million; population density is greatest in the southwest quarter of the island where agricultural conditions are most favorable. Colombo has about 500,000 inhabitants.

The population has been increasing so rapidly (estimated at 2.4 percent annually) that it has almost doubled in the past 25 years. It is possible that economic development programs undertaken in the country will be so outpaced by the rapid population growth that the already relatively

low living standard will be further depressed. Localized efforts in family planning have been underway for some years, and in accordance with a 1958 agreement the Government of Ceylon has received Swedish assistance in a family planning program.

Ethnically about 70 percent of the people are Sinhalese and 22 percent are Tamil. About half of the Tamil population are "Ceylon Tamils" (Ceylon citizens whose ancestors have lived in Ceylon for many generations and who have full voting rights). These Ceylon Tamils live predominantly in the Northern and Eastern Provinces.

The other half of the Tamil population are the so-called "Indian Tamils," whose forebears were brought to Ceylon from south India in the latter half of the 19th century to work on the tea and rubber plantations. About nine-tenths of them were disenfranchised as a result of legislation passed in 1948. As India also refused to recognize these people as its citizens, they have been in effect stateless.

The presence in Ceylon of these Indian Tamils, of whom there are about 1 million, has constituted a major population growth problem which becomes increasingly acute each year. The estates on which the Indian Tamils live cannot provide work for all the young people entering the labor force, and it is virtually impossible for them to obtain outside employment.

In an effort to settle this longstanding issue, an agreement between Ceylon and India was concluded on October 30, 1964. The agreement provided that India would accept 525,000 of the Indian Tamils with their natural increase over a period of 15 years; Ceylon would grant citizenship to 300,000 during the same period; and the future of the remainder (approximately 150,000) would be considered later. It was also agreed that those being repatriated to India could take with them a minimum of U.S. \$840 per family. The Ceylonese Government obtained parliamentary approval in June 1967 of legislation allowing for implementation of the agreement. Possible problems resulting from the agreement include its effect on an already overcrowded India, as well as economic difficulties for Ceylon, such as the loss of experienced estate labor and the drain on foreign exchange.

Other minority groups in Ceylon include the Moors, Burghers (descendants of Portuguese and Dutch colonists), Eurasians, Malays, and a small



CEYLON

- ⊙ National capital
- +—+— Railroad
- Road

0 20 40 Miles
0 20 40 Kilometers

number of Veddahs, the earliest known inhabitants of the island.

Buddhism is the religion of most of the Sinhalese, Hinduism that of the Tamils, and Islam that of the Moors and Malays. Christianity cuts across ethnic lines with some 900,000 followers, most of whom are Roman Catholics.

Sinhalese is the official language of Ceylon. The literacy rate is about 81 percent.

HISTORY

The earliest known inhabitants of Ceylon were the Veddahs, a few of whose descendants still live in the jungle regions of Ceylon. They and the other primitive peoples of Ceylon were subjugated and largely assimilated by Aryan invaders, the Sinhalese, who came from northern India to Ceylon in about the sixth century B.C.

The early settlers from India occupied the dry north-central area and constructed elaborate irrigation works to insure a supply of water for the growing of the principal food, rice. (Efforts were made under British rule and are continuing now to reconstruct these works and resettle the area.) In the third century B.C., with the coming of Buddhism to Ceylon from India, Sinhalese civilization flowered and the Buddhist religion spread rapidly. The architectural and irrigational ruins at Anuradhapura, the first capital, are testimonials to the high culture reached by the Sinhalese during this early period.

The subsequent history of the Sinhalese records a series of invasions from southern India. The most notable of these was the Chola conquest in the 11th century, which made Ceylon for the first time since the Aryan conquest a dependent kingdom tributary to an Indian empire. The Tamil invaders never adopted Buddhism but clung instead to the Hindu religion, which they follow to this day. Meanwhile Moslems (called Moors) from the Persian Gulf were building a profitable trade with Ceylon, where some settled.

European Settlement & Independence

The Portuguese, the first Europeans to come to Ceylon, were attracted by the spice trade. Ceylon then being the sole producer of a fine grade of cinnamon. Beginning in 1505 they gradually gained control of the western maritime provinces and established themselves in the north as well. They were able to maintain control over coastal Ceylon for nearly 150 years. It was during this period that Christianity was introduced to the island.

In 1638 the Dutch, motivated by a desire to control the profitable cinnamon trade, entered Ceylon and with the aid of the King of Kandy succeeded after 20 years in supplanting the Portuguese. They were interested primarily in increasing trade, and most of their activities in Ceylon were devoted to this end. The major permanent

heritage left by the Dutch was a foundation for a system of civil law.

The Dutch, in turn, were supplanted by the British following a military expedition in 1796. Whereas the Portuguese and Dutch never succeeded in bringing the interior of the island under their control, the British, aided by a group of dissatisfied Kandyan nobles, finally succeeded in doing so in 1815. Ceylon remained a British Crown Colony, receiving periodic extensions of democratic participation in the Government, until 1931. In that year the Donoughmore Constitution enfranchised Ceylonese adults and gave them an opportunity for some self-government. In 1946 the Soulbury Constitution replaced the Donoughmore Constitution and granted the island a parliamentary form of government. The following year the Ceylon Independence Act was passed. Ceylon became fully independent and a member of the British Commonwealth of Nations on February 4, 1948.

Postindependence

Ceylon's first parliamentary elections were held in September 1947. The moderate United National Party (UNP) won these elections, as well as those held in 1952, by a comfortable margin. However, in general elections held 4 years later the UNP was defeated by the Sri Lanka Freedom Party (SLFP), whose campaign emphasized Buddhism, nationalism, "democratic socialism" in Ceylon, and nonalignment in international affairs. SLFP leader Solomon Bandaranaike was assassinated in September 1959, and his coalition government fell the following December. The UNP formed a shaky minority government following the March 1960 general elections but fell a few months later after receiving a vote of "no confidence."

In July 1960 the SLFP, under the leadership of Mrs. Sirimavo Bandaranaike, widow of the late Prime Minister, won a near majority of parliamentary seats and was able to form a wholly SLFP government. To bolster its faltering parliamentary strength, the SLFP formed a coalition in June 1964 with the Lanka Sama Samaja Party (LSSP) but fell in December when 14 SLFP members of Parliament left the party because of the increasing influence of leftist elements in the coalition, economic stagnation, and the Government's press nationalization plans.

In the March 1965 general elections the UNP, with the support of other parties that had opposed Mrs. Bandaranaike's government, was able to form a coalition government. UNP leader Dudley Senanayake, who had headed previous UNP governments, again became Prime Minister.

In the elections held on May 27, 1970, the SLFP, again led by Mrs. Bandaranaike, and its coalition, the LSSP and the pro-Moscow Communists (CP/M), won a landslide victory. The SLFP won 91 parliamentary seats (plus six seats

assigned to SLFP members) and with its two coalition partners controls 122 of the 157 parliamentary seats.

GOVERNMENT

Ceylon has been a completely self-governing nation in the Commonwealth since gaining its independence. The constitutional Head of State is Queen Elizabeth II. A Governor-General is the local representative of the Queen, who appoints him on the recommendation of the Ceylonese Prime Minister (Head of Government).

Legislative power rests in a bicameral Parliament consisting of a Senate with 30 members and a House of Representatives with 157 members. The Constitution restricts the Parliament from making any law which discriminates against any community or religious group. Any bill may be introduced in either chamber except a money bill, which can be introduced in the House only. Of the 30 Senators, 15 are appointed by the Governor-General and 15 are elected by the House of Representatives. One-third of the Senators retire every second year. One hundred fifty-one of the Representatives are elected for a maximum term of 5 years by universal adult suffrage; the remaining six are appointed by the Governor-General to insure representation of minority groups.

The general direction and control of the Government is vested in a Cabinet of Ministers which is responsible collectively to Parliament. The leader of the largest party in the House of Representatives traditionally is appointed by the Governor-General to head the Cabinet in the capacity of Prime Minister. Under the constitutional Order in Council, the Prime Minister is also the Minister of Defense and External Affairs. The members of the Cabinet must be or become members of either chamber of Parliament within 4 months after appointment. Not less than two of them, including the Minister of Justice, must be members of the Senate.

Ceylon has an independent judiciary consisting of a Supreme Court, Commissioners of Assize, a Criminal Court of Appeals, and a number of subordinate courts. The Supreme Court, composed of a Chief Justice and 10 Puisne Justices, has appellate and review jurisdiction in civil cases, original jurisdiction in criminal cases, and exclusive jurisdiction in the more serious criminal offenses. It is the highest court with regard to civil cases, but its decisions on criminal cases may be appealed to the Criminal Court of Appeals. Commissioners of Assize are judicial officers appointed by the Governor-General in his discretion to hold any criminal session or part thereof of the Supreme Court. The final judicial authority for Ceylon, as for some other members of the Commonwealth, is the Privy Council. In practice, however, nearly all judicial matters are handled completely within the island's judicial system.

POLITICAL CONDITIONS

During Mrs. Bandaranaike's first term as Prime Minister (1960-64) the Government followed a Socialist bent. It nationalized many primary and secondary schools, insurance, certain elements of banking, and petroleum importation and distribution. In addition, state trading was fostered, state control over cooperatives strengthened, and public sector enterprises favored over private investment. The Government also moved toward loosening Ceylon's ties with the West and developed closer economic and aid ties with the Communist countries.

From the viewpoint of U.S.-Ceylon relations, the most significant of these actions was the expropriation of the distribution facilities of two U.S. oil companies, Esso Standard Eastern and Caltex. When the Government of Ceylon failed to take appropriate steps to pay compensation as required by the Hickenlooper Amendment to the Foreign Assistance Act of 1961, the United States suspended economic assistance to Ceylon in February 1963. In June 1965 the Ceylonese Government and the two U.S. oil companies signed compensation agreements, and the economic suspension was lifted on July 3, 1965.

When UNP leader Dudley Senanayake became Prime Minister in 1965, the Government continued to follow a declared policy of "democratic socialism," as espoused by the SLFP during the campaign in 1956. The Government inherited a number of pressing problems, including the need to increase the rate of economic growth in order to maintain at least the current living standards of the Ceylonese in the face of the rapid population increase. It encouraged the economy's private sector and foreign investment and placed primary emphasis on sound economic development, particularly increased agricultural production. The results of the Government's "grow more food" program have been very encouraging. It also reduced explosive communal and linguistic tensions and kept labor agitation within reasonable bounds.

Based on its campaign platform, the newly elected SLFP-led government is likely to again place emphasis on a Socialist approach to the economy with greater state control. Economic development, particularly increased agricultural production, will probably remain the primary focus of government attention but greater emphasis is likely to be put on industrial development. A rising cost of living and unemployment, particularly unemployed university graduates, will continue to be the most difficult problems facing the Government.

There are several extreme leftist political groups in Ceylon: two Communist parties, one pro-Peking (CP/P) and one pro-Moscow (CP/M); the Mahajana Eksath Peramuna (MEP), which is Marxist in its economic tenets but nationalistic and Buddhist in its approach to local political and social issues; the LSSP, which is Trotskyist; and the LSSP (Revolutionary Group), which broke

away from the original LSSP when the latter joined the SLFP government in June 1964. In the 1965 and 1970 elections the SLFP, the LSSP, and the pro-Moscow Communist Party formed an "opposition coalition." The number of seats in the House of Representatives held by the extreme leftist groups is 25. This includes 19 by the LSSP and six by the pro-Moscow Communists.

The impact of the Marxist parties individually on Ceylon's political and economic life is greater than their overall popular following would indicate. The leftist leaders have a consistent record of "anti-imperialism," and they cater to popular mass aspirations. They control most of the larger urban trade unions and are able, by raising demands on behalf of labor, to cause the Government serious difficulties.

ECONOMY

Ceylon's economy is predominantly agricultural, with manufacturing accounting for only 13 percent of gross national product (GNP). (In 1969 GNP was about U.S. \$1.8 billion and per capita GNP was \$128.) Restrictions in recent years on the importation of foreign goods have stimulated manufacturing, but the scarcity of foreign exchange and of minerals and other natural resources probably will inhibit any large-scale industrialization in the foreseeable future.

Tea, rubber, and coconut are Ceylon's most important products. They account for 90 percent of its foreign exchange, bring in 30 percent of the national income, and provide employment for about 20 percent of the total work force. Tea alone accounts for 60 percent of the value of all exports and about 20 percent of the GNP. Total exports in 1969 amounted to approximately \$322 million and imports to \$427 million.

Ceylon has depended traditionally on exports to finance not only importation of manufactured goods but also a large share of its more basic needs, including about 50 percent of the food consumed on the island. Until quite recently this system worked well, and the average Ceylonese enjoyed a living standard which, although low by Western standards, was appreciably higher than that of most Asians. In the last few years, however, there has been a general decline in world market prices of tea and rubber. The decline in the rate of increase of export income, plus a rapidly expanding population, has meant a steady drain on Ceylon's total foreign reserves. By the end of December 1969 they had fallen to \$55 million, compared with a peak of about \$268 million in 1956. Some restrictions on imports remain in effect to stem the outflow of foreign exchange. These measures have had a depressing effect on the internal commercial life of Ceylon and have contributed to rising unemployment.

The Government derives approximately 40 percent of its revenue from export and import duties. These have been affected by the decline

in commodity prices and the reduction in imports. At the same time, the Government has felt that political considerations prevent curtailment of its heavy expenditures for food subsidies and social services. Budget deficits have become chronic, and the cost of living has risen steadily for some years. In November 1967 the Ceylon rupee was devalued by 20 percent. Some further adjustments in the exchange rate were made in May 1968 (5.95 rupees = U.S. \$1.00).

Although organized labor in Ceylon accounts for about 1.5 million members of the total labor force (estimated at nearly 4 million), it is fragmented into more than a thousand unions. Moreover, three large unions of agricultural workers on the tea, rubber, and coconut estates comprise nearly half the organized workers. White-collar employees, particularly in government ranks, are union members to a much greater degree than in the United States. The bulk of the unorganized labor force consists of small farmers.

The multiplicity of competing unions and the relatively high rate of unemployment and underemployment reduce the bargaining power of workers. Ceylonese labor leaders have tried to compensate for this through the use of political power. Many, if not most, of them have Marxist orientations and tend to view relations between management and labor as an aspect of the "class struggle."

Only those unions which have long been openly associated with the Ceylon Communist Parties (Moscow and Peking) are affiliates of the (Communist) World Federation of Trade Unions. The Ceylon Workers Congress, the largest union of estate workers and by far the largest union in Ceylon, is an affiliate of the International Confederation of Free Trade Unions.

For the past several years consumer prices have risen rapidly while basic statutory wages did not increase until 1969. The growing disparity between price rises and wage stability has furnished fuel for incendiary agitation by some of the more militant labor leaders.

FOREIGN RELATIONS

Mrs. Bandaranaike's government is likely to again move farther away from the West and develop closer political and economic ties with Communist countries as it did during 1960-64. Among the publicly stated policies of the Government is the recognition of Communist regimes in divided countries (North Korea, North Viet-Nam, and the Soviet Zone of Germany). The Government has declared it will follow a nonaligned policy and has indicated it will play a more active role in the meetings of nonaligned countries than did the previous Government.

Ceylon is a member of the United Nations and several of its specialized agencies and the Colombo Plan.

International Aid Effort

The International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) have taken the lead in organizing an aid effort by a number of free world countries including the United States, the United Kingdom, the Federal Republic of Germany, Canada, Australia, Japan, and Italy. An IBRD-sponsored meeting of the respective donor countries was held at Washington, D.C. in July 1965 to assess Ceylon's economic requirements. Five more meetings have since been held: at London in 1966, at Tokyo in 1967, and at Paris in 1968, 1969, and 1970.

The international aid effort has attained considerable success. The IBRD report prepared for the 1970 meeting found that Ceylon had managed to overcome economic stagnation and to create a strong momentum for growth in the past 5 years.

Trade and Aid With Communist Countries

In an effort to break Ceylon's long-established trade dependence on the West, as well as to open new markets for its products, the SLFP governments actively sought broader trade and aid relations with Communist countries. The 1952 rubber-rice barter agreement between mainland China and Ceylon remained in force under the SLFP governments and was renewed for a fourth 5-year period by the government in late 1967. Under this agreement Ceylon exchanges its rubber at favorable rates for much-needed rice. Barter agreements have also been signed with other Communist countries. Trade with Communist countries has risen during the past several years. In 1969, 13 percent of Ceylon's total exports was shipped to mainland China and 12 percent to the Soviet Union and Eastern Europe, while Ceylon received 11 percent of its total imports from mainland China and 9 percent from the U.S.S.R. and Eastern Europe. Settlement terms under these agreements require payment in pounds sterling or other convertible currency beyond the stipulated swing credit.

Since 1957 mainland China has made available \$41 million for economic aid (\$26.3 million in grants), but only \$26.6 million had been used through mid-1969. The Soviet aid agreement with Ceylon, signed in 1958, provided a line of credit, repayable in goods and/or pounds sterling, amounting to about \$30 million. Through mid-1969 only \$19.8 million of this had been utilized, but a cold storage plant, an iron and steel plant, and a tire and tube factory have been completed.

U. S. POLICY

The United States is interested in the maintenance of friendly relations with Ceylon. It is assisting the present government in a variety

of ways including bilateral economic assistance under the aegis of the IBRD.

Trade

The United States is Ceylon's second best consumer for tea and its leading non-Communist buyer of rubber. Total exports to the United States in 1969 amounted to \$20.6 million, while imports from the United States were \$28.6 million (including aid commodities). Import duties and import controls and restriction during recent years have seriously limited the market for American consumer goods. While there is a market for capital goods to service Ceylon's incipient industrialization, U.S. prices, credit terms, and shipping costs often militate against such sales because of competition from other sources, especially Commonwealth countries which enjoy preferential customs rates.

United States Aid

Between 1956 and the February 1963 suspension, the United States provided Ceylon with assistance totaling approximately \$85 million, about two-thirds of which was in food supplies delivered under the PL 480 (Food for Peace) program from agricultural surpluses. Fiscal year 1963 assistance programs were suspended in accordance with the Hickenlooper Amendment. The people-to-people PL 480 program of food for school luncheons, expectant mothers, and the aged, which is operated by CARE, was, however, continued at the rate of about \$5 million a year. With the lifting of the suspension, aid was resumed.

In recent years U.S. aid to Ceylon has been provided at a level of approximately \$20 million per year. It has consisted mainly of dollar-repayable PL 480 loans to finance the import of wheat flour. There have also been smaller development loans to finance commodity purchases from the United States. The CARE program continues at a level of approximately \$2.5 million a year. The Export-Import Bank has authorized a loan of \$3.3 million to assist the construction of a new Intercontinental Hotel at Colombo.

PRINCIPAL GOVERNMENT OFFICIALS

Governor-General—William Gopallawa
Prime Minister; Minister of Defense and External Affairs; Minister of Planning and Employment—Mrs. Sirimavo Bandaranaike
Deputy Prime Minister; Minister of Irrigation, Power, and Highways—Maithrapala Senanayake
Minister of Foreign and Internal Trade—T. B. Ilangaratne
Minister of Shipping and Tourism—P. B. G. Kalugalla
Minister of Industries and Scientific Affairs—T. B. Subasinghe
Minister of Finance—Dr. N. M. Perera

Minister of Cultural Affairs—S. S. Kulatilleke
Chief Justice of the Supreme Court—H. N. G. Fernando

Ambassador to the U.S.—Neville Kanakarathne
Ambassador to the U.N.—H. Shirley Amerasinghe

Ceylon maintains an Embassy in the United States at 2148 Wyoming Avenue, N.W., Washington, D.C. 20008.

PRINCIPAL U. S. OFFICIALS

Ambassador—Robert Strausz-Hupé
Counselor and Deputy Chief of Mission—Peter J. Peterson

Defense Attaché—Cmdr. Amadeo B. Caruso, Jr., USN

AID Representative—Roy E. James
Public Affairs Officer (USIS)—Victor L. Stier
Political Affairs Officer—Herbert G. Wing
Economic Affairs Officer—James W. Reeves

The U.S. Embassy in Ceylon is located at 44 Galle Road, Colombo 3.

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DEPARTMENT OF STATE PUBLICATION 7757

Revised July 1970

Office of Media Services
Bureau of Public Affairs



OFFICE MEMORANDUM

TO: Mr. J. Burke Knapp

DATE: January 29, 1971

FROM: I.P.M. Cargill

SUBJECT: CEYLON

1. At Copenhagen I had preliminary discussions with the Finance Minister about plans for the future, particularly with regard to the Aid group, and about various matters relating to Bank/IDA projects. It was agreed then to send an economic mission to Ceylon after the budget presentation (which was two months delayed) and that I would join the mission in its last week. The timing of the mission was designed to overlap with IMF consultations.
2. When I arrived in Ceylon on December 10, Blobel gave me an extremely bleak account of the situation. I have already sent you a note analysing the economic position, and it is obvious from that that Ceylon faces the worst crisis in its history. I agreed with the Finance Minister to prepare this note to serve as the basis of discussions next month because it was apparent that he did not understand his problems and, in particular, did not grasp the implications of his budget.
3. In my view Ceylon cannot possibly meet its external obligations this year without substantial accommodation by commercial banks in Europe and the U.S. Total payments to these banks falling due in 1971 amount to \$67 million and it is disturbing that at this late date the Government has not reached agreement with its creditors. In December the only liquid foreign exchange available to the Central Bank as working balances totalled about \$5 million, consisting very largely of the balance of short-term borrowings from these banks. At the same time, payment of about \$8.5 million to German banks was long overdue. Even with the drawing of SDR's (\$11 million) in January the situation remains unmanageable. To be fair, it has to be said that all the short term foreign bank credits were incurred by the previous administration in the 18 months before the elections, and a good deal of it after we had warned them about the dangers and without our knowledge. These borrowings were used for the most part to import consumer goods.
4. The previous government was well aware of the facts, and deliberately concealed them in its efforts to win the election. The present government must therefore be forgiven to some extent for having made during the election campaign a number of extravagant promises which, if fulfilled, could only aggravate an already difficult situation. What is astonishing is that in December, when Blobel and I called on the P.M. and all the ministers concerned with economic affairs, seven months after the election, none of the politicians were aware of the grave problems the country faced. In my first talk with the Finance Minister a look of gloom spread over his face as I expounded our view of the situation and he finally agreed that perhaps Ceylon was facing a period of austerity. At the official level the only people with understanding and knowledge were the Secretary and his staff in the Ministry of Planning and Employment. The Central Bank knows the facts but has no understanding, and given the personality of the Governor is ignored.

President has seen

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5. Not surprisingly the budget was a real clinker. The Planning Ministry was not consulted and when the Secretary wrote a critical note about it after it was presented to Parliament, the Finance Minister was irritated and paid no attention. The budget is, with every other economic measure of recent months, consumption oriented. In the private sector investment has been brought to a standstill and since government investment has not been raised, total investment is falling. Furthermore, some of the extraordinary revenue measures cannot be repeated so that the outlook for the future is even bleaker. Indeed, given the pressures on external reserves likely to be created by these policies, Ceylon may be facing a period during which net additions to productive capital assets will be very small, if at all positive.

6. Although, as I have said above, the government may be forgiven some of their election promises because they were deceived by the appearance of prosperity and handicapped by ignorance of the facts, nonetheless the platform on which they ran was pretty wild. The basic theme was that the Senanayake regime had sold out to the West and that at every point Ceylon's sovereignty was being impaired by improper deference to the wishes of the West. The IMF and IBRD were, of course, prime culprits and the Aid Group nothing but an instrument of imperialism. All our problems with projects arise out of the need to strike an independent pose, and that "opera bouffe" episode of the letters in July, cancelling and then uncancelling our loans, reflected the dawning realisation of the difficulties confronting Ceylon. The Finance Minister had committed the inanity of inserting into his Budget speech the last three letters of intent to the IMF as examples of the kind of outside interference the previous government had tolerated. The consultations with the IMF were broken off because he could not as a result accept language which is pretty much boiler plate in letters of intent.

7. Along the same lines, immediately after the elections the Government took various steps calculated to annoy the main aid givers -- diplomatic recognition of Hanoi, East Germany, etc. -- and with regard to the Bank debate continued between those who wished to cancel all pending projects and those who advocated a more moderate course. By July the Prime Minister and the Finance Minister had realized that their flamboyant political gesturing was not going to secure from the Eastern Bloc or from Mainland China either the kind or amount of aid they were getting from the Aid Group, and further that they could not do without this aid. (During the calendar year Ceylon will get \$55 million of commodity aid from past pledges of the Aid Group -- about 15% of total imports). I have informally consulted with the USA, the UK and Germany and my reading of their attitudes is that they would prefer to continue with an aid effort that has held out some promise of achievement, provided (i) Ceylon refrains from further political gestures embarrassing to them, and (ii) threats against foreign commercial interests are dropped, and (iii) a consistent set of economic policies is evolved that aim at a reasonable rate of economic growth. Further, these three countries, the largest aid givers, are looking to the Bank to take the lead in exploring the possibility of preparing a good case for continuing aid.

8. I, of course, did not realize how bad the situation, externally and internally, was until I got to Ceylon, because the facts only emerged as a result of the work of Blobel's mission in the two weeks before my arrival. I came to two conclusions. First, if there is any possibility of bringing about a sensible handling of Ceylon's problems, the IBRD is probably in the best position to provide the help and advice needed, and, consequently, that the Bank should aim at keeping discussions going with the Government. Second, there is little possibility of new Bank/IDA operations in the next year or more and that, to the extent possible, a disengagement would be desirable. I agreed with the Finance Minister to continue discussions next month. I have tentatively fixed on April 27 as the date of the next aid meeting but holding this meeting will depend on the outcome of my discussions in Ceylon and thereafter with the main aid givers.

9. With regard to our projects, the Government backed away from the position it had taken regarding consultants, awards of contracts, etc. in respect of the Mahaweli and Maskeliya projects. With regard to roads, the loan and outstanding portion of the credit will be cancelled as the government wishes to adopt a wholly different approach from the one it contemplated in the Bank/IDA project. The outstanding portions of the DFCC loans will be cancelled.

10. The only issue on which there is disagreement in the Bank relates to the provisions for charging water rates in the Mahaweli project area, as explained in a separate note attached. Blobel and I and the Projects Department staff discussed this at length at all levels in Government and it was clear that this issue was a genuinely sensitive one, as sensitive perhaps as the question of the rice subsidy. One of the clearest promises made in the election campaign was that charges for water in irrigation project areas would not be introduced and the view was unanimous on the Ceylonese side that the Government could not at this time reverse its position. On our last day in Ceylon, the cabinet was to consider the outcome of our discussions. Just before Blobel and I were called by the Permanent Secretary of the Planning Department who said that he had discussed the matter with the Prime Minister who had asked him to try to arrive at some politically acceptable compromise. Blobel and I therefore suggested a form of words which in effect defers the decision on the charging of water rates until studies required by the loan agreement have been carried out.

11. The Government itself has been trying to get out of its predicament by making various proposals, none of which I found very satisfactory (e.g., charging a price for the change from leasehold to freehold). I think it is quite possible that if we are to insist on the retention of the original clause the Government would have to give in. I suggested at one time that work on the Mahaweli scheme might be halted, because of the fiscal pressures it would impose; all concerned said that this would be practically and politically impossible to do, not only for domestic and technical reasons, but on account

of their relationship with Yugoslavia which won the main civil works contract. I think that this probably is an impractical suggestion. On the other hand it seems clear that the Government has nowhere else to go for the money except to the Bank. In my opinion, however, whatever we may achieve by a hard approach of this kind will be more than offset by the damage we will do to our relations and consequently our influence with the Government. If, as I believe, the Bank should attempt to maintain its position as leader of the Aid Group, it would be a pity to allow what is, in present circumstances, a fairly unimportant issue to hamper its efforts to help Ceylon to adopt a sensible approach to the very grave problems which at present confront it.

Attachments

IPMC:cm

OFFICE MEMORANDUM

TO: Files

DATE: October 14, 1971

FROM: Alfred S. Cleveland

SUBJECT: Annual Meeting 1971 - Meeting with the Ceylon Delegation

Present: Mr. N. M. Perera, Minister of Finance
Mr. C. A. Cooray, Permanent Secretary, Ministry of Finance
Ambassador Neville Kanakarantne
Mr. L. R. Jayawardena, Director, Perspective Planning, Ministry of Planning and Employment
Mr. N. M. Kappagoda, Director, Foreign Resources, Ministry of Planning and Employment
Mr. S. de Alwis, First Secretary, Ceylon Embassy
Messrs: Cargill, Votaw, Melmoth, Blobel, Roulet, Baneth, Cleveland and Kavalsky

1. The meeting which took place at the Sheraton Park Hotel on September 29, commenced at 3:00 pm. and ended at 4:15 pm.

Ceylon's Economic Development Policies

2. Mr. Blobel recalled that at the last meeting of the Aid Group most of the countries represented agreed to make new commitments in 1971 but also indicated that assistance beyond this would be considered in light of the concrete measures taken by the Government to create a climate in which aid could be effective. He referred to the forthcoming reform policy package, the five-year plan and the new budget as possible indications that the Government is beginning to move in the direction suggested by the Aid Group and asked Mr. Perera to explain these measures to the extent possible.

3. Mr. Perera responded by first stating that the insurgency, which came as a complete surprise, had badly disrupted the timing of the Government's plans for re-structuring economic policy. For example, he said, the higher bus and rail fares had to be postponed and this together with the curfew prevented realization of the full benefits of the higher rates. Also, the insurgency made it impossible to implement the "crash" employment program and was responsible for much of the short-fall of capital expenditures in FY 1971. Mr. Perera pointed out that the cost of suppressing the insurgency was very high including the destruction of property, lost production of export crops and paddy and the direct costs of increasing and equipping the armed forces. The latter, he said, will have to continue in future years.

4. Mr. Perera advised that the reform policy package will be included in the regular budget for calendar year 1972, which will be submitted to the Parliament on November 8, together with the five-year plan. The plan calls for average real growth of the economy of 6 per cent. To meet this target in 1972 about Rs 500 million of additional Government revenue and/or expenditure savings will be required. New tax measures are expected to increase Government revenues by Rs 350-400 million. Other measures now under consideration are:

October 14, 1971

- a). Rationing sugar at 2 pounds per person per month and possibly increasing the controlled price. It is estimated this would save about Rs 45 million in foreign exchange.
- b). Increasing the retail price of flour.
- c). Increasing the price of the second measure of the rice ration from Rs .75 to Rs 1.0.
- d). Charging a small fee for medical services which are now provided free of charge.
- e). Increasing the school entrance age from 5 to 6 years.
- f). Realization of the full annual benefits of the higher bus and rail fares.
- g). Continuing the ban on imported Bombay onions and banning imports of green gram and chillies beginning January 1, 1972.

5. Mr. Perera stated that the large increase in the Government's non-inflationary borrowing in FY 1971 was due mainly to the successful compulsory savings scheme.¹

6. Mr. Cargill expressed his concern about the next meeting of the Aid Group. He pointed out that at the last meeting the Group was persuaded to continue assistance largely because the Government was new and had inherited an extremely difficult economic situation. This argument cannot be used again, he said. Solid evidence is needed that constructive steps are being taken. This calls for drastic action within a very limited period of time. He also urged that Ceylon try to persuade the Federal Republic of Germany to resume its development assistance and suggested that this be discussed with German Officials at an early date. In reply Mr. Perera again mentioned the insurgency and its adverse effect on resources and policy reform. However, he said, the insurgency also had a beneficial effect in that he believed it had prepared the people for the difficult decisions that lie ahead.

Industrial Imports

7. Mr. Perera said that a major current problem for Ceylon was a shortage of foreign exchange for imported industrial materials, equipment and spare parts. He stated that the Government had virtually eliminated all luxury imports and had begun a drive to increase exports of industrial products. The latter, however, is handicapped because of the lack of exchange for essential imported inputs. This situation is made particularly difficult because of the recent requirement by foreign suppliers that letters of credit must be guaranteed by foreign banks.

¹It has been reported that expansion of this scheme will be the major means of increasing Government revenues in 1972.

The ILO Employment Strategy Report

8. The delegation was asked how the Government had reacted generally to the report and what follow-up steps were planned. Mr. Perera stated that the report has not been considered by the Cabinet and in fact has so far been given very limited distribution. The principal reason, he said, was that the Government does not want anything to distract attention from the forthcoming five-year plan and the policy reforms to be announced with the next budget. He added that the fiscal estimates in the ILO Report were taken from the five-year plan as were the recommendations for land reform and modification of the education system. Some of the ILO recommendations will not be acceptable, he said, but many others are most appropriate and will be incorporated into the policy reforms now under consideration. Mr. Blobel remarked that in the Bank's view the ILO report is imaginative and supports the Bank's view that a package of measures would have a collective impact much greater than separate actions taken at different times. Mr. Votaw pointed out that the ILO Report will be published shortly and many persons will then be asking the Government what it intends to do about the recommendations.

Short-Term Foreign Bank Credit

9. Mr. Perera said that the problem of repayment of Ceylon's short-term indebtedness to foreign banks has receded to a considerable degree. The KfW loan has been repaid, the loans from the British banks have been rescheduled and negotiations are continuing to reschedule the balance of a loan from a U.S. bank.

Commercial Trade Credits

10. Mr. Perera emphasized that an extremely difficult problem facing Ceylon over the near future is the large amounts of short-term trade and supplier credits falling due between now and the end of June. Mr. Cargill said that he was aware of this and that in his view Ceylon has little choice but to seek relief through some form of refunding. He added that if the Ceylonese thought it would help he would be prepared at some point to speak to the foreign banks that have discounted some of these credits. Mr. Perera said that he thought this would be very helpful. Mr. Kappagoda offered to prepare a list of outstanding short-term credits indicating due dates, terms and the identity of creditor banks or firms.

Future Bank Lending

11. Mr. Kappagoda, referring to the agriculture mission now in Ceylon, asked how long it might take to complete the lending process after the mission returns. Mr. Roulet replied that this would depend on the findings and recommendations of the mission and it is thus too early to speculate on timing. Regarding the Government's interest in an IDA loan for railway and bus equipment Mr. Roulet said that the forthcoming economic mission would look into this and that the Bank would act as quickly as possible in the light of the mission's findings. Mr. Cargill added that he thought the Power Transmission Project is worth pursuing.

cc Messrs: Cargill Votaw Blobel Baneth Roulet Cleveland
 Kavalsky Jaycox D. King McIvor Hedishima Abd El Aty

Mr. J. Burke Knapp

January 11, 1972

I.P.M. Cargill

Ceylon Aid Group

1. Ceylon's economic position is described in the attached note prepared by the recent economic mission. Development performance deteriorated sharply in the past year, relative to an already very inadequate previous level. The Budget introduced on November 10, 1971, included proposals for raising about Rs 300 million through new taxes, which would at least have brought public savings - at present negative - to their 1969/70 level. On November 11, before the budget had even been discussed in Parliament, measures totalling roughly Rs 200 million were withdrawn under pressure from the Parliamentary caucus of the Sri Lanka Freedom Party. The Finance Minister has repeatedly declared that he will replace these measures, at the latest in January. Until that is done, the fiscal position will be tenable only if investment remains severely curtailed, roughly at last year's level which was the lowest in the past ten years. Failing action, the Five-Year Plan announced in November must remain a purely academic exercise, and the country can have no development program worthy of the term.

2. In 1970, the Aid Group meeting coincided with the last stage of the electoral campaign. The Group expressed strong disappointment at the rapid accumulation of short-term foreign debt and at the inadequacy of public savings. However, noting the Government's intentions to improve its policy performance, the Group decided that for political reasons it was not desirable to suspend or substantially reduce its aid just before the elections.

3. At the 1971 Aid Group meeting, the new Government had not yet completed its first year in power; it had also just finished suppressing a serious insurrection of discontented youth. The Group expressed its sympathy with the Government, which had inherited many severe problems. Nevertheless, the Group also noted that the development policy performance continued to be extremely inadequate, and in effect failed to provide a context in which development aid, properly defined, could be given to Ceylon. At a restricted meeting of the heads of delegations, donor governments nevertheless agreed that on political grounds the first year of the new Government was not an appropriate time for suspending or strongly reducing aid, and therefore the Aid Group's joint effort should be continued for one more year. However, it was made clear that continuation of aid beyond that time would have to be justified by improved development policy. In the words of the Chairman's Report of Proceedings, "...the Group was looking to the Government of Ceylon to set the framework within which assistance could be given effectively and that in determining the amounts and kind of aid to Ceylon members would be guided by the steps the Government took towards resolving the country's economic difficulties".

January 11, 1972

4. During the 1971 annual meeting, the Finance Minister, Dr. N.M. Perera, asked me to help arrange some relief for Ceylon's short-term commercial debt. I told him that it was not impossible for the Bank to intervene usefully, in a technical advisory capacity, in arranging such debt relief. However, before we could usefully engage in any discussions about re-scheduling, we would obviously have to be able to assess Ceylon's balance of payments prospects and, on that basis, to determine what was a practicable schedule for the repayment of commercial debt. Such an evaluation could be made only within an overall assessment of the development program, and after hearing from the Aid Group what contributions it is planning to make in the light of that assessment. These points were also stressed by the recent economic mission. I also informed Perera that any action on our part would also require reliable detailed information on the outstanding debt. Fully reliable information could not be prepared before the economic mission's departure from Ceylon, and the Government promised to send it to Washington later. Nothing has yet been received.

5. The Bank, as Chairman of the Aid Group, faces the following alternative. It may distribute an economic report around mid-March, and call an Aid Group meeting for mid-April. On the basis of economic performance to date, the Bank would have to state at the meeting that Ceylon's economic performance had further deteriorated, and that there was even less developmental ground for continued economic assistance to the country than there had been in the previous two years. It could then let the Aid Group Governments draw their own conclusions and decide whether they want to continue their aid on humanitarian or political grounds. Alternatively, Mr. McNamara may inform the Government that on the crucial question of resource mobilization the Bank shares the views incorporated into the Five-Year Plan; that it notes that Government resources now in sight for 1972 are about Rs 300 million short of that target, and Rs 200 million short of the original budget figure. In these circumstances, the implementation of the development program is clearly impossible. The Bank notes the Government's expressed intention to replace the measures withdrawn (about Rs 200 million) which would bring the budget a considerable way towards meeting the Plan's target for resource mobilization. Therefore we propose to call a Consortium meeting as soon as these new taxes are imposed and we have been able to assess their impact. If this latter path is followed, we should also repeat to the Finance Minister that Bank intervention to arrange relief for short-term commercial debt is similarly predicated on Ceylon having an effective development program.

Attachment

EBaneth/MBlobel:cf

THE ECONOMY OF CEYLON

South Asia Department
January 14, 1972

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Summary and Conclusions

1. Throughout the past decade, the dollar value of Ceylon's exports has been drifting down, mainly because of falling tea and rubber prices. This offset about half the increase in the value of commodity production, causing real per capita commodity availability to decline. Consumption and income levels of the employed population, bolstered by numerous subsidies, remained more or less stable. This was partly achieved by allowing many new entrants into the labor force no share in income: in 1969/70, the unemployment rate was 12 percent of the total labor force, 40 percent for those aged 15 to 24, and over 70 percent for "O" level graduates in that group. Squeezed between falling export prices and incomes, and almost stable per capita consumption, investment remained inadequate. Sharply increased savings, notably public savings, are the indispensable precondition to any development policy worthy of the name. The Bank has stressed this point in all its reports. The employment study mission organized by the ILO in 1971 and the authors of the Five-Year Plan published in November 1971 fundamentally agree with this diagnosis.

2. The long-term savings problem is now compounded by attempts made in the past four years to palliate it by accumulating well over \$100 million short-term debt. This has kept Ceylon, with its annual export earnings of \$330 million and liquid reserves reduced to about \$5 million, teetering on the verge of bankruptcy. In 1971, the situation was saved by the decision of British banks to reschedule over five years about £ 8.5 million, and by a \$25 million free foreign exchange loan by China. In 1972, Ceylon will get more than \$20 million in compensatory and other drawings from the IMF. A full-scale crisis may thus be once again postponed, but efforts to do so - and success in so doing without major sacrifice - distract attention from the long-run problem.

3. The Five-Year Plan proposes additional taxation, including higher prices for subsidized consumer goods, of about Rs 410 million in the first Plan year, 1972. The budget presented to Parliament on November 10 proposed additional taxes at an annual rate of about Rs 330 million. The very next day, the budget was modified so as to reduce the net impact of new fiscal measures to an annual rate of about Rs 130 million. The proposed expenditures were not changed, and the budget is now in complete disarray. Unless the Government follows up on its stated intention to replace the lost tax revenues, Government real investment will have to remain at the ten-year low reached last year.

4. A drastic compression of consumption is the precondition for any real development program, however modest. Given the country's fairly equalitarian society, only the unemployed, the old and the handicapped can be protected from this compression. Such compression of consumption is in any case rendered unavoidable by the likely continued downward drift of export earnings, which can be offset only when enough resources are found to impart dynamism to other sectors. Unemployment of the young, which has protected the incomes of the semi-privileged by restricting entry into their group, is approaching its socio-political limits. The question is not whether consumption will be reduced, but whether it is reduced merely as the unavoidable consequence of continued downward drift, or is purposefully reduced enough, and soon enough, to produce resources for development.

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The Past Decade: Steady Downward Drift of Real Income

1. In per capita term, Ceylon's real GNP has been all but stagnant for the past decade. While this stagnation is intuitively evident to those familiar with Ceylon, it is obfuscated to an unusually large degree by the published national income series. In those series GDP at constant prices increased at an average rate of 4.5 percent from 1959 to 1970. There was no marked change in that trend in the course of the period. The production of commodities (i.e. not including services, construction and the utilities) increased at a slightly lower rate than GNP, to which it contributed about 50 percent. Correcting for the original undervaluation of the export sector, whose volume of production grew more slowly, GNP at constant prices grew at an average rate of about 4 percent and commodities at about 3.5 percent.^{1/}

2. However, prices did not remain constant. Ninety percent of Ceylon's exports earnings still come from tea, rubber and coconut; export earnings are equal to almost 30 percent of GDP. The dollar prices of both tea and rubber have been drifting down since 1951. Coconut prices were firmer, but as production failed to keep pace with domestic consumption, there was a shift from exports to the domestic market, and export taxes bring the domestic price of coconut products much below the level of export prices. These changes absorbed about half the increase in commodity production. The real availability of commodities to the domestic economy, for consumption and investment, increased by less than 1.7 percent annually. With population growing at about 2.3 percent, throughout the period (and indeed ever since the early fifties) there was a slow downward drift of per

^{1/} Shortly after the 1967 devaluation of the rupee from 4.76 to 5.95 per US dollar, a Foreign Exchange Entitlement Certificate (FEEC) scheme was introduced under which certain sales of foreign exchange earn such certificates, and certain buyers of foreign exchange also must buy FEECs. The FEEC now amounts to 55 percent, thus bringing the exchange rate to 9.2 rupees per dollar. The FEEC rate has progressively been extended to most imports, now excluding only a few categories, the most important of which is foodgrain. In this note, the equivalence of Ceylonese to import prices is calculated at the FEEC rate. In correcting the national account series for the undervaluation of exports, we have used a rate of Rs 10 per dollar, thus taking into account the fact that the imports paid by export earnings also bear a custom duty and sell for at least that price, unless they are effected by the Government and bear an overt or hidden subsidy. This treatment may result in a partial overvaluation of the GNP contribution of export sectors for the years prior to 1965; though there cannot be much doubt that imports were so scarce throughout the 1960's that their real value - and therefore the real value of exports - were much higher than indicated by official exchange rates.

capita commodity availability. This was so even if one does not take into account the rise in the dollar price of imports, which became marked in the late 1960's.

The Resource Problem: Excessive Consumption

3. Successive Governments failed to react adequately to these trends, and tried to maintain a general standard of living which Ceylon was in fact unable to support in the face of growing population and declining export earnings - especially as by so maintaining consumption, the Government could never raise the resources for enough investment to allow the growth of production to accelerate. The most striking and widely noted aspect of that standard of living is a network of subsidies for mass consumed commodities and services: rice (of which one measure of 2 pounds per week is given free), flour, sugar, rationed cloth, etc.; as well as free education, free health services (a charge of Rs 0.25 per consultation has now been imposed), subsidized transportation, etc. Some of these subsidies, particularly on imported goods, are in part or totally disguised by the peculiarities of Ceylon's foreign exchange system, and by misleading accounting procedures; they nevertheless exist.
4. A less striking but equally serious aspect of this excessive standard of living is the level of real incomes paid to wage earners, and therefore also expected by the unemployed. These are excessive in relation to general productivity, and also distorted in relation to one another. The excess is largest for clerical jobs. However, even in agriculture there are plenty of tasks left undone because there is no labor to perform them at the going wage rate, or because, though productive, they are not worth performing at the going wage rate.
5. Given the decrease of the overall per capita cake, the excessive shares of income earners were maintained in part by giving no cake at all to many new entrants to the labor force (apart from the free goods). In 1969/70, unemployment amounted to 12 percent of the labor force outside the estates, but over 40 percent of those aged between 15 and 24 were seeking work. The severity of the problem paralleled the distortion of the wage structure: in the same age group over 70 percent of "O" level high-school graduates not pursuing their education were looking for jobs; typically, for clerical jobs.
6. Given the excessive resources absorbed by consumption, not enough - indeed, very little - was left over for investment. There again, the national accounting data are misleading. In them, the rate appears to be an impressive 17 percent, but this figure relates to gross investment, and includes a high proportion of simple maintenance works, which add nothing to productive capacity. Much investment also went to semi-productive fields, such as residential construction and services. Much was, it must also be admitted, misapplied or misused. Be that as it may, per capita investment was inadequate for generating enough real new income per capita even to offset terms of trade losses, let alone to produce actual growth. It was also inadequate to absorb the additions to the labor force.

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7. Another aspect of the same phenomenon is a persisting foreign exchange shortage. In Ceylon, excessive consumption leads directly to imports; food accounts for almost half of total imports and much of the rest is consumption-oriented. Hence, even if there were enough general resources for adequate investment, foreign exchange would still be lacking for capital goods imports; at present, there is no major shortage of imports for the current needs of industry, but it has been avoided only at the cost of an intolerable short-term debt burden. In fact, ever since 1969, when productive imports were rather more adequate in volume, though not necessarily in effectiveness, than in normal years, Ceylon has been teetering on the verge of bankruptcy.

8. All this is not to say that Ceylon consumes too much in an absolute sense; but it consumes more than it can afford. There is now widespread agreement with this analysis of the basic ills of the Ceylonese economy. The ILO's Employment Mission - led by Professor Dudley Seers - and the just-published Five-Year Plan, have produced basically the same diagnosis. There are, of course, other problems, too, more or less tied to these fundamental ills. On these, we still disagree with parts of the Government's diagnosis and prescriptions and, occasionally, with some of those of the ILO mission. However, these disagreements would become operationally important only if the fundamental resource constraints were eased.

Genesis of the Short-Term Payments Crisis: 1969/70

9. Towards the middle of its term of office, the previous Government attempted to boost production and investment. With aid receipts roughly constant since 1966 and continued refusal to cut consumption more than was required to offset the continued fall of export prices, this boost was financed through a major accumulation of short-term foreign debt. In 1968, \$29 million were drawn on the IMF, in addition to minor short-term bank borrowings and reserve losses. In 1969, gross reserves fell by \$12 million, and the Central Bank borrowed almost \$42 million from foreign banks and \$2 million from the IMF. In addition, medium and short-term indebtedness to suppliers increased by \$36 million. The total short and medium-term net foreign asset position deteriorated by \$92 million in 1969. This is roughly equal to 40 percent of gross investment carried out during the year; and may well amount to 80 percent or more of the actual net increase in domestic productive capacity. In addition, aid receipts also resulted in a \$40 million increase in net foreign indebtedness.

10. Clearly, a major readjustment was urgently required. Additional resources were needed both to increase investment from its still very inadequate level, and to stop relying on short-term foreign debt. On the balance of payments side, the task was of truly heroic dimensions: the 1969 short-term cash deficit was of roughly \$92 million, and had been financed by such short-term means that over the next two years not only further borrowing had, in theory, to be stopped, but the flow had to be reversed:

a total annual improvement of about \$130 million was to be achieved with exports of \$330 million and commodity aid of about \$45 million!

11. In fact, no substantial improvement was achieved in 1970. Reliance on suppliers and on short-term trade credits net of repayments again amounted to \$36 million, though there was a four-fold increase of the short-term credits within that category. Despite continued increase of the Central Bank's net liabilities, by about \$14 million, overall monetary movements turned from a positive item of \$57 million in 1969 to a negative item of \$8 million in 1970: a total change of \$65 million. An uneasy equilibrium was achieved only through a temporary improvement in the dollar value of exports by \$14 million, thanks largely to better tea prices, and through a \$54 million cutback of imports to \$392 million, from \$446 million. Import value had only once fallen so low in the 1960's, in 1961. Within that reduced total, the absolute level of food imports increased, and therefore the level of non-food imports was compressed in a truly drastic manner.

1970/71: Development Grinds at a Halt

12. Following the May 1970 elections, the UNP was replaced by a coalition Government which had come to power on a platform combining populist, sinhala nationalist and left-wing slogans with promises of improved consumption. In particular, it had explicitly promised the restoration of the second ration of rice, the suppression of which had been one of the UNP Government's few substantial attempts at reducing consumption. The Government had also promised to deal decisively with the unemployment problem. These diverse promises were probably irreconcilable in any case, but their contradictory nature was particularly palpable in the context of the balance of payments crisis with which the new Government immediately found itself confronted. In the event, and despite some strongly worded public statements (notably in the 1970 budget speech) about the need for belt-tightening, the Government chose to sacrifice the employment program, and the future in general, to immediate consumption gains. In particular, as proposed in its election platform, it restored the second measure of rice ration, albeit charging for it Rs 0.75 per measure - i.e. about 70 percent of the domestic procurement price.

13. On the revenue side, very little additional effort was made. Large banknotes were exchanged against new ones, but out of the Rs 100 million additional income tax the Government hoped to obtain through this forced disclosure of "black money", only Rs 22 million materialized. The Government announced its intention to introduce a "capital levy" but no action has yet followed, though of course the announcement itself affected private sector confidence and investment activity. Much later in the year, in May 1971, bus, rail and air fares were raised. These measures were commendable in themselves, and because they represented a breach in a long-established taboo which had kept bus fares constant since 1953. However, the raise was not

enough to eliminate the operating deficits of the CTB (buses) or of the railways, nor even to reduce them substantially.

14. The only major new tax measure actually implemented (not including the buoyancy of the existing taxes) does not appear in the Government's fiscal statements proper. That was a substantial upward revision of provident fund contributions, both of employees and of employers, thanks to which the net current surplus of the provident funds increased from Rs 97 million in 1969/70 to Rs 172 million in 1970/71. Though in the fiscal and national accounts these contributions appear as private savings, by their compulsory nature they are truly a tax, and are most probably treated as such by employees and employers alike. They were by far the most dynamic quasi-tax element in 1970/71, and in view of the sorry state of the budget, their contribution was extremely welcome. Nevertheless, one cannot help noting that they constitute an unselective employment tax, with a perverse resource allocation impact on employment.

15. To add to the country's immediate problems - and to point to the urgency of dealing with the unemployment of youth - an insurrection occurred in April 1971. We have little reliable knowledge on its motivations or extent; but it is quite clear that almost all the insurgents were below the age of 30. The actual destruction wrought by the insurrection seem to have been quite minor, but economic life was perturbed for about a month, and defense and security expenditures doubled, from an admittedly low starting level.

16. The Government nevertheless managed to stave off an economic crisis, but through a combination of measures which further mortgaged the future. Overall current Government revenues more or less stagnated, essentially because the normal buoyancy of internal taxation was offset by the fall of taxes on foreign trade. The fall in receipts from import taxes was an unavoidable consequence of the compression of non-food imports, in turn rendered unavoidable by the balance of payments crisis and by the Government's decision to protect food consumption. The fall in export tax receipts was a consequence of the continued downward trend of exports. Current expenditures grew mostly according to trend, with two exceptions: as noted, defense outlays doubled, from Rs 92 million to Rs 188 million, and food subsidies increased by about Rs 30 million. In the budget, the increase is from Rs 324 million to Rs 505 million, but about Rs 150 million of these are due to the inclusion of FEECs in the cost of sugar purchases for the first time in 1970/71.^{1/}

^{1/}Of course, if this correction is made, the budget figure for receipts from imports must also be reduced by an equivalent amount. N.B.: 1970/71 figures are revised preliminary estimates, subject to some further revision.

17. As a result, current Government savings fell by Rs 308 million and, for the first time, became negative. The fiscal year ended with a net deficit on current account of Rs 124 million as against a surplus of Rs 184 million in 1969/70. If provident fund receipts are treated as current revenue, the current surplus fell from Rs 281 million in 1969/70 to Rs 48 million in 1970/71.

18. The budget estimates had included a stepped-up investment effort, and Rs 180 million for a crash employment program. Overall resources were clearly insufficient for implementing that program, given the choice not to curtail either current Government expenditures or private consumption. Despite a large increase in its foreign borrowing, the Government only managed to stave off a balance of payments crisis, and to respect the conditions imposed by the IMF under its standby agreement, notably on Government bank borrowings, by drastically reducing capital expenditures. Acquisition of real assets by the Government proper fell from Rs 459 million in 1969/70 to Rs 274 million in 1970/71, the lowest since 1964/65; in real terms, undoubtedly the lowest in the decade. Considering the incompressible salary and administrative elements in the investment program, real additions to productive capacity must have been negligible. The rupee value of the investments of public corporations and of departmental enterprises were better maintained, though in part only because of accounting changes (notably in the treatment of Foreign Exchange Entitlement Certificates /FEEC/). All in all, though no reliable figures are available yet, total public sector investment was the lowest since 1966/67 in money terms, and in real terms probably the lowest in the past decade. The private sector, discouraged by the uncertainty surrounding its role in the Government's development scheme, also reduced its productive investment to the completion of ongoing projects, though unproductive investment, essentially in housing, proceeded at a brisk pace. The inadequacy of productive domestic investment relative to the needs created by growing population and falling export prices was the major cause of the lack of real economic progress and of growing unemployment since the early 1950's, yet the real value of productive domestic investment now fell to the lowest level in at least five, and probably ten, years.

Financial Operations in 1970/71

19. Curtailment of investment eased the pressure on the budget by reducing the need for funds. It also permitted the Government to use the private savings rendered available by the fall in private investment. The Government's domestic non-bank borrowing (adjusted to exclude borrowing from provident funds, whose resources are in the nature of a quasi-tax, and which had also increased from Rs 97 million to Rs 172 million) doubled, from Rs 169 million to Rs 344 million. Nevertheless, the remaining gap was almost exactly as large as in 1969/70 when Rs 420 million had been obtained from the banking system. In 1970/71, such continued monetary expansion would have generated unbearable balance of payments pressures. It was also forbidden by the standby agreement with the IMF, which limited to Rs 88 million the Government's bank borrowing. That is in fact exactly the amount the Government

borrowed from the domestic banking system, though the total expansionary impact of fiscal operations was Rs 18 million larger, because Government cash balances decreased by that amount. The remainder of the gap was covered by foreign borrowing, which increased to Rs 560 million, from Rs 220 million in 1969/70.^{1/}

The Balance of Payments in 1970/71

20. The budgetary situation and the fall of private investment made their impact felt on the balance of payments. Unfortunately, 1971 data are not yet fully available;^{2/} some confusion, which needs to be cleared up, still surrounds even the 1970 figures. Nevertheless, it seems fairly clear that imports, which had fallen from \$446 million in 1969 to \$392 million in 1970 remained almost constant in 1971. Their composition is known only until June. However, in the twelve months ending September 30, 1971, there was a marked increase in the Food Commissioner's imports, and despite some tightening of restrictions on the import of subsidiary foods, there may have been some further increase in food imports over the calendar year 1971 and consequently some fall in non-food imports, notably of capital and current production goods. At best, these remained constant at their depressed 1970 level. Part of the compression of non-food imports was an automatic consequence of the low level of investment. It was further aided by a slight tightening of import controls, particularly early in the second half of 1970, when open general licensing was ended. Licensing for 1971 was on a fairly liberal basis, however, though with the proviso that beyond Rs 200,000, individual private importers should arrange for trade credits of 6 months up to Rs 900,000 and longer for imports beyond that value. These credits often proved unobtainable, as foreign lenders became wary of increasing their exposure in Ceylon. Nevertheless, private industrial production does not yet appear to have been substantially constrained by the shortage of imported raw materials. The position of the public sector corporations with regards to current production imports was actually eased. The import of capital goods was often much more difficult.

21. The increasing difficulty of contracting new credits is reflected in the balance of payments. The net use of short-term trade credits fell from \$24 million in 1970 to \$4 million in 1971. The use of supplier credits of one year and longer remained roughly constant, at \$15 million. One must stress that considerable uncertainty surrounds these credit figures; but in any case, the net use of short-term trade credits involves a constant expansion

^{1/} The 1970/71 figures includes Rs 100 million out of the total \$25 million Chinese loan, as well as large supplier credits for food purchases contracted towards the end of calendar 1970.

^{2/} All figures for 1971 are preliminary estimates; some of them are quite conjectural.

of gross borrowing which, with stagnant or falling trade, must rapidly reach its limits even if no creditworthiness problem arises. Gross Central Bank short-term borrowing, still an important resource in 1970, to the extent of \$14 million, turned into estimated net repayments of \$11 million, a difference of \$25 million. Export earnings fell slightly in dollar terms.

22. Changes in exports and imports very roughly balanced out. Because of an improved services account, which reflected gains from the nationalization of bunker sales, the overall current deficit decreased slightly from \$77 million to \$71 million. Normal aid utilization, from the Aid Group and from East Europe, remained constant, at about \$50 million (with a slight shift in composition away from commodity aid to project aid). Various small improvements (such as a reduction of repurchase obligations from the IMF), together with the improved current account balance, just about offset the \$20 million fall in the net resources brought in by short-term commercial borrowing. Thus, taking all the usual balance of payments accounts together, their overall net impact was a deterioration of \$25 million, as compared to 1970: this corresponds to the forced \$25 million shift in the Central Bank's net liability account from \$14 million to \$11 million, i.e. from an increase to a forced reduction in net indebtedness. In fact, that deterioration would have been much steeper had the Central Bank not been able to reschedule Z 8.5 million due to British banks and \$5 million due to the Manufacturers Hanover Trust - a rescheduling no doubt helped by Ceylon's palpable inability to repay these amounts on schedule, demonstrated by its temporary default to the KfW in December 1970.

23. The balance of payments could clearly not absorb this deterioration of \$25 million. Foreign exchange reserves could provide absolutely no cushion: the Central Bank's liquid reserves generally fluctuated around \$5 million and stood below \$3 million for two successive months. No doubt, it would have been possible to avoid a crisis, had the Government decided to cut imports drastically. However, one must note that the short-term effectiveness of import restrictions is impaired by a serious lag. Restrictions bear on new orders, while payments are made on behalf of shipments effected one to twelve, or even eighteen, months ago. In the event, the crisis was avoided without any tough economic decision having to be made: Ceylon obtained a credit of \$25 million from China, in convertible foreign exchange, untied, and interest free.^{1/} In a very real sense, Ceylon's debt service to the Aid Group countries was paid by China, who thus provided fully half of Ceylon's total net aid receipts.

^{1/} Maturity is likely to be ten years, but repayment modalities have not yet been set.

1971 in Summary

24. 1971 was the worst year of a long series from every point of view. Public savings and overall investment, vastly inadequate throughout the past decade, fell dramatically. Unemployment, a major verbal target of everybody's concern, increased in the short run, and much was done to ensure its further rapid increase in future. Exports and imports continued their downward drift, particularly marked for capital goods imports. Despite the Government's borrowing from every available foreign source and encouraging the private sector to do the same, and despite the rescheduling of a sizable part of short-term public foreign debt, foreign payments were continuously in a state of near-crisis, and full crisis was avoided only thanks to an unexpected, unprecedented and possibly unique Chinese loan.

The Future and the Five-Year Plan

25. The Five-Year Plan, presented in November, reflects the Government's concern at this situation. It correctly identifies the joint problems of resources, prices and standard of living as the main obstacles to be overcome - though in the past too, correct diagnoses have been made, and not followed by sufficient concrete measures. In the words of the Prime Minister's foreword, "In the first place, there must be a greater emphasis in the pattern of national expenditures on investments ... Secondly, it is necessary to understand the role of prices in the economic system ... if we want chillies to be grown the people must be prepared to pay a price which will bring a fair income to the grower of chillies. ... We cannot afford to consume today all that we produce without making provision for the future. That was the policy of the past and that policy has clearly failed."

26. The Plan proceeds to define and quantify the main steps required to implement these resolutions. It concentrates on the need to raise public savings. This is all the more correct as the role attributed to the productive private sector is modest, and - given the restrictions and uncertainty surrounding it - the chances of its fulfilling even that role are low. For the public sector, the five-year investment target has been fixed at Rs 7 billion - rising from Rs 1.1 billion in 1972 to Rs 1.79 billion in 1975. Strictly comparable figures are not available for the recent past, and not given by the Plan documents. However, it seems fairly well established that the total public sector investment was not much more than Rs 700 million equivalent in the fiscal year 1970/71. Of this, Rs 274 million were Government investment proper, Rs 89 million the investment of departmental enterprises, and the rest mainly the investment of public sector corporations.

27. According to the Plan document, that investment total and the growth it generates would suffice to absorb all new entrants into the labor force, about 550,000 during the period, and also to bite seriously into the unemployment backlog, also estimated at 550,000. In fact, that estimate was made at the end of 1969. By the time the Plan gets under way,

the recession of the past eighteen months will have raised the unemployment level much higher. Furthermore, the Plan is rather more optimistic about the employment implications of its investment and growth targets than the Seers Mission (or indeed, more optimistic than its own working documents). The Plan is also more optimistic about the growth implications of its investment target than we can be - unless resource allocation and utilization are drastically improved through measures which have not yet been even identified, let alone implemented. Nevertheless, even if they did not quite fulfill the Government's aims and the country's expectations, the planned investment level would probably stabilize or even slightly reduce unemployment, and prepare its future resorption. In terms of its impact on employment, the investment target is an acceptable minimum goal; but it is no more than the minimum acceptable goal.

28. To meet that investment target, the Plan proposes additional taxation (including higher prices on Government sales of consumer goods) of about Rs 410 million in the first Plan year, 1972. If - as the Plan specifies - current expenditures are to rise at an annual average rate of only 4 percent, such new tax measures would indeed meet the Plan's first year resource requirements. However, unless the new taxes were of a highly elastic nature, major additional tax efforts would also be required in each subsequent year.

29. The Plan contains many other proposals, some sensible and well thought out (including many of those in the agriculture field), some interesting but sketchy, others highly questionable, notably those concerning the establishment of large-scale basic industries. The need to promote exports is rightly stressed, notably non-traditional exports whose target growth rate is roughly 50 percent per annum, but not much constructive thought has yet been given to the means of achieving this. In the recent Economic Mission's view, export growth would require a series of specific measures on research, marketing and promotion. The Government agrees with this in principle, but it seems to be unduly conservative in its thinking about the magnitude of the effort required to achieve the desired result, and also to be more concerned with the setting up of commodity groups and boards than with more concrete steps. More fundamentally, the Government has not yet come to share the Mission's view that practically all exports must be made much more profitable, with the possible partial exception of tea. This can be achieved to the desired extent only by giving exports much higher effective exchange rates for their earnings. The tax privileges now contemplated are minor, and will affect exports only marginally, if at

all.^{1/} As for the ambitious target for the development of small industries, whose output is expected to double by 1976, its implications have probably not been adequately thought through nor can it be implemented with the modest and somewhat hesitant efforts at research, extension and assistance that are being planned at present.

30. The Mission has also arrived at the view that rational development policies will be well-nigh impossible as long as the price system has not been drastically reformed. At present, prices are inextricably distorted by a complex array of multiple exchange rates, taxes, and subsidies. Economic benefits can be approximated only very roughly, at the cost of complex calculations, and they rarely coincide with financial reward. Furthermore, the public sector, which is to play an increasingly important role, uses wholly inadequate and haphazard accounting practices, which have little bearing on its actual performance even under the existing price system. The Mission has repeatedly stressed these points in its conversations with the Government, and has elicited sympathetic agreement. There is, however, no evidence of concrete thinking - let alone measures - concerning these problems.

31. The Mission also partly disagrees with the Government regarding the lines in which import substitution is desirable. Of course, rational and effective import substitution policies also depend on a reform of the price system. Even among agricultural import substitutes, the prices paid to domestic producers are now arrayed between 70 percent and 400 percent of the import price. In the industrial field, past import substitution was highly import intensive. Partly in reaction against that, the Plan stresses

^{1/} The multivalence of the Government's attitudes is well illustrated by its stand relative to the applicability of the income ceiling to export earnings. Planning Ministry officials told the Mission that export earnings would be exempted from the Rs 2,000 per month income ceiling, and that they were counting on this to be a powerful incentive for developing exports. Ministry of Industry officials told the Mission that export earnings would not be exempted from the income ceiling. When we reported this back to the Ministry of Planning, we were told that the Ministry of Industry were mistaken, and would be so advised; the Cabinet had explicitly decided to fully exempt export earnings from the income ceiling. Despite these assurances, we also asked N. M. Perera, the Minister of Finance, how the matter stood. He informed us that export earnings would indeed be exempted from the income ceiling, but "of course" only to the extent that they are reinvested in exports activities.

the development of "basic industries: steel, cement, chemicals, paper, tyres". We have not examined specific industrial projects, but we nevertheless have doubts as to the appropriateness of placing much emphasis on such capital-intensive lines, even if they are for import substitution. In addition to a much higher price for imports, effective import substitution will require a much greater amount of research and extension to re-orient the industrial structure towards indigenous materials. Efficiency will also often require a larger scale of production than can be absorbed by the Ceylonese market. Thus, as in the case of the proposed production of tea chests (hitherto imported) import substitution should be increasingly also tied to exports.

32. For increasing agricultural production, the Government tends to place much greater emphasis on extending the area under irrigation than we do. Together with other outside observers representing a wide array of ideologies, the Bank would rather stress the extent of progress feasible through better use of existing water resources.

33. As far as actual policy is concerned, several constructive steps have been taken in the past 18 months. Notably, some genuine progress has been made in improving management and labor relations of public sector corporations. According to the agricultural sector mission, improvements can also be expected in the organization of agricultural cooperatives, credit and extension. The reform of the education system, which is henceforth to lay slightly greater stress on practical skills, is by and large also a favorable development. The Government has at last made official public pronouncements in favor of population control and the Swedish Government, which has just appraised the program, intends to continue supporting it.

34. There also were a number of unfavorable developments. Granting the Government's ideological option for "socialism", its implementation has been ineffective. Incomes are to be limited (through the announced "income ceiling"), but in effect property is not, thus encouraging further misuse of capital. Private enterprise is hamstrung by administrative regulations and delays, and discouraged by pronouncements about future nationalization, and by the uncertainty surrounding the Government's intentions about it. However, few effective steps have yet been taken. The increasing canalization of imports through the State Trading Corporation, and of retail trade through cooperative outlets, results in a duplication of facilities, inefficient distribution, disruption of supplies and local shortages even of rationed goods, and has thus artificially created a source of major consumer dissatisfaction. The Government is not seen to be taking - because it is indeed not taking - the bold anti-capitalist measures which might have politically allowed it also to tax the poor classes; but it is effectively preventing the private sector from contributing to development. Euthanasia of the rentier might be advisable; but for the good of the economy, private entrepreneurship must be either nurtured or killed swiftly and replaced.

35. Specific backward steps have also been taken in agriculture. The virtual dismantling of the paddy promotion scheme need not do long-term harm if it is replaced - as the Bank's recent agricultural sector mission thinks it will be - by an equally good or better program. But while the previous Government had at last accepted the need to impose water charges, at least on Bank-financed new irrigation projects, this has now again been questioned. Yet, according to agronomists of very diverse ideological persuasions, metered water charges are the key to improved agricultural practices and higher yields.

36. All these questions would become important and some of them vital, if enough real resources were raised for investment. Until that is done, however, they are largely peripheral. Without much more substantial resource mobilization, there is simply no hope and no possibility for development in Ceylon. This is why the Government's concern, the Bank's studies and the Aid Group's discussions have all focused on the issue of resources, particularly those raised through the Government's fiscal operations.

The 1971/72 Budget

37. The 1971/72 Budget presented to Parliament at the same time as the Plan included additional tax measures estimated to bring only about Rs 330 million on a twelve-month basis, as against the Plan target of about Rs 410 million. (The 1971/72 Budget itself covers the October 1971-December 1972 period, beyond which the Budget will be placed on a calendar year basis.) The Budget would have left Government savings below their 1969/70 rupee value. It would have raised Government investment slightly above its 1969/70 level in rupee value, but left it in real terms well below that level, which was quite inadequate even at that time, when the private sector still played a dynamic role. Nevertheless, the Budget was at least in bold contrast to the previous year's dismal performance. It constituted a significant reversal of a long downward drift. More important still, it touched a number of taboos. No doubt, many measures went scarcely beyond declarations of intent. Thus for the announced capital levy, or the ceiling on rural holdings (of which it was announced that it will soon be announced) or the ceiling on urban houses, which allows a family with three children to keep five houses of unlimited size. The proposed income ceiling of Rs 2,000 per month will truly hurt the urban salary earners, but it will probably weigh much less heavily on property owners' incomes - particularly from landholdings. In any case, even that measure is not yet implemented, and the modalities of its application are not yet announced. As for the levy of a fee of Rs 0.25 on medical examinations, it has a mainly symbolic impact - though in this case, the symbol is important. Various excise and turnover tax rises have a stronger financial impact; but the greatest share of the additional revenue was to come from three parallel measures, all symbolically important and financially effective.

38. The price of the second rice ration (which was restored by the present Government after the elections) was to rise from Rs 0.75 to 1 rupee per measure, i.e. close to the procurement price of rice. The price of flour

was to rise from about Rs 0.66 to 1 rupee per measure. A sugar ration of 2 pounds per person per month was to be instituted (the average per capita consumption is 3.7 lbs. per person per month, not including annual industrial consumption of about 50,000 tons). The free market price of sugar was to rise from Rs 0.75 per pound to Rs 1.50 per pound.

39. The Budget was tabled in Parliament on November 10. That very evening it was angrily attacked in the Parliamentary caucus of the Sri Lanka Freedom Party, and the following day the Government announced that the flour price rise was withdrawn and the sugar ration raised to 3 pounds - i.e. close to the average consumption. These revisions reduced the net impact of the Budget by about Rs 200 million on an annual basis. Instead of a modest Rs 150 million current surplus, the Budget as it now stands will yield a Rs 50 million deficit. While better than 1970/71, this would constitute the second worst performance in a very unsatisfactory history.

40. As the Budget now stands, the fiscal position is viable only if investment remains at last year's abysmal level. Not even a token beginning can be made towards the implementation of the Five-Year Plan; as the Budget now stands, Ceylon has and can have no effective development program. This is in fact well recognized by the Government, and the Finance Minister has repeatedly declared that the lost taxes will be fully replaced, at the latest in January. At the time of writing these intentions have not yet been realized. ✓ April

41. In purely technical and economic terms, there is ample scope for raising fiscal revenues for development. The most obvious measures are those proposed in the Budget, or similar ones, cutting Government subsidies. They have no resource allocation drawback, no cost of implementation, they leave no possibility for tax evasion. Of course, they have political drawbacks; but it must be realized that, in Ceylon's already fairly equalitarian society, there is simply no possibility of raising the required resources without cutting deeply into the consumption of everybody. Only the most underprivileged - the unemployed youth, the old, the handicapped - can be protected; and these in fact seem to carry little political weight. ✓ April

42. Inasmuch as public savings will need to be boosted further in the course of the Plan period, the tax measures with the highest elasticity would be the most desirable. These would minimize the need for further visible, politically distasteful moves to impose new taxes. The reduction of food subsidies would, by and large, be an inelastic measure. The obviousness of that step should not hide the availability of many other potential tax revenues, often more elastic in nature.

43. Direct taxes may be near their practical limits, and the enforcement cost of implementing further rate increases may be prohibitive - although some increase at the highest levels might nevertheless be desirable for political reasons. However, there is much scope for indirect taxes on consumer goods, including services and housing construction. The relative

simplicity of Ceylon's economy, and its heavy dependence on imports, render such taxes easy to levy, to enforce, and to administer. For instance, imported cloth can be taxed directly; factory produced cloth at the factory gate; handlooms at the yarn import or production stage. Simple metal goods can be taxed as imported steel sheets or copper; housing construction, at the door of the cement factory. Such is the technical ease of enforcing these measures, in Ceylon's circumstances, that there is no particular rate at which these levies need to be limited. One hundred percent or more are not to be excluded. After all, cigarettes and spirits currently bear such high rates in many countries, without creating major problems. And given Ceylon's socialist aspirations, it is appropriate to recall that "socialist accumulation" was long financed in the Soviet Union by means of turnover taxes of several hundred percent on public sector producers of consumer goods.

44. Bank credit financing was not at all considered in the Plan. In the Budget, as presented to Parliament, it was estimated at about Rs 200 million, on a twelve-month basis. In the context of the present adherence to rigid price stability, that is quite excessive. At the past annual trend rate of increase in the money supply of about 5.5 percent, only about Rs 100 million would be permissible, even if private credit expansion remained nil. Physical shortages of current consumption goods, even of those which are rationed, are already current; and the politically demoralizing and economically disruptive effects of such shortages are immense. However, if prices were allowed to rise, particularly if price rises were systematically provoked through the imposition of indirect taxes and a general increase in the cost of imports (through a formal devaluation or otherwise), the scope for deficit financing would be much enlarged.

Conclusion

45. The prescription is known, the technical means are available, the medicine has been prepared. The question is not even whether the patient will take it, for Ceylon must and will cut per capita consumption. The question is merely whether this will be done early enough and boldly enough to raise resources for preparing a long-term improvement; or so slowly and so late that the inevitable decline of consumption never leaves any surplus for investment out of the declining level of income.

Table 4. Ceylon: Balance of Payments

(In millions of U.S. dollars)

| | 1968 | 1969 | 1970 ^{1/} | | | 1971 | | |
|---------------------------------------|------|------|--------------------|---------------|-------|-----------------------------|-----------------------------|-------|
| | | | Jan.- June | July- Dec. | Total | Jan.- June ^{2/} | July- Dec. ^{3/} | Total |
| Goods and services | -64 | -142 | -58 | -19 | -77 | -26 | -45 | -71 |
| Exports, mainly f.o.b. | 332 | 321 | 163 | 172 | 335 | 154 | 168 | 322 |
| Imports, mainly c.i.f. | -396 | -446 | -211 | -181 | -392 | -177 | -210 | -387 |
| Services ^{4/} | 2 | -15 | -9 | -9 | -18 | -1 | -1 | -2 |
| Private transfers | -2 | -1 | -1 | -1 | -2 | -2 | -2 | -4 |
| Official transfers and capital | 38 | 82 | 27 | 45 | 72 | 48 | 33 | 81 |
| Grants | 5 | 8 | 7 | 6 | 13 | 5 | 8 | 13 |
| Commodity aid | 43 | 46 | 18 | 26 | 44 | 17) | 46 | 76 |
| Project aid | 7 | 15 | 3 | 3 | 6 | 13) | | |
| Suppliers' credit | -- | 30 | -- | -- | 14 | 6 | 9 | 15 |
| Short-term trade credit (net) | -2 | 6 | -- | -- | 24 | 17 | -13 | 4 |
| Debt repayments | -10 | -21 | -- | -- | -29 | -11 | -16 | -27 |
| Other (net) | -4 | -1 | -- | -- | 1 | 1 | -1 | -- |
| SDR allocation | -- | -- | 13 | -- | 13 | 11 | -- | 11 |
| Monetary movements ^{5/} | 30 | 57 | 18 | -26 | -8 | -43 | 18 | -25 |
| IMF (net) | 29 | 2 | -1 | -14 | -14 | -3 | -6 | -9 |
| Central Bank assets (...increase) | 4 | 12 | -4 | -1 | -5 | -10 | 5 | -5 |
| Central Bank liabilities (- decrease) | 2 | 42 | 22 | -8 | 14 | -28 | 17 | -11 |
| Other (net) | -6 | 2 | 1 | -3 | -3 | -1 | 2 | 1 |
| Errors and omissions | -4 | 3 | -- | -- | -- | 10 | -6 | 4 |

Source: Data provided by the Ceylonese authorities.

^{1/} Revised.^{2/} Provisional.^{3/} Estimated.^{4/} Including nonmonetary gold and bunker oil.^{5/} Including Crown Agent's net balances and Ceylon-China debit balances.

Table 5. Ceylon: Short-Term Debts^{1/}

(In millions of U.S. dollars)

| | Net Outstanding (end of period) | | | | Net Change (during period) | | | |
|-----------------------|---------------------------------|-------------|--------------------------------------|----------------------------------|----------------------------|---------------|------------------------|-------|
| | Import Credit | | Central Bank borrowing ^{2/} | | Total | Import credit | Central Bank borrowing | Total |
| | (One year or less) | (18 months) | (One year or less) | (Up to five years) ^{3/} | | | | |
| 1967 | 18.1 | -- | 9.6 | -- | 27.7 | -- | -- | -- |
| 1968 | 15.9 | -- | 4.8 | -- | 20.7 | -2.2 | -4.8 | -7.0 |
| 1969 | 21.9 | - | 43.0 | -- | 64.9 | 6.0 | 38.2 | 44.2 |
| 1970 | 45.9 | -- | 67.2 | -- | 113.1 | 24.0 | 24.2 | 48.2 |
| 1971 | | | | | | | | |
| March | 48.3 | 4.1 | 50.4 | -- | 102.8 | 6.5 | -16.8 | -10.3 |
| June | 63.2 | 7.2 | 27.4 | 20.4 | 118.2 | 18.0 | -2.6 | 15.4 |
| August | 69.2 | 9.5 | 19.0 | 20.4 | 118.1 | 8.3 | -8.4 | -0.1 |
| September | 66.9 | 10.6 | 19.6 | 20.4 | 117.5 | -1.2 | 0.6 | -0.6 |
| December (Projection) | -----50.3 ^{4/} ----- | ----- | 40.8 | 20.4 | 111.5 | -27.2 | 21.2 | -6.0 |

Source: Data provided by the Ceylonese authorities.

^{1/} Including 18-month trade credits and rescheduled Central Bank short-term debt.^{2/} Excluding AsDB loans.^{3/} Rescheduled.^{4/} Estimated. Includes 18-month credit.

CEYLON—A CASE OF PERSISTENT

A report by
Jacques DECORNOY

POLITICAL MYOPIA

To the casual observer, a Socialist government which includes a Communist and a Trotskyist as ministers, and has close diplomatic ties with North Korea, China, Cuba and the Provisional Revolutionary Government of South Vietnam, would seem to be safe from leftist pressure.

But on April 5, the people of Ceylon woke up to find themselves in the midst of an obviously Left-inspired rebellion determined to bring down Mrs. Sirimavo Bandaranaike's government. The uprising surprised the Ceylonese themselves, and the shock was even greater in the outside world.

The rebellion was put down, with the help of military hardware from a large number of foreign countries. Thousands of rebels—mostly teenagers or youngsters who had barely reached adulthood—were rounded up at the cost of a still undetermined number of lives. The savagery was on an unprecedented scale for an island that had had no serious political disorders since the mid-19th century.

COLOMBO—Never had there been so many young people on the campus of Vidyalankara University, which stands a few miles outside this capital. The campus is fenced in by a tall, double row of barbed wire, topped with searchlights and guarded by armed men. The odd thing is that the guards are all old, and the persons inside all young, mostly between sixteen and twenty. Vidyalankara has in fact become Ceylon's principal prison camp where young people rounded up after the armed revolt which broke out on April 5 are being held.

In all about 10,000 youngsters, boys and girls, are being held in camps. Most of them are rebels, openly or potentially opposed to the "order" imposed by a government which is made up of "socialists," pro-Moscow "Communists" and "Trotskyists" rejected by the Fourth International.

Being young in Ceylon can at best mean having to put up with being harassed and pushed around. At worst, it may mean torture and death. In the southern fortress-city of Galle this correspondent saw three "terrorists" who had just been arrested by the police and were being taken away. "They'll be killed this evening and their bodies thrown in the river," commented a local inhabitant.

The police had always been detested in Ceylon. Deployed with frequency by a so-called

Le Monde correspondent Jacques Decornoy, who spent some time talking to both government representatives and people in close touch with the young rebels, is convinced that a guerrilla movement was born, perhaps prematurely, on the night of April 5-6, and that the government will have a long, hard struggle to maintain its position.

Economic and political mismanagement has characterized all Ceylonese governments since the island was granted independence in 1948. The Janata Vimukta Peramuna (People's Liberation Front) revolt seems, in retrospect, to have been a natural consequence of the persistent political myopia of Ceylon's leaders and their systematic refusal to tackle the root causes of the island's disastrous economic situation.

progressive government, they are now being openly compared with the late Haitian president François Duvalier's notorious "Tontons Macoutes." A few examples of their activities suffice to drive the point home. But it would be wrong to imagine that they are merely isolated instances of police excesses.

In the village of Katagarama in the south, a young girl was stripped and killed on the spot; at Akuressa, also in the south, two young persons were shot in public and left for dead, but they died only later when their bodies were set on fire. At Kosgoda, two bodies were strung up for public view for several days. An assistant lecturer in geography was so badly beaten up that he died in a Kandy hospital, and a history student was tortured for two days.

A young man was beaten up in Bandaragama, the soles of his feet cut open and the wounds filled up with chili powder. Another young man, picked up in a road outside Colombo, was tortured and thrown into a nest of giant red ants.

The rebel Janata Vimukta Peramuna (JVP)—People's Liberation Front—has minted a new slogan: "The police are dogs, the soldiers are comrades." It may be an attempt to drive a wedge between the two forces of repression, but it is generally true that the Ceylon Army has been behaving in a less beastly fashion.

Armchair leftists pontificate

How did this "happy" island, where tourists soak up the sun on beaches and children with some schooling live far better than their counterparts in neighbouring India, this land which had hitherto experienced no major crisis, plummet into such depths of unbridled violence? Nobody had foreseen the coming storm, although the clouds had been building up for a while.

Ceylonese political leaders, whether self-proclaimed rightists or armchair leftists, and foreign observers alike, tended to examine the situation as though it were a theoretical exercise. Instead of studying what was happening in the countryside and the hills, they lucubrated on the basis of western standards, using imported arguments, be they conservative or Marxist.

It is hard to say which group was most blind to what was really happening in the country: the pro-Moscow Communists, Prime Minister Sirimavo Bandaranaike's political cronies, or the trader class.

In Colombo today, the haves—and these are not just the rich, but all those who have any economic or official weight—do not know what to make of it all, and live in a world that alternates between fantasy and punitive zeal.

"Colombo is Saigon," one shrewd observer remarked. The comparison is apt, if the capital is seen as a symbol of the "old" world fortress whose walls have to be battered down. However the government, thanks to its civil service and its schools, has in the course of the years spread its "bourgeois" and bureaucratic values all throughout the island. Colombo had, in a way, reached out into the farthest village.

What is happening today is that the whole concept of political life, of the relations between persons, in short of the entire social structure, is being stormed by a tiny vanguard of young people.

The government apparently held together, but it was rocked to its very foundation, for the young rebels have to be regarded as convinced and efficient revolutionaries who cannot be fobbed off with a papered-over parliamentary façade. "They could have begged for jobs," said a Ceylonese who has contacts with the rebels, "when the 'left-wing' government was elected in 1970. But they refused to become part of the system."

The rebels are challenging the present course of Ceylon's history and the future that is being prepared for them, in their name, by the government of brown sahibs who in 1968 constitutionally stepped into the white sahibs' shoes.

In fact, independence meant little more than replacing the Union Jack with the Lion rampant, for since the Thirties London had been putting together in Colombo a social group keen on safeguarding British interests, a group dominated by very powerful family clans which had not a little bit of the old feudal instincts.

The revolutionary groups were not inactive, but were divided, concentrated in the capital and incapable of galvanizing the Tamil tea plantation workers in the hill country. Their leaders, all scions of anglicized, middle-class families soon got important posts within the government and for the most part chose a parliamentary alliance with the "progressive national bourgeoisie."

They got their chance in the Fifties when the traditional Right split and the group headed by Solomon Dias Bandaranaike emerged as the dominant political power. Mr. Bandaranaike, husband of the present premier, was assassinated while he was in office.

Mr. Bandaranaike cashed in on his ability to influence the rural population and the Sinhalese masses. He emphasized the welfare state. Socialism in his eyes was turning the population into wards of the state—cut rate public services, free gifts of rice—and nationalization of a few industries and pursuing the policy practised by the preceding government of providing free and universal education. Sinhalese became the official language, but English remained the real passport to social success.

While Mr. Bandaranaike's policies helped damp down certain resentments, they contained in themselves the seeds of later unrest. As for genuine reforms affecting the land structure or social relations in rural life, no attempt was made to enforce them.

In this period the parliamentary mechanism was still functioning properly, and in 1965 the Right came back to power. Just the year before, a young Ceylonese returned to the island, unperceived by everybody except by

a few Soviet specialists in the problems of developing nations and perhaps by the government intelligence services. Rohan Wijeweera was his name. Even he at that time could not have known he was going to become the secretary-general of a people's liberation front and that, with his party friends, he would touch off an armed rebellion in 1971.

Of middle-class origins, the son of a founder of the Ceylon Communist Party, he refused when he was quite young to learn English. It was the first break with an established historic tradition. He went to Moscow's Lomonosov University where he studied medicine for four years. Although he was a pro-Soviet Communist, his contacts with Communists from China and other countries led him to set up an "anti-revisionist" cell. He came back to Ceylon in 1964, but could not return to Moscow to finish his studies because the Soviet government refused to renew his visa. He became a militant pro-Peking Communist in Colombo, but appears to have left the party in 1966 taking with him several officials.

The new movement which he headed was born within the Sinhalese masses, and its ideology was conceived in that context alone. A new situation was created, a situation characterized by a number of splits: youth against the older generations, Sinhalese culture versus westernized culture, diplomas and degrees versus a system incapable of honouring them, new leftist militants against the government and also against the old left-wing parties.

Ceylon's peasant population was not directly involved in the JVP revolt, even if in various regions, especially in areas where the so-called low castes predominate, they were politically sympathetic to the aims of the rebels.

The party's young avant-garde was made up of rural elements and based in the countryside, but was not integrated with the rural population. This drew upon the JVP strictures from all the left-wing parties, including the pro-Chinese Communists, who charged the rebels with being "petty bourgeois adventurers" and even "fascists."

Youngsters train for guerrilla war

The JVP did not fit any of the classic moulds of the proletariat they had learned about and the traditional Left consequently resisted it. The Marxists scoffed at the idea of these "intellectuals" from poor to middling peasant homes pretending to belong to the proletariat. In their eyes, the rebels' "putschist tendencies could only play into the hands of the Right."

But, in fact, the typical JVP member had worked on his family farm before joining the party. He was neither lazy nor starving, but that did not mean he had no worries. With the schooling he had received, he had hoped to become a regularly paid employee, either in the government or in the private sector. But all these doors were closed to him.

In fifteen years, some 2 million youngsters passed out of schools and colleges, but only a tiny number among them were able to find work in government offices or in industry. An overwhelming majority of them merely swelled the ranks of the unemployed, for only some of them found employment on family farms and estates.

Mrs. Bandaranaike's government says that half the number of "terrorists" arrested had jobs before the April rebellion. This is probably true, but it only goes to show that the young people were no longer content with getting any kind of work. They have gradually become convinced that the present regime cannot find a place for them in the national economy, and have therefore drawn their own revolutionary conclusions. The whole present-day social structure must be torn down and replaced with a new, radical form of socialism.

Colombo's leftists failed to understand the changes that were occurring. While they reasoned along traditional lines, the JVP ranks grew until they reportedly numbered about 100,000 militants and officials. According to one JVP sympathiser, about 20,000 youngsters were given short and secret courses of guerrilla instruction.

The JVP movement remained a well-kept secret until about April 1970—one month before the general election which swept Mrs. Bandaranaike into power. The Colombo newspapers did not take the movement seriously, as usual preferring to rely on "police

sources" rather than undertake their own investigations. But in April they began to publish items about "terrorists" being trained.

Police files referred to them—absurdly enough—as "Che Guevarists" but the label stuck and even the pro-Peking Communist Party used it. Rohan Wijeweera's name suddenly made news when he was arrested. That apparently was the moment when the JVP decided to come out of hiding.

When the JVP entered the election fray, its militants knew the purpose was not to support Mrs. Bandaranaike's "left-wing" coalition, or to set up a pressure group within the parliamentary system. The idea was to make sure that all the old opposition candidates who had rallied round Mrs. Bandaranaike were elected.

So the young people voted heavily in favour of the "Left." From now on, the government's failures, setbacks and excesses could no longer be laid at the door of the Right, and the old-time politicians who had been clamouring for "Socialism," "Trotskyism" or "Communism" would be held to their responsibilities. The country would then learn that one part of its ruling class had simply been replaced by the other.

Shortly after the elections, Rohan Wijeweera was released, and the JVP organization continued to work behind the scenes preparing its militants, awakening the rural Sinhalese masses and setting up a tight system of cells. The movement had its roots among the native Sinhalese, reflecting their repressed nationalism. But in the middle of last year, the JVP began to broaden its base, tackling other groups without which a revolution would be well-nigh impossible. City industrial workers and the Tamil-speaking tea plantation workers were now courted.

This explains the important meeting held on a tea plantation last November when police bullets killed two workers. The meeting was addressed by a significant variety of speakers—Eala Tampoe, a longtime revolutionary Trotskyite who has been working in the industrial milieu; Ilancheliyam, the Marxist Tamil leader of the Young Socialist Front; Wijeweera, a Sinhalese, who came accompanied by two young Buddhist monks to what was essentially a Hindu area.

Police operate without restraint

The significance of this breakthrough was not lost on the traditional left-wing parties which had always systematically kept these social forces divided. But the JVP movement had caught fire and it grew rapidly, perhaps too rapidly, for it drew upon itself the attention of a number of groups, both at home and abroad, who were anxious to break it up before it became "dangerous."

The government's concern to maintain order was only natural. But it made no attempt to find out what really was happening. Even before the first shot was fired, or the first police station attacked by the rebels, a state of emergency was imposed and some 600 militants—including Wijeweera—were imprisoned.

Regulation 44 issued on March 16 authorized any police superintendent or person having a warrant "to take any action which appears necessary to take possession of a corpse, bury it or burn it" without benefit of a witness, and regardless of the existing laws.

The police were authorized to arrest anybody they liked and were no longer under any restraint whatsoever. The government did not have to "whitewash" these excesses, as is sometimes necessary in other parts of the world. Here the government deliberately ordered the excesses.

Ceylon's civil war began on the evening of April 5 when strange-looking militiamen in dark-blue uniforms set up control points on the roads. On April 8, Mrs. Bandaranaike published a victory communiqué. But, as some officers disclosed, it actually took the army two weeks of fighting to take back the villages and hamlets captured by the young rebels. The army and police were ill-prepared for the task, and the JVP rebels fought hard, despite their ludicrously inadequate equipment and at no time did the ordinary people rise up against them. Some of them are still holding out, holed up in the highlands where natural caves are plentiful. For supplies, they help themselves to what they can find in trucks parked on the roadside, often in broad daylight, or by foraging in villages. At night they move into action.

No one knows whether they are still receiving reinforcements, but what is certain is that the hardliners among them will continue to hold out for a long time. They are often former students or teachers (about a thousand are still missing from their classrooms). The fact they are all more or less politically oriented, even more than the fear of being tortured should they fall into the government's hands, has probably made them opt for a long guerrilla type operation, particularly since the failure of their April coup.

The JVP move may well have opened a new phase in the development of Ceylon, but the group cannot succeed alone, for the government, or to be more precise, the system, can with the help from all quarters hold out for a long time to come. To succeed the JVP will have to broaden its bases, wooing the Tamil workers on the "estates" and the Tamils in the north of the island, neither of which groups was involved in the rebellion.

Mrs. Bandaranaike knows this. That is why she and her allies in the pro-Moscow Communist Party and among the "dissident Trotskyists" have been to such pains to point out that the workers are behind them. But the coalition may not be quite as smooth as it appears.

The political parties which now hold the reins of power are beginning to feel that their bases are slowly eroding. They are aware of the paradox of political parties which claim to be leftist but show their distrust of 60 per cent of the population by refusing to accept them as volunteers to fight for the government.

If the armed struggle continues, the government will have serious economic and financial problems on its hands. It will then not be able to count too long on the docility of a working class which has a long history of strike action going back to the 1890s.

For the moment the government is planning to speed up the implementation of its programme and push through before the end of the year constitutional reforms to turn Ceylon into a republic. It is also possible that it may nationalize a few industries, but many persons who voted for the coalition in 1970 are sceptical. "The JVP is right," they say, "when it says that the government undertook no real socialist measure in the eleven months it was in office."

"During the election campaign the coalition candidates accused the Right (the previous government was that of the rightist United National Party) of being extravagant. But after the elections, the present government bought French cars for all its elected members, who also went on frequent trips abroad.

"The UNP had been accused of being a tool of the World Bank and Western interests. But what has changed? Being a progressive abroad, by recognizing North Korea and the Provisional Revolutionary Government of South Vietnam, didn't mean being progressive at home."

The JVP challenge to Mrs. Bandaranaike's government is not economic, but political and cultural. Nevertheless the government will have a hard time solving two problems which overlap each other in large measure—the presence of a large number of unemployed persons and the masses of educated underemployed who are ill-suited to the kind of work offered them.

"We created 25,000 jobs in a year," said a minister. But he did not mention the 15,000 jobs that were suppressed when the "land army," organized to settle virgin lands, was disbanded by Mrs. Bandaranaike on the grounds that it was being used by the Right. Conservative estimates put the number of unemployed in Ceylon at 585,000, of whom 460,000 live in the country. Some 230,000 of these are under nineteen, 250,000 between nineteen and twenty-four, and 167,000 have been to colleges or universities.

Basic land reform needed

At the present rate of unemployment, it is calculated that in five years between 800,000 and 850,000 will be without work, and that in 1935 the jobless rate would be running at 1,500,000. A minimum of 170,000 new jobs would have to be created every year for the next fifteen years to absorb the workless.

Experts like France's René Dumont, who recently submitted a blistering report to the United Nations on the economic mismanagement in Ceylon, say only immediate and drastic measures would eventually permit a small country with a population of some 13 million to tackle the colossal problems with which it is faced.

There must be a fundamental land reform, and an end to the protection of middlemen and landowners. The country needs a dynamic government willing to give the right tools to the young to help build the country. That the young are willing to make sacrifices for the good of the country was shown by one small incident last April: the army summoned the inhabitants of a small village and asked if there were any "terrorists" in their midst who were prepared to die for their cause. Three young girls stepped out and were shot dead on the spot.

One of the curious developments of the recent rebellion in Ceylon was the way in which a heterogeneous assortment of nations, sometimes mutually hostile ranging from the Right to the Left, rushed to the aid of Mrs. Bandaranaike's left-wing coalition with guns, planes, and money. Both India and Pakistan aided the government. China gave Ceylon a \$25 million loan three weeks after the insurrection broke out and told Colombo not to hesitate to call upon it for "material assistance."

Chinese Premier Chou En-lai is said to have sent a letter to Mrs. Bandaranaike in which he condemned the "handful of people who call themselves 'Guevarists' and with help from foreign spies have created a chaotic situation."

But in the clandestine rebel "schools" in the fastness of the jungles, they continue to read both Chairman Mao and Marshal Kim Il-sung, not to mention Cuban and Vietnamese writers, and Franz Fanon, the black revolutionary. It may be doubted whether the Communists really understood the forces they faced, the origins, ideology and strategy of the JVP. It is possible that this unprecedented situation, utterly different to any they had known before, prompted them to condemn the movement out of hand.

Meanwhile Ceylon's right-wing and left-wing leaders boast of their long years in politics; the former recall their bygone political exploits, the latter dissect at great length the thoughts of nineteenth century European Marxists. At night there are "curfew parties" in the capital where bright chatter and hard liquor flow. Police guard the streets, and the visitor is assured that those who are homeless and have to sleep on the pavement will not be molested in spite of the 6.30 p.m. curfew as long as they stay where they are.

Staying put in one's place is, in fact, the order of the day. It is because they did not want to stay put in their places that the young revolted. The homemade bombs which went off on the night of April 5-6 probably went off prematurely. But that was the night when the Ceylon resistance movement, after a long slow gestation in the womb of obscurity, was at last born.

by Ananda Jayavira

CEYLON CONFRONTED WITH A SERIOUS ECONOMIC CRISIS;
LEFT-WING COALITION GOVERNMENT HAS TAKEN UNPOPULAR MEASURES

COLOMBO: Following the April 1971 uprising of the Front for the Liberation of the People, the island has found a sort of calm. This has now been ended by the serious political crisis which has shaken the United Front Government of Mrs. Bandaranaike, which must also tackle an unprecedented economic crisis.

On November 11, Mr. Perera, the Minister of Finance and a Trotskyist dissident, presented his budget. Having to tackle a deficit of more than Rs 2 billion, the Government had decided on the one hand to take measures such as land reform, income ceiling and nationalization; and on the other hand to considerably diminish social expenditures. Mrs. Bandaranaike was proposing to announce a ceiling on landholdings and the nationalization of several industrial sectors, while Mr. Perera was follow up by announcing the measures unpopular. But the right wing of her own party persuaded Mrs. Bandaranaike that a simple speech on land reform would immediately be followed by occupation of lands by the villagers; as for the nationalization projects they were abandoned so as not to anger the Western aid givers.

Finally, on November 10, 1971, Mrs. Bandaranaike pronounced a speech which announced no concrete measures. The next day Mr. Perera announced that the price of rice would be raised, that the sugar ration would be limited to 2 lbs. per month per person and that the principle of free health services in the state hospitals would be abandoned. The budget limited to Rs 2,000 per month the income that could be spent by individual families, taxes and compulsory savings taking up the remainder and the ownership of dwellings would be controlled.

The awakening of public opinion

These decisions provoked a great deal of disquiet in the country. There were strikes and go-slow movements, an attempt was made to sabotage a train, and street meetings were held despite the "state of emergency" rules. Public pressure was such that it became necessary to withdraw the measures on the increase in the price of rice, and to increase the sugar ration. It nevertheless remains true that the Minister of Finance, who says that he is a Marxist (while he is following the advice of the World Bank) had attempted to place upon the poor the cost of the financial measures. Members of his party have in fact criticized him. The budget also exempted barbed wire from some taxes. The newspaper of the Pro-Sovietic Communist Party had an editorial entitled "Barbed wire is cheap", which is an allusion to 16,000 people in jail. The dissatisfaction of the workers, students and the labor unions related to the leftist Coalition Party do not seek to hide it.

Public opinion has suddenly awakened after the period of terror following the April uprising and the repression which imposed measures of silence and censorship, forbade strikes and the exercise of fundamental rights. The revolt had been put down with a great deal of savagery by the army and the

police, helped by both Western and socialist countries and by the Asiatic neighbors of Ceylon. There have since been numerous revolts and shootings in jails, and some people have been killed. Mr. Sanmugadasan, Chief of the pro-Chinese Communist Party, is still in jail as are also several known political figures who were "a danger to public security". Several army officers are now undergoing trial because of the Kataragama affair; they killed a school girl in public under the pretext that she was a rebel.

An international committee against the repression in Ceylon has been formed. In the island itself, the protests are numerous against the situation which has been imposed for many months. The youth movement of the pro-Soviet Communist Party has asked for the end of the state of emergency, for a Committee of Enquiry on the atrocities of the police and army, and for the release of Mr. Vasudera Nananayakkara and other leftist personalities. The Communist Party has rejected this resolution of its Youth Wing. The party is also facing the dissidence of its youngest members. One of the biggest labor unions, favorable to the Communist Party, a federation of public service workers, started a campaign for the return to democratic government and for the restoration of union rights. The Union of Ceylonese Composers, which is related to this union, has asked that Socialist countries, including China and the USSR, stop all economic and military aid as long as the Government has not fulfilled its electoral promises (nationalization of the banks, plantation, and of large companies). The Ceylon Mercantile Union, led by the Trotskyist Bala Tempoe, has not ceased to oppose the Government since the beginning of the repression. In October, Ceylonese jurists asked for the reestablishment of public freedoms; some of them have constituted an "office of missing persons" whose aim is to trace the thousands of persons who disappeared during the April events.

"The next few months will be crucial"

However, the most important recent event was the formation of a "movement for civic freedoms in Ceylon", constituted by well-known liberal and left-wing personalities. It is presided by Saratchandra, the most famous dramatist of the country. It is composed of artists, writers, well-known unionists and also of Buddhist dignitaries and Catholic prelates like the Bishops of Kandy and of Kurunegala, and the Rev. Fr. Tissa Balasuriya, ex-rector of the Catholic Aquinas University.

The Government says it is democratic and socialist, and it will have problems if it tries to ignore all this agitation, abroad and above all in the island. It cannot refuse to take into account the fact that this agitation comes not only from brilliant intellectual circles, but also from labor unions affiliated to the coalition parties. Confronted with this situation and with a grave financial crisis, the authorities cannot promote serious social reforms. In fact, Mrs. Bandaranaike's party is not at all revolutionary, nor are in fact the pro-Sovietic Communist Party, nor the whole Marxist groups. On the other hand, the Government could not decide on a single ^{new} measure weighing on the poor classes without provoking a great wave of discontent in the island, and without losing all working class support. The question is whether a new left-wing force can be organized, or whether the right-wing, assisted by the military, will assume power. We have the habit of saying in Ceylon that the "next few months will be crucial". For once this seems to be true.



October, 1971

SUMMARY

Reproduced from

MATCHING EMPLOYMENT OPPORTUNITIES AND EXPECTATIONS: A PROGRAMME OF ACTION FOR CEYLON

The report of an inter-agency team
organised by the International Labour Office

785. It may help the reader to see the structure of the argument if we run over some of the points again and repeat them roughly following the order of the report. To read this summary, however, is no substitute for reading the report as a whole. What has been discussed there with qualifications and reservations becomes blunt and sweeping in a summary. After all, the report itself is a summary, each chapter distilling the essentials from the papers and meetings of the mission members working in the corresponding field.

THE SIZE AND NATURE OF THE CHALLENGE

786. The emergence of large-scale unemployment in Ceylon can be traced primarily to the contrast between the fast growth of its population (more than 2 per cent a year) and the downward trend in the volume of imports which the country can afford. This has been due in turn to the slow growth of demand for tea and rubber and the rise in import prices, though from another point of view the blame could be ascribed to Ceylon's failure to make the necessary changes in the productive structure. Ceylon in brief has not responded to these trends, and one symptom has been a foreign exchange shortage of increasing severity over the past twenty years, with import controls of growing strictness.

787. In historical perspective, what has been happening is that the profits of the tea industry, the original base of the social services, have failed to grow substantially in the past two decades, and that no comparable source of foreign exchange, government revenue and savings has been developed to take its place. Many measures, especially subsidies and taxes (including those incorporated in the exchange-rate system), have in fact blocked the necessary structural changes.

SUMMARY

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788. The particular form which unemployment now increasingly takes—the jobless secondary-school leaver—reflects the still more striking contrast between this economic inertia and the accelerating output of an educational system which has also failed to adapt itself.

789. Population, the balance of payments, education, policy inertia—we have here the four main factors behind the present crisis in Ceylon.

790. Unemployment can be defined in more than one way, and measuring its scope is by no means easy whichever way is followed. But a starting point is the fact that various surveys carried out during the past decade show between 10 and 13 per cent of the Ceylonese labour force as openly unemployed—at the end of 1969 nearly 15 per cent, according to the Socio-Economic Survey. It is particularly severe among those between the ages of 15 and 24, and more particularly those with some secondary education. Thus, of youths aged 15 to 19 with "O" level passes, more than 90 per cent are seeking work, and the figure is still over 60 per cent for men aged 20 to 24 with the same qualification. These rates, high even by current standards in the third world, are higher still among women.

791. The basic problem, however, is one not so much of unemployment as of employment—that is, the working of the labour market as a whole, which covers the employed and those on the margins of employment as well as the unemployed. This becomes clear once we recognise that the basic reasons for being concerned with unemployment affect the employed as much as the unemployed. Thus unemployment in the sense of shortages or inadequacies of work opportunities afflicts not only those without jobs, but also those working short hours and those working full time but severely frustrated by the type of work they do or its remuneration. Incomes inadequate for nutrition and basic necessities are the plight of many in badly paid jobs or with little land, as well as those without work. Finally, unemployment in the sense of the under-utilisation of labour arises from all the various forms of low productivity and not merely from open unemployment.

792. Ceylon's labour market reveals two types of imbalance: (i) an over-all imbalance between the total supply and demand for labour, and (ii) a structural imbalance, in which the types of work which people are willing and able to do does not match the pattern of opportunities available. The structural imbalance arises because the opportunities for additional work occur at the wrong season or in the wrong place, require special skills or offer too low an income or too low a status compared with what the various types of labour can offer or people will accept.

793. We have emphasised the structural problems because they appear to be so severe in Ceylon. This is revealed by one striking fact—despite open unemployment of more than 500,000, the Government has been forced to

import several thousand labourers from India (a strange echo of the past) for toddy-tapping. But we must not forget that even if the attitudes, aspirations, skills and location of labour could be magically changed overnight, so as to fit the pattern of the demand for labour, there would still be an over-all imbalance, owing to the shortage of foreign exchange and capital—and ultimately to the structure of production and the distribution of income.

THE KEY FIELDS OF LONG-TERM EMPLOYMENT STRATEGY

794. The fundamental contrast between the fast population increase and the slow growth of export earnings makes it increasingly hard to sustain the expansion of social services (especially education) and food subsidies (especially the rice subsidy). Ceylon has achieved, to an unusual degree, important social advances in the fields of education and health. But it should be remembered that, given the present condition of the tea market, the welfare state is being sustained only with the help of two linked deficits—in the balance of payments and in the budget. These will be mentioned again later. Basically, the monetary incentives which could sustain a growing welfare system have been impaired, and have not been replaced by an emphasis in the educational and political spheres on voluntary sacrifices, discipline and hard work, or with an adequate system for forming and implementing strategies of economic and social change.

795. Our point of departure for an employment programme has been the socialist goals of the Ceylon Government. The content of our long-term proposals does not, however, depend very much on specific political assumptions: there are big physical and organisational jobs to be done, whatever the political framework. The broad shape of any programme in the years ahead will be determined primarily by the structure of the labour force and its prospective rate of growth, and by the chronic imbalances in foreign payments. We therefore start the construction of our employment programme with a discussion of these problems.

Structural balance in the labour force and in the economy

796. The basic problem posed by the population is not excessive numbers (about 12.5 million in 1970) but rapid growth. Population policy raises sensitive issues, but we cannot avoid bringing out the links between it and employment. The best way to do this is by presenting the following hypothetical situation. Suppose that a family planning campaign policy had been implemented at the same time as the malaria eradication campaign in the 1940s and the present target birth rate of 25 per thousand had been reached in 1955. Then a mere continuation of past trends in employment would have been sufficient to reach full employment in the 1980s.

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797. In reality, however, the labour force will grow at nearly 3 per cent per year. On present trends, this implies unemployment rising to still higher levels. If something like full employment (i.e. unemployment brought down to 5 per cent) is to be reached in the mid-1980s, employment will need to increase by 3.5 per cent per year, somewhat faster than 3 per cent because of the need to absorb the backlog of unemployment. However important the structural changes required, there is no escaping the problem of expanding total work opportunities as the labour force grows.

798. This being said, we come back to one type of structural imbalance which appears crucial—the imbalance between expectations and opportunities among those with educational qualifications. In the mid-1960s some 8 per cent of the labour force had completed “O” levels. In the year 1985—if present trends continue—75 per cent of those entering the labour force will have had some years of secondary education!

799. Expectations are relative. It is the sharp differences between the rewards, financial and other, of various work opportunities which aggravates the frustrations of those who sit waiting for jobs and incomes beyond what the economy can sustain, and which makes the adjustment to reality so gradual and painful. This may become a very severe problem unless the expansion of work opportunities in various sectors is accompanied by far-reaching reforms in the educational system and the structure of salaries and wages.

800. Work opportunities are not going to expand fast enough, anyway, unless the balance-of-payments problem is solved. Since 1968 almost 10 per cent of Ceylon's total national expenditure has been met by a foreign deficit, covered mostly by costly private credits, increasingly difficult to obtain. By 1985 Ceylon would need much more imported raw material for employees to work with and merchandise for them to buy. To pay for these, exports would have to more than double.

801. How can Ceylon achieve this target—the minimum for a full employment strategy, but requiring a huge effort? Non-traditional exports are still less than 10 per cent of the total. By 1985 these could form a much bigger proportion; still, it is hard to see how in practice they could provide the bulk of the necessary increase. A continued increase of the traditional tree-crop sales (tea, rubber, coconuts) would be both necessary and feasible. Exports of these products should and could take more highly processed forms—so that the income and employment from the industrial operations involved should be created in Ceylon, not abroad. Examples are tea bags, crêpe rubber and coir fibre. But the primary stage should not be neglected. Coconut growing needs to be made much more profitable, especially for exportation, and the tea replanting programme needs to accelerate.

Technology

802. At present, businessmen often choose techniques of production that save labour to an unnecessary degree. The central reason is that policies in many fields combine to subsidise equipment. Machinery can, for example, be imported at an exchange rate of about Rs 6 to the US dollar; it is also cheap to borrow money; big depreciation allowances and investment grants positively encourage the replacement of labour by capital.

803. On the other hand, labour is artificially expensive in some sectors of the economy. Moreover, employers' contributions to superannuation funds are in effect a tax on wages. Many types of discrimination and patronage raise the cost of labour.

804. The scope for the greater use of labour is considerable, not only in manufacturing but also in agriculture, construction, transport and services. The choice between techniques seems in fact to be more limited in manufacturing than in other sectors. The need for capturing export markets places a high premium on quality and international competitiveness, but even here the use of labour-replacing equipment like automatic power-looms and conveyor belts is questionable.

805. Some of our recommendations are—

- (i) the removal of the various subsidies on new equipment mentioned above;
- (ii) a more intensive use of installed equipment through multiple-shift operations, tractor repairs, etc.;
- (iii) the development of a national programme of building repair and maintenance;
- (iv) labour intensification in agriculture through hand weeding of paddy, double-cropping, minor irrigation works and better water control;
- (v) the better synchronisation of construction work with seasonal activity in agriculture;
- (vi) encouragement for the selection of projects that would save foreign exchange and increase employment by special evaluation procedures.

Agriculture

806. Today Ceylon has a farm work force of about 2.25 million, but provides it with less than 1.75 million man-years of work. The gap is certainly due to inadequate demand—but it is also due to mis-matching, in the sense that people are not prepared to undertake available work. The task is therefore not only to encourage farmers to choose the right methods and crops but also to gear incentives, training and institutions to shifting the preferences of workers. In 1950-70 output, especially of rice, rose rapidly, but this did not suffice to distribute work (or income) opportunities widely. In the future, moreover, there will be less possibility of extending the area under cultivation.

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And anyway the necessary increase in output cannot be attained unless more man-hours are applied to the soil.

807. To absorb in useful work about 95 per cent of the (over 3 million) man-years available in the farm sector by 1985 is not an impossible target. It will need a new rural development strategy with the following major components: (i) changes in production processes; (ii) radical land distribution; and (iii) a rural works programme combining drainage, minor irrigation and consolidation.

808. Little labour is used in Ceylonese agriculture by international standards; weeding, the application of manure and compost, non-mechanised ploughing and rice transplanting are surprisingly rare. Many of the causes of this state of affairs could be removed quite easily. They include not only tractors imported at artificially cheap rates (mentioned above) but also the lack of urban compost factories, the neglect of techniques (e.g. mouldboard ploughs, rotary weeders) to make work less strenuous, and perhaps an excessive concentration of extension efforts on rice. Somewhat indiscriminate subsidies are leading to a severe waste of water (and hence reducing double-cropping and Yala work levels), and encouraging men to wait about (eating free rice) for office jobs rather than work on the farm.

809. But changes of policy in these areas will not create enough jobs or output without a major shift of land ownership and use into small but viable holdings. It will hardly be possible to increase all the very small holdings to a viable size, and their owners should be given a priority claim on jobs in a major rural works programme, discussed later, provided they are prepared to lease their land out.

810. The argument that land reform could raise employment and output does not necessarily apply to tea or rubber. While nationalisation is basically a political question—and as such not a matter for an international mission to discuss—it does have employment implications. The foreign exchange problem is so acute that any reorganisation should be carried out with the least possible disruption of exports. In any case, whatever the decisions on the ownership and control of estates and agency houses, they should be announced and implemented quickly; present uncertainties are damaging output and reinvestment and hence employment. Unless replanting rates are accelerated in tea, very serious market losses (and even greater unemployment) are a serious risk.

811. Land use can be shifted gradually towards crops requiring a lot of labour, many of which (fruit and vegetables) are needed to supplement the workers' diet. Animal husbandry, with special emphasis on dual-purpose ploughing-milking animals, is a high priority (particularly on mid-country land diversified out of tea, and also under coconut trees). Changing the structure of output requires an integrated system of credit, extension and marketing, based on co-operatives and directed at the farm rather than the crop.

Industry

812. The industrial sector is relatively small. Much of the output consists of traditional consumer goods requiring relatively low levels of technology or labour skills. So far, this sector has done little to relieve the foreign exchange shortage or to create employment. Nearly 75 per cent of material inputs into industry are imported. Taking the 1960s as a whole, industrial employment probably did not grow faster than 4 per cent per year.

813. The present structure of industry poses serious problems for a long-term employment strategy, namely—

- (i) The basic industries, being developed within the public sector, do not generate much employment for unskilled labour but require on the other hand not only large investments but also critically scarce human resources—technical, managerial and administrative personnel.
- (ii) Other, large-scale domestic industries, run by the private sector, have been so far operating in the highly protected domestic market and have not yet attempted to prove their competitive strength overseas.
- (iii) Small-scale manufacturing, which may cater well for immediate employment needs, does not seem to hold a great potential for future growth of output.

814. The logic of industrial expansion without a heavy need for foreign exchange, or for much new technical research or marketing know-how, points at least initially to further processing of local products, especially the traditional export crops (tea, rubber and coconuts), as mentioned earlier. Import substitution could be pushed further, however, by joint agricultural-industrial planning (e.g. in cotton textiles) and by developing light machinery production.

815. In addition, a large export-oriented sector of industry will have to be developed. We recommend a detailed study of the costs and benefits—in the light of the Government's objectives—involved in establishing a free processing zone. But it is necessary to guard against the danger of treating the zone as a sort of panacea; Ceylon's planners can hardly afford to rely on something which is still at a very nebulous stage. More important in the short term is the exchange rate for manufactured exports, which will be referred to again below.

816. Perhaps the chief requirement for the private sector is that, whatever the policy on nationalisation, this should be clearly defined and announced so as to end uncertainty (the same point as has just been made about the estates).

817. As to the role of the public sector, we suggest linking salary and wage increases to performance, especially in exporting, and stress the need to train more and better managers. The most important point, however, is that, while public corporations should be given policy guidelines, they should be left entirely free to take their own day-to-day decisions, especially on whom they hire and fire.

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818. Construction offers interesting possibilities. Its attractiveness for labour absorption does not stem only from relatively low import requirements per job. It can be dispersed around the country; besides, an ambitious and imaginative housing programme could mobilise private savings, thus restraining consumers' demands for foreign travel and imported luxuries.

Labour

819. As mentioned earlier, the relative attractiveness of different types of work is only partly a matter of earnings. The security of a job, the pleasantness of the work and the social status it brings are all attractions additional to income. In all these respects the present pattern of remuneration in Ceylon is often perverse; it over-encourages the search (or willingness to wait) for certain types of work, so that the demand for jobs is well beyond what the occupation concerned can absorb. Even more perverse are wage, salary and other differentials which encourage types of education and training of low priority for future development. These differentials in favour of formal qualifications have narrowed slowly over time, but far too slowly in relation to the flood of educated unemployed into the labour market and the numbers seeking to go on to higher education. They still exceed what would be necessary to attract sufficient qualified applicants for further study—particularly as education is very largely free. Even after allowing for the risks of unemployment, climbing the educational ladder is still richly rewarding for those who reach the higher rungs. These excessive differentials must bear a large part of the blame for the continuing pressures for secondary and higher education, even after educated unemployment has become so severe.

820. There is no point in pretending that changes in the structure of incentives of the magnitude required will be possible without much greater and tougher action by government than has been the case in the past, including the revision of its own salary scale. Moreover, these changes have to take place in a period when there is not much room for increases in consumption. The newly employed will raise their consumption a good deal; so there needs to be restraint on those already employed. The 3.5 per cent yearly expansion in employment—required for full employment by 1985 (see above)—would permit them to raise their consumption by less than 1.5 per cent yearly. Indeed, it is difficult to imagine how the structure of earnings can be compressed rapidly without some decline in real salaries at the top.

821. Even where incentives broadly correspond to what the market needs, their operation is often frustrated by artificial barriers and discrimination within the labour market. The obvious example is the estates. The estate labour market, where there is already a good deal of unemployment, raises important issues for long-term employment strategy.

822. If the full programme of repatriating 50,000 residents a year (implied in the Ceylon-India Pact of 1964) were implemented, the general labour surpluses on the estates could begin to give way to general labour shortages in the second half of the 1970s. Such shortages would exert pressures for the integration of the estates with the general labour market, tending to raise wages, and the Government would have little option but to go along with this—in spite of the effects it would have on tax revenue from tea and the need to replace this revenue with other measures. If, however, repatriation proceeds at a level of 15,000 a year or less, unemployment will grow, unless there is a large outflow into other sectors, and a still sharper contrast will emerge between conditions on and off the estates. The Government would then be faced with a basic choice—whether to allow the estate labour market to remain sealed off or to take steps to integrate it in the economy. We very much doubt whether the present dualism is in the long run compatible with development.

Education

823. In numbers of pupils and of teachers, in output of school-leavers and graduates, the level and growth of Ceylon's educational system are impressive. And yet, in spite of heavy financial outlays and less inequality of opportunity than in most countries, there is a widespread sense that the schools and universities have failed to respond to the national needs. They have failed largely because they have been unable to adapt to the consequences of expansion and equality of opportunity.

824. The kind of secondary education which was appropriate at a time when all the products of secondary schools could be absorbed into middle-class occupations becomes glaringly inappropriate now that some 35 to 40 per cent of each group receive ten years or more of education, and most of them have no alternative but to become farmers and manual workers. Instead of adapting themselves and becoming instruments of general education, the secondary schools retain their single-minded concern with qualifying pupils for white-collar jobs, by pushing as many students as possible as far up the ladder as possible.

825. Drop-out rates in primary education and failure rates at "O" and "A" levels are heartbreakingly high. The years of preparatory study by those who fail these tests are really almost pure waste, because the passing of the examination assumes in the classroom such overwhelming importance as the sole *raison d'être* of schooling. The school's function to educate has been superseded by the demand that it should qualify.

826. One consequence is that the knowledge and skills acquired by the majority who fail the tests (which are designed to prepare the successful minority for further education) are inappropriate to their needs and those of the nation. Even more crucial in the long run is the effect on attitudes. The frustration and

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consequent sense of alienation of those who fail are easily imagined. The effect on the lucky ones who succeed can be, if anything, worse. For many years they have been conditioned to look on learning as a means of gaining not the knowledge to do a job, but the qualifications to get one. It is hardly surprising that they should see their eventual post as something which entitles them to status and salary, not as an opportunity to earn these—much less as an opportunity for self-fulfilment or for public service.

827. If present trends continued till 1985, three-quarters of all entrants to the labour force would have received at least ten years of education and sat "O" level examinations. This would be a very costly way of imparting to people what would necessarily be for most of them inappropriate knowledge and attitudes. The reason why earlier recommendations seem to have had little effect is, we suggest, that none of the changes has altered the structure of incentives making the whole system revolve round the royal road to the university, and stimulating and perpetuating the growing mis-match between job expectations and job opportunities.

828. The educational strategy we propose may be summed up as follows: concentrate resources for expansion and for the enrichment and diversification of the curriculum on level-one education, where basic attitudes and orientations are formed and which may provide the basis for an opening up of the rural community to greater social integration and economic productivity; deal with the problems of levels two and three primarily by structural reforms, altering patterns of selection and occupational qualifications.

829. There is a good case for dividing level one into five years for basic intellectual skills and three years for training as a citizen and productive worker through the introduction of pre-vocational courses. During the latter period the school would be open to all age groups and this in itself would go a long way towards keeping the early school-leavers in touch with education and training. So that the practical courses in Grades 6 to 8 should not be poor relations, selection for the coveted science stream places in Grade 9 should not be by the Grade-8 test of academic achievement but primarily by aptitude tests. The very recent proposals for educational reform put forward by the Ministry of Education, to be implemented from 1972, seem to go a long way in the direction outlined above.

830. The more drastic of our proposals concern that part of the educational system which at present comes after "O" level, that is, upper secondary and all tertiary education. They also affect non-formal education. We refer to the ideas now gaining ground for recurrent education combining formal education and in-career qualification, as opposed to sequential education and pre-career qualification. In the context of Ceylon, recurrent education could take something like the following shape:

- (i) The "O" level certificate should be made a terminal certificate which the vast majority of candidates can pass.
- (ii) Only a handful should be selected by achievement and aptitude tests for pre-university courses.
- (iii) All others, that is, the overwhelming majority, should leave school for work and/or vocational or technical training courses. The Government, followed, one hopes, by private enterprise, should replace graduate recruitment by recruitment at "O" level.
- (iv) After two or three years, everyone should be able to apply for entry into pre-university or university courses, usually returning to the original workplace after graduation.
- (v) At every point where selection takes place—between science and arts in "O" level courses, for job selection, for university places—aptitude tests should be given more weight than achievement tests in order to liberate the school curriculum from the distortion which results from preoccupation with the examinations on which the chances of a lifetime now depend.

831. Recurrent education attempts to do away with the dichotomy formal versus non-formal education by integrating both in one consistent and complementary system. It also tries to marry more closely the world of work and the world of the school and the university.

832. Later entry, the greater sophistication of the students and their knowledge (particularly important in the professional schools like engineering) of the work environment in which they will later use their expertise should all serve to enliven university teaching. Equally great will be the effect on arts and social sciences as they become in effect in-service training for older students already assured of a career as administrators or teachers.

833. The reforms suggested above would, of course, meet the needs only if accompanied by assistance to teachers and many complementary measures that we propose elsewhere in the economy, especially the reconstruction of the labour market. The changes we propose are drastic, but represent no more than a graduated response to Ceylon's educational crisis.

Government organisation

834. A central problem is the need to reorient the administrative structure, which was originally designed for routine needs, to development and planned evolution, so that Ceylon can respond to changing requirements more flexibly than in the past, and especially to employment needs. This calls for increased co-ordination of central departments, with the Ministry of Planning and Employment playing a key role. It also implies developing the infrastructure of planning—the statistical and research services. To maximise public commitment

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to the objective of employment strategy means involving not only other interest groups but also the regions in the process of planning.

835. The problems of plan implementation are most acute at the local level. First is the problem of co-ordinating the activities of officials, who are each responsible to a different government department. Secondly, there is the gap between the divisional level officers and the elected village council bodies, which have very limited powers. Some of these ills can be cured by administrative reforms, but some only by sending first-rate people into the administrative and technical services. Finally, there is a need to evolve a style of administration appropriate to the problems of planned development, and to call forth positive co-operation and initiative from the public at a time when some sacrifices must inevitably be asked for as well.

836. The recommendations we make are the following:

- (i) to develop sectoral planning committees widely representative of the interests involved both inside and outside government, with core sub-committees doing detailed drafting;
- (ii) to try to build planning staffs at the district level so as to strengthen regional planning as a basis for national plans;
- (iii) to develop devices for the continuous monitoring by the Ministry of Planning and Employment of the economic decisions taken by other ministries;
- (iv) to expand and improve the quality of statistical information by strengthening and upgrading the statistical services;
- (v) to improve the speed of delivery of statistical information so that it provides early signals of difficulties;
- (vi) to expand and at the same time reorient the gathering of statistical information so as to concentrate specifically on data needed for an employment policy;
- (vii) to involve university teachers more closely in both research and planning;
- (viii) to establish an independent social and economic research institute;
- (ix) to concentrate on building administrative centres at the local level, which would be centres of technical as well as of administrative services;
- (x) to strengthen village councils by expanding their sources of revenue and their powers of autonomy;
- (xi) to enable local authorities to control civil administration at their level, with safeguards both for the career structure of administrators and for the technical support of technical officers.

AN IMMEDIATE PROGRAMME

837. We were requested in our terms of reference "to recommend measures to reduce the magnitude of the unemployment problem in the short term".

Since these were prepared, the tragic insurrection of April 1971 has given fresh urgency to this aspect.

838. Our report was prepared in the period of national self-questioning which followed the insurrection. To understand all the reasons for the uprising is difficult for a group of outsiders, but the frustrations of unemployment and underemployment obviously played a part. There was a widespread feeling in Ceylon that the emergency had marked the end of an era and underlined the need for fundamental changes in the future if the generations were ever to be reunited on a path of sustained development.

839. Yet to reduce unemployment rapidly while correcting the balance-of-payments deficit is a formidable task. The dilemmas over incomes policy outlined above are thrown into sharper relief. We indicate how full employment could be reached, while realising that the strains of implementing such a policy might be less severe only than the strains of growing unemployment.

840. Our ideas for the years immediately ahead can be regarded as a supplement to the Government's 1972-76 Plan, spelling out what a fast full employment policy implies for taxation, exchange rates, wages, etc.

What can be done to raise output and employment ?

841. The Draft Five-Year Plan sets out to increase incomes at a rate of 6 per cent a year. New jobs would be created for 725,000 persons outside the estate sector: 300,000 in agriculture, 225,000 in industry (including construction) and 200,000 in services. This would reduce unemployment.

842. In *agriculture* we believe, as the Draft Plan does, that output could rise by 5 per cent a year over the period 1970-76; but this would need much more by way of improved water control (and pricing) than has so far been set out. Even so, we do not believe that agriculture can contribute nearly enough to employment during this period without special attention being given to the increased use of labour, and particularly to a major, unconventional rural works programme. Such a programme creates not only employment as it proceeds, but also yields water, drainage and reclaimed land on which people can work later. It complements land reform, both by providing work before the new rural sector has been developed sufficiently to make adequate use of labour, and by constructing or improving bunds, tanks and wells to help the beneficiaries of the reform.

843. Labour supply is paradoxically often the main limit on the use of labour-intensive methods. The problem is one we have already mentioned several times: there may be lots of idle hands, but they are in the wrong place or are available at the wrong time or have unrealistic expectations regarding pay, conditions or status.

844. The contribution of *industry* to employment expansion in the next five years can only be moderate if the long-term objectives of growth and export promotion are not to be sacrificed. Clearly, the acute unemployment and foreign exchange situation justifies a greater emphasis on small-scale industries than on large-scale ones. But too much reliance on handlooms, for example, to attain additional output and employment targets during the Plan may make it difficult to develop textile exports—the quality of handloom products is usually uncompetitive. Credit and technical advice need to be steered to small-scale producers to enable them to become more efficient.

845. There are ways of expanding output without further burdening the balance of payments. To purchase second-hand machines would save foreign exchange (and capital). Existing capacity could be more highly utilised if import licensing policy were changed to favour raw materials and spare parts rather than capital goods. Construction could be sharply increased—imports of materials and finished products only account for 10 to 15 per cent of output.

846. But even with all these various measures, it is difficult to foresee quite as fast an expansion of industrial employment as is envisaged in the Plan—without at any rate such a concentration on handlooms as would do some damage to long-term prospects.

847. There may, however, be possibilities of expanding employment in *services* faster than the Plan envisages. In education and health, good use can be made, not merely of young people, but precisely of those types which are in biggest surplus: (a) those who live in country areas (which is where the improvement in educational and health services is most needed); (b) those with some level of secondary education; and (c) women—education and health being traditionally their areas.

848. Additional jobs should come from *self-employment*. This could and should be encouraged in other sectors too, but relatively easy entry and lower technical skill requirements of some service trades may make self-employment a simpler solution in this sector.

Organised schemes for youth

849. Can the employment targets of the Plan be fulfilled? The answer must be “yes” if a rural works scheme is set up to deal mainly with unemployment and underemployment in the countryside, and if special expansion is planned for education and health.

850. The increase in employment envisaged in the Plan, however, would still leave considerable unemployment. Moreover, it is not clear whether much of the extra employment created under the Plan would be suitable for, or even acceptable to, youth, particularly those with “O” levels and, more particularly

still, girls with "O" levels. How can employment be created specially for young people?

851. The history of youth schemes in Ceylon has not been very encouraging. The difficulties, particularly in the case of camp-based, residential schemes, are well known: heavy infrastructure costs, difficulties of finding leadership and effective teachers, and the low wages that can be afforded, which lead to a sense of being cheated. These difficulties are somewhat less in the home-based type of scheme, but the problem remains of finding work projects which are both close to the homes of the youth and also provide some sense of group accomplishment.

852. It is clearly better that youth be absorbed into regular employment. The suggestion which follows is designed partly as a response to this need, and partly to improve the chances of success for such special youth schemes as are devised.

853. The suggestion is to establish a national youth service wage scale, i.e. a scale of maximum wages graded by age and not by educational qualifications. During the first two or three years of any young person's working life he or she would be paid at the appropriate scale (say, between Rs 50 and 100 a month, depending on age). Thus, someone who started work at the age of 17 would be on this scale until the age of 19 or 20; someone who qualified as a doctor at the age of 24 would enter the scale at the bottom.

854. The same rates would apply in the private sector, but here the difference between the national service scales and normal wage scales would be paid into a special fund—used, for example, for training purposes or to help finance special youth schemes.

855. The main advantages of the scheme are—

- (i) it makes possible an expansion of employment in the government sector without an increase in the salary bill;
- (ii) it generates funds for other employment creation schemes;
- (iii) it makes possible more lasting adjustments of wage differentials along the lines discussed earlier;
- (iv) it removes a source of frustration for young persons mobilised in special work schemes and being paid less than those in regular jobs;
- (v) it fits in with our educational policy proposals; and
- (vi) it stimulates self-employment, because it corrects the present strong incentive to settle quickly into secure wage-paid employment.

Fiscal and exchange-rate policy

856. Inflationary pressure is building up dangerously. It is possible to eliminate the payments deficit, because imports of necessities like rice and fish could be largely replaced by home production, and imports of luxuries could

A programme of action for Ceylon

be cut back further. But this is hampered by the excess of purchasing power. Even if no special employment programme were necessary, the mere reduction of the payments deficit would require measures removing several hundred million rupees from the public's spending power.

857. The budget deficit at present is approaching 10 per cent of gross domestic product. A large-scale employment programme in a short period requires considerable changes in the budget. These will not be easy. To restrain the purchasing power of the employed (both to allow increases in consumption by the now jobless and to bring the balance of payments under control) and to do this without social injustices or damaging the expansion of output and employment is a major undertaking.

858. Fiscal changes should also affect prices (as well as total purchasing power) in ways that encourage exports and discourage imports, and that reorient the economy towards more labour-intensive methods of production.

859. About Rs 550 million should be drawn off the economy as soon as is feasible. And to leave something for increased welfare expenditure to safeguard the most vulnerable types of people, the total economies need to exceed this figure. How can this be done?

860. The first major measure suggested is to raise the effective rate of exchange paid for Foreign Exchange Entitlement Certificates (FEECs). These certificates should also be required for some equipment and non-essential goods which are at present imported at the official rate, and consequently subsidised. (We also discuss the possibility of a freely floating rate at a higher level.) All in all, the net revenue gain to the public sector would be of the order of Rs 200 million. Part of this, however, would be offset by the effects of something else we believe to be necessary, namely the removal of the export duty on coconuts.

861. The only other major possibility of economising that does not reduce employment is to cut food subsidies. The cost of the rice subsidy runs into over Rs 600 million. While we are well aware of the social value of this subsidy, its reduction is really the only way of financing a big rise in employment and of achieving a major reduction in imports. Besides, welfare can now best be promoted by ensuring that the subsidies reach those who really need them (see below) and by reducing unemployment. We suggest that the ration of two measures of rice should be maintained, at least for the present, but that 75 cents should be charged for the first as well as the second. This would mean savings of about Rs 470 million. We also think that local sugar and tea prices should be raised, primarily to save imports and expand exports, respectively.

862. The effect on income distribution would need to be balanced by higher taxes on the rich. Income tax could be raised, as could indirect taxes on luxuries. Investment incentives should be cut. The total yield from all these measures can be roughly estimated at Rs 700 million.

863. This fiscal programme would not only make it possible to reduce the payments deficit and unemployment; it would also ease the burden on import and exchange controls, the operation of which in any case needs rationalising.

864. Even after the adoption of this programme, fiscal pressure will need to be maintained.

Income and price policy

865. We implied above that the income policy required in the long run involves a big break with past trends. The shift needed for the immediate programme involves an even sharper break. We have seen that total consumption can only increase at best by 1.5 per cent a year up to 1985. However, if unemployment were to be reduced substantially earlier (by 1976), employment would have to increase by over 4 per cent a year. This would leave virtually nothing for increases in average consumption per worker. Moreover if those at the bottom of the income scale are to receive priority, average consumption for better-off families will have to fall.

866. The adjustments needed in the structure of wages are numerous and will be particularly difficult to carry out in a period when only modest increases in general consumption levels are possible. To achieve this, we make two proposals. The first is that those entering government service should start on a scale lower than the existing one. This would enable employment to expand faster, and also reduce the attractiveness of government jobs. The other is the establishment of new institutional machinery. We suggest an Incomes Council to lay down guidelines for wage settlements in general, and an Arbitration Court to deal with disputes and violations. All wage settlements would have to follow the guidelines laid down by the Council and be registered with it before they could take effect.

867. In the next few years the guidelines would have to be so set that those with wages and salaries above a certain level would only benefit from nominal wage and salary increases, while those toward the bottom of the scale would enjoy some (though not much) increase in real terms.

868. In addition, on grounds of equity and to help restrain inflation, there would be a case for cheap rations of some items, such as sugar, which would otherwise press heavily on the wage earner's budget.

869. The process of shifting income to the newly employed will itself do much to relieve the poverty at present attributable to unemployment. In the process, however, it will also have harsh effects on families who do not benefit from any of their members filling the new jobs, yet who have to pay more for their rice or in other ways suffer from fiscal measures and price movements. For this reason, we have set the yield of tax increases and subsidy reductions high enough to allow for spending over Rs 100 million on specific welfare schemes

A programme of action for Ceylon

(such as free milk for young children and school meals) and supplements to national assistance benefits aimed at the age groups most vulnerable to the effects of poverty.

Support from outside

870. However serious the policy failures in Ceylon, we would be less than objective if we did not emphasise the treatment that Ceylon has received at the hands of the world community. Ceylon's deteriorating export position, her receipts of foreign aid, insufficient to offset even the fall in tea prices since 1965, the high interest rates often charged, even on aid loans, are not unique for a developing country, but the consequences have been particularly serious, indeed tragic. This is the result not so much of deliberate action by other countries as of a world system of trade and aid in which the most vulnerable and often the poorest are allowed to go to the wall while the standards of living continue to rise in countries many times richer. It is not an exaggeration to say that the lives of many people in Ceylon have been frustrated by unemployment because other countries have been unwilling to pay a little more for a cup of tea.

871. Although this report concentrates primarily on the changes of policy needed in Ceylon to deal with the employment problem, we must emphasise that there may well be no possible solution without a response from the nations of the world (East, West or both) beyond that which has been accorded to Ceylon in the past.

872. The rest of the world can help Ceylon to take the difficult decisions implied in the employment programme in four specific areas, namely short-run debt, development capital, trade arrangements and technical assistance. Such help, backed by tough measures by Ceylon, could help to make her an example of how to solve the problem of chronic unemployment now afflicting many countries.

873. *Short-term credits* (including the refinancing of interest upon interest) brought Ceylon over \$100 million of costly relief in 1970. The interest on commercial and bank debts has now reached \$14 million a year. Much aid to Ceylon is now in effect not providing the means for growth and employment creation, but is paying off commercial creditors. What is needed is a funding operation under which governments would take over the debts and spread out their repayment over the years ahead.

874. Ceylon has been receiving over \$60 million a year of *capital aid*, but servicing past debts was costing \$25 million in 1970. If short-term credits are eliminated by the funding operation, we would think that a gross aid flow of rather over \$400 million (in 1970 prices) from 1972 to 1976 might suffice, provided Ceylon adopts the fiscal and income policies indicated above.

Even so, conditions are critically important too. Donors should abandon charging interest (which cannot be paid except out of more aid), agree to untie aid (so that it can be spent anywhere) and guarantee support for five years ahead.

875. As for *trade*, there are clear dangers of a new wave of protectionism elsewhere among the industrial countries, partly in response to their own (much less severe) unemployment and balance-of-payments problems. Coconuts play a key part in the land reform and the export thrust; a deal is needed with the European Economic Community on oil and dessicated coconuts. However as we indicated above, we expect tea to remain the most important of Ceylon's exports for some years to come, so that a long-term international tea agreement has become urgent. It would be a confession of international incompetence if the Second Development Decade witnessed a repetition of the price decline of the 1960s.

876. Turning to *technical assistance*, it is clear that it is only when the Ceylonese authorities have considered their over-all strategy and sectoral policies in the light of our report that specific projects can be usefully defined in detail. There are certain key areas, such as statistics, land distribution, small-scale industry, education and training, which stand out as suitable for technical assistance projects.

SUMMARY STATEMENT OF BANK LOANS
AND IDA CREDITS TO CEYLON

(As of December 31, 1971)

| | <u>Bank</u> | <u>IDA</u> | <u>Total</u> |
|--|-------------|-------------|--------------|
| Total Amount (less cancellations) | 74.1 | 19.6 | 93.7 |
| Of which has been repaid to Bank and others | 15.5 | - | 15.5 |
| Total now outstanding | <u>58.6</u> | <u>19.6</u> | <u>78.2</u> |
| Amount sold | 3.6 | | |
| Of which has been repaid | <u>0.3</u> | - | <u>0.3</u> |
| Total now held by Bank and IDA | <u>58.3</u> | <u>19.6</u> | <u>77.9</u> |
| Total disbursed | 43.6 | 4.6 | 48.2 |
| Total undisbursed | <u>30.5</u> | <u>15.0</u> | <u>45.5</u> |

Details of Bank Loans/IDA Credits

| | <u>No.</u> | <u>Date</u> | <u>Original Amounts</u> (less cancellation) | <u>Disbursed</u> | <u>Undis- bursed</u> | <u>Committed</u> |
|--------------------------|------------|-------------|--|------------------|--------------------------|------------------|
| Power I | 101 | 7/9/54 | 15.9 | 15.9 | - | - |
| Power II | 209 | 9/17/58 | 7.3 | 7.3 | - | - |
| Power III | 283 | 6/6/61 | 14.1 | 14.1 | - | - |
| DFCC I | 520 | 11/22/68 | 2.3 ^{1/} | 2.2 | 0.1 | - |
| DFCC II | 634 | 7/18/69 | 3.0 ^{2/} | 0.5 | 2.5 | 0.2 |
| Power IV | 636 | 7/28/69 | 17.0 ^{3/} | 3.5 | 13.5 | 0.4 |
| Mahaweli | 653 | 1/30/70 | <u>14.5</u> | <u>0.1</u> | <u>14.4</u> | - |
| Total Bank Loans | | | 74.1 | 43.6 | 30.5 | 0.6 |
| Lift Irrigation | 121 | 6/19/68 | 2.0 | 0.8 | 1.2 | - |
| Highways | 133 | 11/12/68 | 0.6 ^{4/} | 0.5 | 0.1 | - |
| Land Reclamation | 168 | 11/13/69 | 2.5 | 0.5 | 2.0 | - |
| Mahaweli | 174 | 1/30/70 | <u>14.5</u> | <u>2.8</u> | <u>11.7</u> | - |
| Total IDA Credits | | | 19.6 | 4.6 | 15.0 | - |

- 1/ Original amount was \$4.0 million, out of which \$1.7 million has been cancelled.
- 2/ Original amount was \$8.0 million, out of which \$5.0 million has been cancelled.
- 3/ Original amount was \$21.0 million, out of which \$4.0 million has been cancelled.
- 4/ Original amount was \$4.9 million, out of which \$4.3 million has been cancelled.

CEYLONAID GROUP ASSISTANCE

(\$ Million)

| <u>Year</u> | <u>Commitments</u> | | <u>Total</u> | <u>Disbursements</u> ^{1/} |
|-------------|----------------------|------------------------------|--------------------|------------------------------------|
| | <u>Commodity Aid</u> | <u>Project and Other Aid</u> | | <u>(Total)</u> |
| 1965 | 42.3 | 7.0 | 49.3 | 1.5 |
| 1966 | 47.3 | 1.9 | 49.2 | 25.3 |
| 1967 | 40.7 | 6.2 | 46.9 | 43.6 |
| 1968 | 50.2 | 14.7 | 64.9 | 43.6 |
| 1969 | 67.0 | 39.6 | 106.6 | 50.3 |
| 1970 | 34.5 | 69.5 | 104.0 | 51.2 |
| 1971 | 42.0 | 14.0 | 56.0 ^{2/} | 41.0 |
| | <u>324.0</u> | <u>152.9</u> ^{3/} | <u>476.9</u> | <u>256.5</u> |

Source: Ministry of Planning and Employment

^{1/} Primarily Commodity arrivals until 1970^{2/} Approximate: Based on adjusted pledges^{3/} Includes \$76.3 million of Bank loans and IDA credits of which \$20 million have been cancelled.

January 1972

OFFICE MEMORANDUM

TO: Mr. J. Baneth

DATE: January 12, 1972

FROM: Alfred S. Cleveland ^{ASC}SUBJECT: CEYLON - Short-term Foreign Bank Borrowing

At the beginning of 1971 Ceylon's position regarding short-term foreign bank loans seemed critical indeed. In December, 1970 the Government defaulted on DM 30 million outstanding on a line of credit from KFW. Payments of \$5.0 million to Manufacturer's Hanover Trust and £8.5 million to three British banks would fall due in July and December, 1971 respectively and additional repayments to Indian and Italian banks were also due during 1971.

Since then the situation has eased very considerably. Agreement was reached on payment of the KFW balance in two equal installments in March and June, 1971 and these payments were made. The £8.5 due the British banks have been rescheduled over a five-year period. The \$5.0 million balance of the Manufacturer's Hanover Trust loan has been reduced to \$4.8 million and falls due during the second half of January, 1972. Discussions are continuing regarding longer-term rescheduling.

A recent balance of payments estimated for the period of 1971 to 1976 indicates that total short-term foreign bank borrowings outstanding at the end of 1970 amounted to \$63.2 million of which \$16.1 was scheduled for payment in 1971 and the balance to be repaid in equal installments of \$9.4 over the succeeding 5 years. These estimates are net of an average interest rate of about 10%.

Repayment of bank borrowings is thus not particularly burdensome in itself but the amounts are not negligible and should be considered within the context of Ceylon's total debt service obligations. For the period 1971 to 1976 a recent estimate indicates that total capital and interest payments will amount to about 47% of export earnings in 1972 and thereafter decline to about 31% in 1976.

FOREIGN BANK BORROWINGS

| <u>Name of Bank</u> | <u>Outstandings as at June 30, 1971</u> | <u>Repayment Schedules:</u> ^{1/} |
|--|---|--|
| National & Grinlays Bank | £ 4 million | 30.6.72 - £ 705,882 |
| | | 30.6.73 - £ 705,882 |
| | | 30.6.74 - £ 705,882 |
| | | 30.6.75 - £ 941,177 |
| | | 30.6.75 - £ 941,177 |
| Chartered Bank | £ 1.5 million | 30.6.72 - £ 264,705 |
| | | 30.6.73 - £ 264,705 |
| | | 30.6.74 - £ 264,705 |
| | | 30.6.75 - £ 352,943 |
| | | 30.6.76 - £ 352,942 |
| Hongkong & Shanghai Banking Corporation | £ 3 million | 30.6.72 - £ 529,412 |
| | | 30.6.73 - £ 529,412 |
| | | 30.6.74 - £ 529,412 |
| | | 30.6.75 - £ 705,882 |
| | | 30.6.76 - £ 705,882 |
| Indian Banks | Ind.Rps. 50 million | 365 days from date of each drawing |
| Manufacturer's Hanover Trust | US\$ 5.0 million | Due on 7.16.71 Reduced to \$4.8 million in 3rd quarter 1971. Balance \$4.8 million due in 2nd half of January, 1972. |
| Italian Bank | US\$ 2.5 million | 180 days |

^{1/} Net of average interest rate of 10%

OFFICE MEMORANDUM

TO: Mr. J. Baneth

DATE: January 6, 1972

FROM: Alfred S. Cleveland ^{ASC}SUBJECT: CEYLON - Short-term Trade Credits

During the Annual Meeting in September, 1971 Dr. M.M. Perera stated that an extremely difficult problem facing Ceylon over the near future is the large amounts of short-term trade credits falling due. Mr. Cargill replied that in his view Ceylon had little choice but to seek relief through refunding. He added that if the Government thought it would be useful the Bank would be prepared at some point to provide informal assistance. Dr. Perera said this would be very helpful and it was agreed that the Government would provide the Bank with full data on the short-term credits falling due over the next 18 months.

This data was not received prior to the departure of the economic mission in mid-November and one of the initial tasks undertaken by the mission was to examine the status of this exercise. It was found that although the Ministry of Planning had requested the data from the Central Bank and the Bank in turn had requested the commercial banks to prepare detailed data for each credit, difficulties had been encountered primarily because of differences between the amounts of import licenses issued and the amounts actually utilized. Following detailed discussion of the procedures used to identify and report short-term trade credits, it was concluded that reasonably accurate data was available and would be assembled. It was further agreed that the Central Bank would tabulate the data indicating the amounts of short-term trade credits falling due over the next 18 months by creditor countries beginning with the fourth quarter in 1971.

A tabulation showing the total amounts falling due and separate tabulations for amounts due from the private sector, government corporations and the Government were provided the mission shortly before its departure from Ceylon. However, examination of this data indicated clearly that the amounts due from the Government were substantially under-stated and this in turn raised doubts about the accuracy of the estimates for private sector industries and public corporations. The responsible Government officials concurred in this assessment and agreed to review the data and revise the tabulations. Thus far the revisions have not been received.

OFFICE MEMORANDUM

TO: Files

DATE: January 12, 1972

FROM: Alfred S. Cleveland ^{ASC}SUBJECT: CEYLON - Compensatory Financing and other Fund Drawings

The Fund has advised that Ceylon has been invited to apply for compensatory financing in an amount equivalent to US\$16.1. If the government responds promptly the matter will go before the Fund's Board on Friday, January 14. The amount of compensatory financing for which a country is eligible has been determined in the past by a fixed formula expressed in US dollars. With devaluation of the U.S. dollar an interim procedure has had to be developed and if objection to the staff recommendation for Ceylon occurs during the Board's consideration of the matter it will probably center about the nature and use of the interim procedure.

In addition Ceylon is eligible for a third drawing of \$5.5 million in January, under the standby of March 1971 and a final drawing of \$5 million in February. Also, Ceylon was allocated \$10.4 million of SDR's on January 1, 1972. However, because Ceylon utilized all of the SDR's allocated in 1970 and 1971 and is, therefore, far from meeting the requirement that on average 30% of total SDR allocations outstanding must be held in reserve, it is unlikely that any of the 1972 allocation will be utilized unless an emergency situation arises.

It may also be noted that although Ceylon's short-term debt outstanding in September, 1971 was well in excess of the Fund's ceiling of \$66 million, heavy repayments in October and November reduced the amount outstanding to \$43.7 million by the end of November.

The principal implications of the foregoing are that Ceylon's short-term trade credit problem, which in September the government believed would require some form of refunding, has now eased considerably; and further, that because of this and with the prospect of compensatory financing, Ceylon's credit position regarding continued financing of imports on trade credit may have substantially improved. At best, however, this would be a short-term palliative and the price would be high. The cost of imports financed in this way runs 15-20% higher than spot purchases.

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OFFICE MEMORANDUM

TO: Files

DATE: January 12, 1972

FROM: Alfred S. Cleveland ^{ASC}SUBJECT: CEYLON AID GROUP

The Ceylon Aid Group was formed to provide coordinated assistance in overcoming the severe economic problems faced by the country following the crisis of 1965. Examination of the situation indicated that restructuring of the economy was required but that the balance of payments had deteriorated to such an extent that sizeable external assistance would be necessary. The Bank had begun discussions in the last months of Mrs. Bandaranaike's first government on how this assistance might be mobilized. This led to creation of the Ceylon Aid Group - primarily consisting of Australia, Canada, France, Germany, Japan, the United Kingdom and the United States with representatives from IMF, Asian Development Bank, UNDP and observers from Denmark, India, Italy, Sweden and OECD.

The Group has met every year since the first meeting in July, 1965 under the chairmanship of the Bank. In one sense the group is unique, being neither a consultative group nor a consortium. The question of the Group's status has been discussed with the principal members from time-to-time who have concluded that the present structure suits the Ceylon situation very well and that the Group has functioned both efficiently and effectively so far.

The development strategy that prevailed throughout the last half of the 1970's and which was worked out in consultation with the Bank and concurred in by the Aid Group, together with the record of success and failures, is described in the Country Program Paper included with this briefing material. In general the group was satisfied with the progress made and the amount of new aid commitments therefore increased steadily over this period.

At the meeting in April, 1971 however, the group expressed its disappointment at the failure of the new government during its first year in office to face up to its extremely difficult problems and to undertake the urgently required reorientation of economic policies. The group concluded that although continuation of aid was probably not warranted on grounds of economic performance, it would not be politically desirable to discontinue assistance. Nevertheless, the indications of additional aid were disappointing amounting to about \$65 million as compared to nearly \$100 million in 1970. This was largely due to abstention by Germany for political reasons and the position taken by both the United Kingdom and France that their pipelines of aid to Ceylon were adequate for the time being. The group made it clear, however, that assistance in subsequent years would depend upon establishment of an economic framework within which aid could be given effectively.

Between its inception in 1965 and the end of 1971 total commitments by the group have amounted to about \$477 million of which about \$256 million have been disbursed. Nearly 70% of commitments have been in the form of

relatively quick-disbursing commodity aid and a much higher percentage of disbursements have been in this form. The largest donor has been the United States followed by the U.K., Germany, France and Canada. From 1965 to the present total Bank/IDA lending to Ceylon has amounted to \$76.3 million of which \$20 million has been cancelled, largely by the present government. In recent years AID Group assistance has financed about 20% of Ceylon's imports. If the group's support were to be discontinued or substantially decreased and not replaced from other sources, Ceylon's import capacity would decline drastically. Should this happen, and even with best of intentions, it is unlikely that the Government would be able to cope with its present difficulties.