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SUPPLEMENT
TO THE
FEDERATED MALAY STATES
GOVERNMENT GAZETTE

OF FRIDAY, THE 25TH OF AUGUST, 1922.
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SATURDAY, 26TH AUGUST, 1922.

The following Notification is, by direction of the Chief Secretary to Government, published for general information.

C. W. H. COCHRANE,
Acting Under Secretary, F.M.S.

No. 5327.—For general information, the Government publishes a despatch from the Right Honourable the Secretary of State for the Colonies, dated the 8th February, 1922, upon the subject of the financial position of the Federated Malay States, and a copy of the reply, dated the 21st April, 1922, of His Excellency the High Commissioner for the Malay States:

F.M.S.

DOWNING STREET,
8th February, 1922.

No. 60.

SIR,—I have the honour to transmit to you the accompanying copy of a letter from the Association of British Malaya regarding the present financial situation in Malaya and especially in the Federated Malay States, together with a copy of the reply which I have caused to be returned to the Association.

2. I shall be glad if you will furnish me at an early date with a full expression of your views on the subject, and with the statistics requested by the Association in paragraph 9 of their letter.

I have, etc.,
(Sd.) WINSTON S. CHURCHILL.

HIGH COMMISSIONER

SIR L. N. GUILLEMARD, K.C.B.,
&c., &c., &c.

THE ASSOCIATION OF BRITISH MALAYA,
359, MANSION HOUSE CHAMBERS,
11, QUEEN VICTORIA STREET,
LONDON, E.C. 4,
28th January, 1922.

SIR,—The Committee of this Association have recently had an opportunity of reading the addresses made by the Governor of the Straits Settlements, and the Chief Secretary in the Federated Malay States, on the presentation to the local Councils of the respective Budgets for the Colony and the Malay States for the year 1922.

2. These statements have been read with grave anxiety, because they show not only an ever increasing extravagance in public expenditure but also a new departure in policy which has involved both the Colony and the Federated Malay States in enormous losses.

3. For the moment the Committee propose to deal with the case of the Federated Malay States, because the Straits Settlements form a Crown Colony administered, like others, on well-recognised lines, under the direct authority of the Secretary of State for the Colonies. There is a Legislative Council with a number of unofficial members, a large European population and an able Press well qualified to criticise all subjects of public interest.

4. In the Malay States, Federated or otherwise, the case is quite different. Forty-five years ago certain of these States, either asked for or were persuaded to accept British advice; and in 1896, after about 20 years' experience of the value of that advice, the Rulers of four States were, after the proposal had been fully explained to them, induced to join in one Federation and entered into a treaty engagement with the protecting Power by which, while their own status was confirmed, they agreed to accept a Resident-General who would not only tender advice but control the administration of affairs, subject to the authority of the Governor of the Straits Settlements as High Commissioner. Since then there have been further changes. Since the inauguration of Federation on principles accepted by the then Rulers and on an understanding that the Resident-General would always have a knowledge of Malay affairs and speak Malay the Resident-General has been replaced by a Chief Secretary and there is now a Federal Council, of which the High Commissioner appears to be President, with various ex-officio European members and a number of unofficial members mostly European. The Malay Rulers of the four Federated States are also members and form a minority of this Council whose proceedings are conducted mainly in English.

The Committee have no knowledge that the status of the Malay Rulers has ever been changed since they first accepted British Advisers in 1874 and subsequent years, but it is evident that the authority and influence of the Rulers have waned, and it is not unusual to read an annual report by a high British official in the States in which there is no reference to any Malay Ruler.

5. The Committee do not know how the Secretary of State for the Colonies regards the Malay States, or to what extent his authority is exercised to control the High Commissioner and through him the proceedings of the Chief Secretary and the Residents. In criticising the actions of those responsible for recent events, it is assumed that the High Commissioner and the Chief Secretary are responsible for the policy of taxation in the Federated States and especially for the expenditure of public funds. Should this assumption be ill-founded the Committee beg that they may be put right and that they may be informed who is now responsible for the general administration of Government in the Federated Malay States, and especially what is the position of the Malay Rulers in this connection. As an instance in point it is noticed that the Chief Secretary on the 3rd November, 1921, told the Federal Council that they had before them a Bill to enable him to borrow from the Government of the Straits Settlements a sum not exceeding \$15,000,000.

6. On the same occasion, 3rd November, 1921, the Chief Secretary explained the financial difficulties in which the Federated Malay States found themselves involved and the main causes which had brought about a position where the States had not the means to meet their liabilities and must borrow a very large sum of money. After stating that in May, 1920, the Federated Malay States had to borrow from the Government of the Straits Settlements \$15,000,000 (£1,750,000) to redeem a loan raised in 1916 "for the purpose of lending money to the Imperial Government," he informed the Council that it was intended, with the help of the Straits Settlements, to raise a loan of ten millions sterling to adjust accounts which had become complicated by reason of losses on the purchase of rice and "investments" in tin. As regards the former the Governor told his Legislative Council that the loss amounted to £5,600,000 of which the Federated Malay States were to pay half and, according to His Excellency, the loss was partly due to the fact that a great sum of money had been provided to purchase rice in Saigon and, when the money was not wanted there and had to be withdrawn, there was an alarming loss in exchange. As to the tin investment, it appears that the Government of the Federated Malay States undertook, for a time, to buy any tin offered at certain fixed prices; because, according to the Chief Secretary, the price had fallen from \$212 to \$90 a picul, that is, roughly, from £419 to £190 per ton. According to the best information obtainable the Government began its purchases on 7th December, 1920, at the equivalent of £220 per ton c.i.f. London, raised the price on 20th December, to the equivalent of £230 per ton; reduced the price on 14th February, 1921, to the equivalent of £200 per ton and ceased its operations on 25th February, 1921. The total loss sustained is not mentioned and cannot be stated because the Government appear to be still holding the tin for a rise. This is the new policy to which criticism is directed. When the price of tin reached £419 a ton, it was the highest on record, and when it fell to £190 per ton that was nothing extraordinary. I attach a return of the average annual price of tin for the last 44 years and the Committee ask the special attention of Mr. Secretary Churchill to these figures. The average price for a year has been as low as £61 odd, per ton, and in the 28 years, 1878-1905, the average of any year was never as high as £190 and yet the Federated Malay States in that time made amazing progress, paid the costs of administration including the construction of all railways and other works, and amassed a large reserve. The Chief Secretary told the Council that the policy of Government entering the market as a purchaser of tin was to prevent unemployment of miners on a large scale and the dislocation of works throughout the country. The statements are difficult to reconcile, because unemployment at the mines would usually mean more labour available for works. The real question is whether it is the business of the Government to attempt by these means to bolster up an industry that is going through a phase of temporary depression. Any one who knows the modern history of the Malay States is aware that in the first 28 years of British advice—and even since then—the price of tin has gone up and down periodically, and the Government never found it necessary to step in and purchase tin even when the price was as low as £61 a ton. It was always realised that when the low price drove Cornwall, Bolivia and other producers out of the market, Malay miners could still produce at a small profit, and when production was restricted the price would rise again. The Federated Malay States have entered into a speculation which has locked up such a large sum that the administration is embarrassed, and the Government will be very fortunate if they can get out with even a moderate loss. The Committee ask who is responsible for this new departure and whether the officials concerned are still employed.

7. The Committee have not been able to procure any details as to the rice purchase, for the loss on which the Federated Malay States seem to be liable for nearly £3,000,000, but it is fair to ask whether that loss, or at any rate a large part of it, might not have been avoided by the exercise of more foresight. As to the \$15,000,000 which the Chief Secretary was to borrow to redeem a loan raised for the purpose of lending an equivalent sum to the Imperial Government, the Committee would be glad to know whether that is a correct statement of the facts and if so when it is proposed to repay the amount to the Federated Malay States.

8. The Chief Secretary informed the Federal Council that if the Government assets were calculated on the least favourable basis they would still exceed the liabilities by \$10,128,260 or, say, about £1,180,000. In 1918 the revenue of the Federated Malay States was given as about £8,000,000 and the surplus assets as £12,500,000; yet, after three years of peace, the assets have been reduced by over £10,000,000 though the country has enjoyed what is an enormous income for a group of States which, 45 years ago, began their new life with heavy debts and a revenue under £100,000. It would be interesting to learn what has become of this £10,000,000. Railway construction is probably the largest single item of expenditure and the Committee notice, from the last report of the General Manager of Federated Malay States Railways, that they now give a return of $\frac{1}{2}$ per cent. on the capital invested, with no allowance for depreciation. The first railway constructed in Selangor gave a high return on the cost, and as the present position shows that, if reasonable allowance were made for depreciation, the Malay railways would now be working at a loss, it seems possible that some portions of the system were constructed before there was any real need for them. It is not suggested that Government railways should only be constructed where they will give a return on the capital expended, but it is urged that when, as is now the case in the Federated Malay States, the open lines give no return extensions should not be undertaken unless there is a very strong reason to justify the outlay.

9. For 30 years or more the administration of the Federated Malay States was conducted on the principle that the annual expenditure should come within the annual revenue, and while, in 1905, that revenue was still less than £2,500,000 great works had been constructed and paid for and there was a large surplus balance. Now that the revenue has reached £8,000,000 and most of the necessities of good and progressive government have been provided, the administration finds itself in financial difficulties and my Committee urge that the cause is great and needless extravagance. The Committee have not the means to make what would be an instructive comparison of the yearly growth of public departments, the numbers and salaries of the personnel and their allowances throughout the last 25 years, but they would be greatly obliged if you would supply them with those figures and also with a similar return of the sums paid to the Malay Rulers throughout the same period.

10. The Committee of this Association wish it to be understood that they do not write merely to criticise mistakes, some at least of which are now admitted. If that were the object it is obvious that they would not address the Colonial Office. All the members of the Committee have personal knowledge of the Straits and Malay States: some of them had a share in directing the policy of the past and in persuading the Malay Rulers to accept a system

which is no longer observed. They claim also a rather special acquaintance with Malay mentality and the history of British relations with the Malays. They are anxious that this letter should be laid before the Secretary of State because the facts prove that, in recent years, there has been extravagance and the old principles, on which the prosperity of the Federated Malay States was built up, have been abandoned. The idea of teaching the Malay Rulers and their people to develop their rich lands on safe principles of finance, for the advantage of the people of the country, seems to have given place to schemes which, in a short time, have led to the dissipation of a great accumulated reserve and the borrowing of millions to enable the Federation to meet its commitments. It is extremely unlikely that the Malay Rulers have been consulted in all these later developments, as was invariably done for many years after the Colonial Office warned the Governor that His Majesty's Government defined the functions of a Resident to be "the giving of influential and responsible advice to the Ruler".

11. There is unrest in India and trouble in Egypt, where British control has conferred such great benefits on the people of the country. Even in Ceylon, there is a growing agitation for something more nearly approaching self-government. The Malays are more primitive than the natives of these countries, but they are Muhammedans. If they feel they have a grievance they are very slow to express it to any but their closest friends. In many cases they opposed the advent of British interference in their affairs; but, after years of experience, frankly changed their minds and expressed their deep satisfaction. That was when they were consulted in all that was done, shared the responsibility for plans of development, and the credit which followed success. Their loyalty to a new regime which deprived Rulers and Chiefs of much personal power has been remarkable. It would be a profound misfortune, if, by failing to carry the people of the country with them in all the schemes for further administrative development, the British officials, however unwittingly, induced in the Malays a feeling that they were neglected, and their interests put aside for other considerations which they might not understand because no one had troubled to explain them. That the Government should pass in three years, from possessing a surplus of £12,000,000 to the necessity for borrowing £10,000,000 would occasion comment, even in Malaya, unless a satisfactory explanation had been supplied to those who not only had a right to ask for it but to whom it was for every reason expedient to give it.

12. The Committee invite the attention of the Secretary of State to these considerations and to the fact that the annual revenue of the Federated Malay States has grown from about £166,000 in 1880, £837,000 in 1890, £1,593,000 in 1900 to £3,097,000 in 1910. From 1910 onwards the revenues of the Federated Malay States were largely increased by premia and rents received from land leased for the cultivation of rubber and by duties on the produce of a great agricultural industry founded mainly on British capital, something like £90,000,000 having been invested in rubber plantations. By 1918 the revenue had risen to nearly £8,000,000 and was but little less in 1919, that is a rate of progress which probably has no parallel in any British Possession or Protectorate. The revenue is raised from a population estimated to number about 1,250,000 in all, and it means an annual contribution of £6 per head. Figures just published state that, with all the burdens imposed by the late war, the rate of taxation in France is £11 per head and in Germany only £3 per head. The Committee believe that the revenue of the Federated Malay States is larger than that of any British Crown Colony or Dependency and that the rate of taxation per head is much higher in the Federated Malay States than in any of those countries. They urge that the funds available in the Federated Malay States are more than ample to meet all legitimate costs of administration and that those responsible should be instructed to revert to the previous practice of keeping the annual expenditure within the annual revenue. Whilst taxation is at the rate of £6 per head—or anything approaching that figure—there can be no justification for extravagance and the imposition of new taxation to meet it. The Colonial Secretary of the Straits Settlements, when introducing the Budget for 1922, informed the Council that the Estimates provided for an increase of \$1,679,227 in personal emoluments only and it is probable that, if the figures were available, a similar increase would be found in the provision for salaries and allowances of Government officers in the service of the Federated Malay States. When however the Chief British Official tells the Federal Council that the assets have been reduced, quite recently, by something approaching £10,000,000, and that another £10,000,000 is to be borrowed to adjust accounts and carry out a programme of works to which the Government is practically committed, the Committee feel that they must approach the Secretary of State to invite his attention to the facts and ask for an assurance that will allay the anxiety of members of an Association deeply interested in all that concerns the welfare of British Malaya.

I have, etc.,

(Sd.) F. K. MURRAY-JOHNSON,
Secretary.

THE UNDER SECRETARY OF STATE FOR THE COLONIES,
COLONIAL OFFICE,
DOWNING STREET, S.W.1.

The following are the average prices of cash tin from 1878 to 1920 inclusive:

	£	s.	d.
1878	61	19	2
1879	70	15	0
1880	87	7	6
1881	91	17	11
1882	102	8	9
1883	93	5	0
1884	81	0	0
1885	86	12	6
1886	97	6	6
1887	111	15	0
1888	117	10	0
1889	93	0	9
1890	94	3	6
1891	91	3	0
1892	93	6	8
1893	85	7	7
1894	68	14	2
1895	63	7	1
1896	59	9	11
1897	61	8	0

	£	s.	d.
1898	71	4	1
1899	112	8	7
1900	133	11	6
1901	118	12	8
1902	120	14	5
1903	127	6	5
1904	126	14	8
1905	143	1	8
1906	180	12	11
1907	172	12	9
1908	133	2	6
1909	134	15	6
1910	155	6	2
1911	192	7	0
1912	209	8	5
1913	201	13	7
1914	151	2	9
1915	164	4	0
1916	182	3	5
1917	237	13	1
1918	329	11	2
1919	257	9	8
1920	296	1	7

(Intld.) F. K. M. J.

4796/22.

DOWNING STREET,
8th February, 1922.

SIR,—I am directed by Mr. Secretary Churchill to acknowledge the receipt of your letter of the 28th of January regarding the present financial situation in Malaya and especially in the Federated Malay States.

2. The information which is already at Mr. Churchill's disposal would enable him to deal with a great part of the representations contained in your letter, but he considers it undesirable to do so, without first obtaining the observations of the High Commissioner thereon. A copy of your letter is accordingly being sent to Sir L. Guillemard for a full expression of his views, and he is being requested to supply the statistics referred to at the end of paragraph 9 of your letter.

3. On receipt of the High Commissioner's reply Mr. Churchill will cause an answer to be returned to your Association.

I am, etc.,

(Sd.) G. GRINDLE.

THE SECRETARY,
ASSOCIATION OF BRITISH MALAYA.FEDERATED MALAY STATES,
No. 153.GOVERNMENT HOUSE, SINGAPORE,
April 21st, 1922.

SIR,—I have the honour to acknowledge the receipt of your despatch of 8th February, 1922, asking for my observations on a letter which you have received from the Association of British Malaya regarding the financial position of the Federated Malay States.

2. You are fully aware from previous correspondence of the critical position in which the finances of the Federated Malay States now stand. I have devoted much time to looking into the causes of the crisis and I welcome the opportunity you have given me of placing before the Association, whose interest in all that affects Malaya is well known, a full and frank statement of a position with regard to which they, in common with many less well-informed than themselves, are in some respects incorrectly or imperfectly informed.

3. My observations, which I shall develop in detail, may be summarised as follows:

I admit the unfortunate state of the Federated Malay States finances to-day, and I attribute it to two causes—

- Primarily to the fact that finance in the years 1912-1919 was not conducted on sound lines. The evil effects of this were increased by a system of Treasury control inadequate in itself and in addition inefficiently exercised
- In a secondary degree to expenditure sanctioned since February, 1920, when I assumed office as High Commissioner, which was either (1) unavoidable or (2) sanctioned by me at a time when, relying on incorrect information as to the financial position given to me by my responsible advisers, I was justified in believing that the necessary funds were available.

Since the true state of the finances has become known to me I have endeavoured to improve the position in the following ways—

- By drastic reduction of expenditure including curtailment to the lowest possible level of works of development.
- By raising money on loan and transferring to loan account the cost of all works properly so chargeable.
- By overhauling the Treasury system.

4. The recent period of world-wide depression of trade has hit Malaya very hard and the effects on the financial position of the Federated Malay States have been disastrous, but, as I hold that the unforeseen misfortunes of the immediate past are not the fundamental cause of our present financial difficulties, I think it will make for clearness if I start with a short sketch of the recent financial history of the Federated Malay States.

5. The primary cause of the present position is, in my opinion, that the Government has in the past overloaded the revenue with heavy expenditure on capital account, much of it on works done under contracts continuing over a period of years.

6. The normal procedure with regard to national finance is that the annual revenue should bear annual working expenses and that capital works, which will ultimately prove directly remunerative, should be paid for out of loans with adequate sinking funds charged on the revenue. Most countries have no alternative but to follow this normal procedure.

7. Every rule, of course, has its exceptions, and in times of abounding revenue it is legitimate to do a certain amount of capital work out of revenue. It may be even legitimate to continue doing this over a series of years provided the works can be quickly carried out, and do not involve the mortgaging of the problematical revenue of future years. It is always dangerous to charge to revenue any capital work continuing over a series of years especially when it is carried out under contract, and if this is done to any extent the danger is progressively increased.

8. In the light of these remarks, which are truisms, I wish to call your attention to the sums which have in the Federated Malay States in the period 1912-1919 been charged in respect of capital works either on annual revenue or on balances which consist of accumulated surplus revenue.

9. In the first place, there was spent on capital works in connection with railways (excluding Johore Causeway and Prai Docks to which I shall come later) over \$62,000,000. I have no reason to doubt that the extensions of the railway system financed with this money were in themselves desirable, that they will ultimately prove remunerative, and that they were efficiently carried out by the capable General Manager of the Railway System, Mr. Anthony, and if this expenditure stood alone, I do not think that, in the circumstances, any exception need be taken to charging it to revenue. But it was only a part of the whole amount so charged.

10. In addition to the normal programme of railway development, a number of special burdens, some of them involving continuous payments over a series of years, were also laid upon the revenue. They are as follows:

1. Loan to Siam—Agreed to in 1910-1911. The question was raised at the time whether the financial position justified the loan being left permanently to be met out of surplus balances and revenue, and Sir John Anderson recognised that it might be advisable to make the position safer by raising a loan for railway construction, but a loan was not raised. Payments on account of the loan are still being made to Siam	\$40,714,000
2. Planters' Loans Fund, Enactment No. 27 of 1915	4,000,000
3. Purchase of Singapore Railway paid for in January, 1913, by transfer of securities valued at \$1,864,571 and a cash payment of \$2,271,428	4,136,000
4. 1916—Prai Dock—Purchased by the Federated Malay States Government	634,000
5. 1917—Johore Causeway—Sanctioned 28th March, 1917. Estimated cost \$15,000,000, of which the Federated Malay States' share is \$10,402,000, payable over a series of years up to 1924	10,402,000
6. 1919—Prai Wharves Extension—Approved 16th June, 1919. Original estimated cost, payable over a series of years up to 1924, \$17 millions, subsequently increased by agreement with the contractors in view of increased cost of materials and labour to	20,000,000
	\$79,886,000

11. The total of these calls on the revenue and surplus balances amounts to very little short of \$80 millions, of which \$37½ millions had been met by the end of 1919, leaving \$42½ millions to be provided in 1920 and subsequent years.

12. In addition to the expenditure already mentioned in the period under review the Government also contributed large sums on patriotic grounds to the Imperial Government. In 1912 H.M.S. "Malaya" was given, the cost of which, over a series of years, is \$24,000,000. In 1916 Special War Taxes were imposed and yielded in the years 1917, 1918 and 1919 a total of \$16½ millions, which was given to the Imperial Government for purposes connected with the war. The sums so given amount to \$40,250,000.

13. Lastly, in the year 1916, the Federated Malay States raised a 6 per cent. loan of \$15 millions, which was not lent to the Imperial Government, but absolutely placed at its disposal. This is made clear in the official report of the speech of the Chief Secretary to which reference is made in paragraph 6 of the Association's letter. No proper provision for sinking fund was made in connection with this loan, which remained therefore as a charge against revenue and balances. It was repayable in 1921 and the intention was to find the redemption money by the sale of securities forming part of the balances, but, as all the securities were required in 1921 to cover the commitments of the Federated Malay States Government in London, the intention did not materialise, and the 1916 Loan had practically to be repaid out of the 1921 Loan carrying 7 per cent. interest.

14. When all these amounts, other than the 1916 Loan, charged on or to be met out of revenue and surplus balances, are added together they total out as follows:

Ordinary Railway Development	\$ 62,000,000
Special Capital Expenditure	35,172,000
Loan to Siam and to Planters' Loans Board	44,714,000
Gifts made to Home Government	40,250,000
	\$182,136,000

That figure is 43 per cent. of the total revenue collected in the period 1912-1919.

15. The position towards the close of my predecessor's tenure of office was stated by him at the last meeting of Federal Council, at which he was present on the 30th April, 1919, as follows:

"I am glad that Mr. Clodd recognises that our policy during the war of economising in order to help the Home Country was the right policy, and I can assure him that the bold policy he refers to will be carried out by these States. I think I may say that my successor will have a large surplus, and I certainly hope that from

that surplus our requirements for public works and railways can be met. I do not say that they will be fully met, for even with that large surplus (if we proceed with railways as fast as we wish to, and provided we can get the material and the men) I do not believe that, even with that large surplus, we shall not have to obtain a loan. I do not say that we shall have to do that now, but in a few years' time it may be that we shall have to ask for a loan.

The Estimates for the year 1920 were prepared in accordance with this declaration of policy.

16. Early in February, 1920, on the second day after my arrival in this country, I noticed that the Federated Malay States Estimates for 1920 budgetted for a deficit of \$34 millions, and I asked whether this was satisfactory. I gathered that the position was considered quite safe owing to the fact that we possessed adequate balances, which were stated as being over \$100 millions.

A full statement showing the financial position should, of course, have been waiting for me on my arrival in the country. In the absence of such a statement I had naturally at that time no knowledge as to the value of these balances regarded as available cash, or of the liabilities actual or probable which the Government would have to meet, but I asked the then Chief Secretary to consider whether in his opinion the time had not come for relieving the revenue of the cost of capital works and floating a loan. His view was that a loan might be desirable soon, but that there was no urgency in the matter. A short time afterwards, on March 14th, 1920, I wrote to him directing his attention to the continuing loss on the sale of rice as affecting our balances. He promised to look into the whole question and report to me, but he did not supply me with the detailed statement necessary to clear up the financial position.

17. On June 13th, on the actual eve of his departure, he sent me a minute in which he stated that he was "entirely in favour of the Federated Malay States raising a general purposes loan when a favourable opportunity offers." He gave no hint that there was any urgency in the matter, or that he had any doubt as to the availability of sufficient balances on which we could rely until the "favourable opportunity" occurred.

18. It was not till some time later that I found reason to question the accuracy of the information supplied to me, and it was not until after the Government had locked up a considerable portion of its available cash in the purchase of tin, and the Treasury had at length realised how heavy the loss on rice would prove, that a close analysis of our resources and of the burdens to be met from those resources disclosed the true position.

19. It was then discovered that the financial position on my arrival in February, 1920, was really as follows:

The surplus assets on 31st December, 1919, were shown in the official accounts (see <i>Federated Malay States Government Gazette</i> , 7th May, 1920) as amounting to	\$110 millions
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But this figure did not represent the available cash surplus. On the credit side of the account, investments were shown, as is customary in Government accounts, at their cost price with no allowance for depreciation, and loans and advances, being governed by definite schemes of repayment, could not be regarded as cash. I was advised that, after adjusting the account in the light of these considerations, the 110 million dollars really represented a realisable cash value of about	\$54½ millions*
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The debit side of the account did not fully show outstanding liabilities. There had to be paid in cash in 1920 (which could not be shown in the Estimates) on account of the Loan to Siam £300,000 equal to over	\$2½ millions
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Leaving	\$52 millions
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The Estimates for 1920, which included under railway expenditure (in addition to over \$14 millions on revenue account) \$31½ millions on capital account, including Prai Wharves and Johore Causeway, resulted in an estimated deficit, to be met out of balances, of...	\$34 millions
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So that by the end of 1920, on the assumption that revenue would not fall off or expenditure increase, the available surplus would be down to	\$18 millions
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20. Against this surplus of 18 million dollars there were further liabilities ahead as follows:

(a) Loss on the sale of rice to be paid to the Straits Settlements Government. That there would be a large loss was known in February, 1920, and I had called special attention to it by a minute dated March 14th. In the event it came to about 19 million dollars by the end of 1920, and by the end of May, 1921, when rice was decontrolled, to \$21 millions	\$21 millions
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(b) Known commitments to be charged to or found from revenue or surplus balances in 1921:	
Loan to Siam	\$ 6,428,000
Prai Dock	5,703,770
Johore Causeway...	1,677,659
	\$13,809,429
	\$14 millions

(c) Known commitments to be charged to or found from revenue or surplus balances in 1922 and after:	
Loan to Siam	\$ 4,885,000
Prai Dock	7,500,000
Johore Causeway	6,700,000
	\$19,085,000
	\$19 millions

21. It ought to have been clear as far back as February, 1920, to anyone knowing the facts that the deficit of \$34 millions on the 1920 Estimates was definitely risky, that the time was more than ripe for a loan, and that till a loan was floated expenditure should be rigidly kept down.
22. On 1st July, 1920, I received a minute from the Treasury to the effect that it was not considered that a loan at that time was justifiable or likely to be successful, and that it was hard to see why the Federated Malay States should borrow at a high rate of interest with actual revenue exceeding actual expenditure and with large surplus funds. It was added that the Federated Malay States War Loan redeemable in May, 1921, could be repaid without difficulty and possibly even without selling the ear-marked investment.
23. The facts were as follows:
- (1) In the years 1916, 1917 and 1918 the revenue exceeded the expenditure because during the war the Government had been unable to spend its money even on necessary works and services. In 1919 expenditure practically caught up revenue (\$70,677,000 compared with \$72,100,000) and the 1920 Estimates budgetted for an excess of expenditure over revenue of \$34 millions.
 - (2) As regards "large surplus funds", the balances though large on paper, would scarcely provide sufficient cash to finance the known commitments and liabilities of 1920 alone, to say nothing of the known commitments of 1921.
24. If the true facts had been brought to my notice even as late as 1st July, 1920, much expenditure that was incurred in 1920 could have been avoided, and the estimate of expenditure for 1921 largely reduced, though it must be remembered that the railway construction programme of the immediate future could not have been largely curtailed.
25. I would direct your special attention to the foregoing analysis of the balances for it contains the key to the whole situation.
26. In the event, the actual revenue for 1920 exceeded the estimate, and the working deficit on the year was only 28 millions instead of 34, a saving of 6 millions, but this saving was more than swamped by the loss on rice, so that by 1921 the available surplus had practically disappeared.
27. The important fact to note is that the analysis is based on information available early in 1920. It leaves out of account altogether the unforeseen troubles that fell upon us later, viz., the unexpected expenditure on tin at the end of 1920 and beginning of 1921, and the failure of revenue in 1921. The analysis therefore shows clearly that, quite apart from these unforeseen troubles, the available balances were not more than adequate to meet the liabilities of the year 1920, as known early in 1920, to say nothing of 1921. This should, of course, have been reported to me spontaneously early in 1920 by the responsible authorities on whose advice I had perforce to depend, and who were in a position to know the facts.
28. In other words the policy of the Government in the period 1912-1919 had resulted in laying on the revenue a burden greater than it could bear, and it found itself at the beginning of 1921 with a failing revenue, with no available balances to fall back upon, and committed to heavy capital expenditure on uncompleted works. A heavy deficit on the 1921 budget was inevitable. The deficit was largely increased by the unforeseen troubles which fell upon us, but it was primarily due to the policy of the past in connection with capital expenditure. I may mention that over 26 million dollars of the estimated deficit for 1921 was due to railway capital expenditure alone.
29. To sum up, the primary cause of the present financial position is that, relying on balances which, though large on paper, represented comparatively little available cash, the Government in the years 1912-1919 laid upon the revenue the following burdens: A large programme of normal railway development, in addition to special important works involving heavy expenditure over a series of years, and concurrently with large loans and liberal gifts to the Imperial Government.
30. I do not wish it to be understood that I am condemning outright the policy of spending surplus revenue on capital works. The Federated Malay States are justifiably proud of the fact that they have built railways at a capital cost of \$160,000,000 out of their past savings, but, in the light of the present financial situation, it is difficult to avoid regret that the policy was carried so far as to use up all the savings, and leave nothing available for a rainy day. It was perfectly legitimate for the Government to do a certain amount of capital work out of revenue and to continue doing this over a series of years. But the danger point was reached when the programme adopted involved the mortgaging of future revenues.
31. I should further like to make it clear that I do not imply that the expenditure was on wrong objects, but it was patently too great for this country to incur, and in this respect I would mention particularly the Prai Wharves and Johore Causeway. Quite apart from the question whether these undertakings will prove remunerative, or whether the time was ripe for their construction, I am clear that the circumstances did not justify the charging of the cost to revenue.
32. Speaking generally, I feel that in the years I have passed in review the prosperity of the country was so great, its revenue so abundant and its future so encouraging that a great part of this heavy expenditure could have been undertaken without landing the Government in trouble.
33. So far as I can form an opinion it ought to have been possible, following sound financial principles, by which I mean a cautious policy as to loans and gifts to the Imperial Government, and the restriction within reasonable limits of capital works charged to revenue, to carry out an adequate programme of development (though not so extensive as that actually carried out) and not only to have kept available enough money to redeem the 1916 Loan and to meet unexpected expenditure like the unavoidable loss on rice, but also to have possessed reserves to meet a possible failure of revenue and to assist in tiding over lean years.
34. Having dealt with the position which I inherited, I pass to the expenditure incurred since I took office. That expenditure, as I said in paragraph 3 above, is of two kinds:
- Under the head of unavoidable expenditure, I put the loss on rice. It was clear as early as the end of 1919 that a heavy loss to the Federated Malay States was involved. But in any case, the people of Malaya had to be fed, and the consequent loss faced. A high price had to be paid for the rice. What else could be expected when it was known that the Government must have the rice, and when it had to purchase either from India, which avowedly regarded us as "foreigners", or from foreign countries, where the market was controlled by a powerful ring. As to the price at which we sold, we only maintained it in the teeth of strong pressure for reduction from the public and the Press.

35. I now turn to expenditure, sanctioned by me, which cannot be regarded as unavoidable.

It must be remembered that at the time I assumed office, the general impression was that the Federated Malay States Government was in a very flourishing financial position and that this impression was confirmed by my responsible advisers.

I was called upon on all sides to embark on projects the need for which was universally admitted, but which had been hung up by the war.

36. In reply to this general appeal, which coincided with my own desires and my own judgment, the following action was taken:

- (a) Expenditure was authorised on hospital accommodation, on bringing up to strength the depleted staffs of medical and sanitary officers and nurses, on the execution of sanitary works, and on medical research;
- (b) Expenditure was sanctioned on the starting of new public works, some already approved and long overdue, and the upkeep of existing works, with the necessary additions to a staff depleted during the war;
- (c) Various new schemes for the development of the country on remunerative lines were under discussion, e.g., schemes of drainage and irrigation, schemes for the utilisation of water power for producing a supply of cheap electricity for all purposes. Expenditure was sanctioned on investigating these problems;
- (d) After careful investigation, sanction was given to the addition to the salaries of Government servants of temporary allowances to meet the high cost of living. These allowances were considerably smaller than the similar allowances being paid in the United Kingdom.

37. I am prepared to justify my action in sanctioning the expenditure set out in the preceding paragraph. On the information given me by my responsible advisers, I should not, I consider, have been justified in withholding my sanction.

The converse, of course, holds good. If I had known the truth as to the financial position, I should not have been justified in acting as I did, and a great part of the expenditure referred to in the previous paragraph would not have been incurred.

38. The purchase of tin stands in a different category. I sanctioned it reluctantly after much consideration as a choice of evils and on the merits of the case I consider that I was justified, but I freely confess that, if I had known the facts as to the financial position, the scale would have turned the other way, and I should have been forced to decide against purchase.

39. Since the true position of the finances has been known, every effort has been made to cut down expenditure, and much expenditure has in fact been cancelled, but the reductions have been to a large extent wiped out by unexpected calls upon the exchequer. This again in many cases is an incidental result of the heavy continuous capital expenditure charged to revenue in the past. Take for instance machinery or railway materials. These have to be ordered in advance and payment is usually made by the Crown Agents in London. Owing to the war and the conditions prevailing since, there has been very great uncertainty as to the date when goods that have been ordered will be delivered, and the bills presented to the Crown Agents and paid by them. This uncertainty would have been a disturbing element in our finances, even if there had been in existence an efficient system of control, under which the Treasury would have kept the Government informed as to the orders outstanding, the probable date of their execution, and of the demand for payment, and the consequent effect upon overdrafts at home.

The looseness of Treasury control in these matters, and the absence of definite knowledge as to outstanding liabilities has been one of the greatest difficulties met with in the task of ascertaining the real financial position. More than once, unexpected payments involving large overdrafts have upset the calculations.

40. The present financial situation is being dealt with on the following lines:

A loan has, with your sanction, been issued in London by the Straits Settlements Government and the proceeds will be lent to the Federated Malay States Government.

The programme of works of development has been drastically cut down, and all works properly chargeable to loan account have been charged to the loan. Annual expenditure not properly chargeable to loan account is being reduced to the lowest possible level.

41. The Treasury staff has been strengthened and its whole machinery is being overhauled under the direction of Mr. Pountney, who has, with your approval, been appointed Financial Adviser to both Governments, and of whose services in connection with the present financial crisis I find it impossible to speak too highly.

42. It will be clear from what I have written that I agree very largely with the criticisms of the Association in matters of finance.

43. I hold with them (*see* paragraph 5 of their letter) that the High Commissioner, advised by the Chief Secretary, is responsible for financial administration. I agree (*see* paragraph 10 of their letter) that unsound policy in the past has resulted in the dissipation of available reserves and the borrowing of millions to enable the Federation to meet its commitments. That is the unfortunate position which I inherited.

44. I agree with the statement in paragraph 12 of their letter that it is necessary to keep annual expenditure within the annual revenue. Since I realised that the available balances had been used up, I have endeavoured to arrive at that result.

45. I agree with them that the proper financial policy is as stated by them in paragraph 10 "to teach the Malay Rulers and their people to develop their rich lands on safe principles of finance for the advantage of the people of the country". To that policy I propose to adhere.

46. Turning to matters of high policy I am entirely in accord with the general tenor of the letter of the Association as to the necessity of maintaining the authority and influence of the Rulers. I have directed and shall continue to direct my best efforts to secure this result. I fully agree with the view expressed in paragraph 11 of their letter that it would be a misfortune "if by failing to carry the people of the country with them in all the schemes for further administrative development, the British officials, however unwittingly, induced in the Malays a feeling that they were neglected and their interests put aside for other considerations which they might not understand because no one had troubled to explain them."

47. My observation of the administration since I took office does not lead me to think that this danger is now being incurred. The Rulers through their Residents are in close touch with the Chief Secretary to Government and myself; they are present at Conferences on important matters; and in Federal Council they are able to follow the proceedings and either directly or through their Residents to express their views.

48. Having dealt with the main question raised by the Association, I may, before concluding, touch on certain special points mentioned in their letter:

(a) The Association lay stress (in paragraphs 8 and 11) on the fact that in 1918 the Federated Malay States Government were stated to possess a surplus of £12,500,000.

It is quite true that the published statement of assets and liabilities at the end of 1918 shows the surplus as \$108½ millions, or approximately £12,650,000, but regarded as available cash these are illusory figures. It is necessary to analyse that statement in a manner similar to the analysis set out in paragraph 19 in respect of the end of the year 1919. It will then be seen that the realisable surplus at the end of 1918 was \$55¼ millions only, or roughly £6,500,000, the remainder of the surplus being locked up in loans and advances. Moreover, it is to be observed that of this \$55¼ millions, a sum of \$26 millions was pledged to cover the outstanding liabilities on the then sanctioned items set out in paragraph 10 and that the Estimates for 1919 showed a deficit of \$6¼ millions. A loan of \$9¼ millions was then repaid to the Federated Malay States, and a further liability of \$17 millions was shortly after incurred by the sanction of the Prai Wharves undertaking. Thus, at a time when the available balances could not properly be looked upon as more than \$16¼ millions, and a liability of indefinite amount due to loss on sales of rice had been accepted, a budget for 1920 showing a deficit of \$34 millions was framed.

(b) The concluding words of paragraph 3 of the Association's letter read in conjunction with the opening words of paragraph 4 would seem to convey the impression (though I doubt whether this was intended) that the Federated Malay States does not possess a Press qualified to criticise subjects of public interest.

I am glad to say that this is not the case.

(c) The statistics asked for in paragraph 9 of the Association's letter will be prepared and forwarded later.

49. I have gone at length into the causes of our present financial trouble because in my opinion the lesson to be drawn from the past is encouraging. Our troubles are due in my opinion to a mistake in policy or rather to developing a policy, in itself justifiable up to a point, too far and continuing it too long. That is a mistake that is not likely to be repeated in the future.

50. I am convinced that the country is not suffering from a permanent set-back. My faith in the recuperative power of the Federated Malay States is great, and I feel sure that good times will return and revenue revive. I may in conclusion point out that as a set-off to the public debt the Federated Malay States have floating assets which, though not readily realisable, are worth £8,000,000.

I have, etc.,

(Sgd.) L. N. GUILLEMARD.

THE RIGHT HONOURABLE

WINSTON CHURCHILL, M.P.,

&c., &c., &c.,

COLONIAL OFFICE.