1. In accordance with its terms of reference, the Working Party has conducted the consultations with Ceylon under paragraph 4(b) of Article XII and paragraph 1(g) of Article XIV.

2. The Working Party had before it:

(a) a basic document prepared by the secretariat in collaboration with the Ceylon authorities describing the system and methods of the balance-of-payments import restrictions in force in Ceylon. The document also contains a statement on "the effects of the restrictions on trade" embodying the views of the Ceylon authorities; and

(b) documents provided by the International Monetary Fund.

These documents should be deemed to be supplementary material annexed to this report.

3. In conducting the consultations the Working Party followed the "Plans" recommended by the CONTRACTING PARTIES for consultations. The present report summarizes the main points of the discussion during the consultations.

Consultation with the International Monetary Fund

4. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with these consultations with Ceylon. As a part of the consultations between the CONTRACTING PARTIES and the Fund the representative of the latter referred to the results and background material from its 1956 consultation with Ceylon, and supplied a supplementary paper on developments subsequent to that consultation. In accordance with agreed procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning Ceylon's position. The statement made was as follows:

"During the Eleventh Session, the International Monetary Fund transmitted to the CONTRACTING PARTIES the results and background material from its 1956 consultation with Ceylon under Article XIV

1See QRC/17/Add.2
of the Fund Agreement, which consultation was concluded on October 31, 1956. The Fund's 1957 consultation with Ceylon is scheduled to be held soon, with discussions between the representatives of Ceylon and the Fund staff to be held in November.

"As some time has elapsed since the conclusion of its 1956 consultation with Ceylon, the Fund has provided a supplementary paper on Ceylon, dated August 30, 1957, to supply background information on subsequent developments in the internal situation, the balance of payments, and the restrictive system. This paper, together with the background material from the 1956 consultation under Article XIV of the Fund Agreement, and the results of that consultation, have been distributed to the members of this Working Party.

"With respect to Section I of the Plan for Consultations, relating to balance-of-payments position and prospects, as the CONTRACTING PARTIES have been informed, Ceylon has taken action which resulted in a virtual elimination of discrimination against imports from the dollar area. Subject to this development, and pending the conclusion of its 1957 consultation with Ceylon, the Fund sees no reason to alter the appraisal of the situation contained in the results of its 1956 consultation which have already been available to the CONTRACTING PARTIES.

"With respect to Section II of the Plan, relating to alternative measures to restore equilibrium, the attention of the Working Party is drawn to the results of the last Fund consultation with Ceylon. The Fund has no additional alternative measures to suggest at this time."

Statement by the representative of Ceylon

5. The representative of Ceylon opened the consultation with a general statement in which he described the economic background of the country, recent developments in its balance of payments and the present state of its import restrictions. The complete text of the statement is given in Annex I to this report. It was noted that the economy of Ceylon was highly dependent on foreign trade and that, consequently, a major aim of Ceylon's monetary and fiscal policy was to moderate the impact of external influences on the domestic economy in order to ensure stability. At the same time emphasis was laid on the longer-term objectives of economic development - of expanding and diversifying the economy so as to reduce the present structural dependence on the export of a few primary commodities.

6. As regards the balance-of-payments situation and prospects, the representative of Ceylon referred to the documents supplied by the Fund, which showed that the situation had been less favourable in 1956 than in 1955; the increase in foreign assets had been much smaller, principally due to a substantial fall in export earnings. There had also been a substantial
increase in imports which, in the view of the Ceylon representative, reflected in part the high level of liberalization that had been attained. The balance-of-payments situation in the first half of 1957 had been even less satisfactory, resulting in a considerable decline in the external assets. The Government was keeping the situation under close and continual review, particularly in view of the persistent decline in monetary reserves in recent months.

7. At present, however, restrictions were applied only on a small number of products. Among the thirty odd items for which no import licences were issued, some were being imported through State trading. The import of some other items was considered undesirable in view of the possibility of their being used for adulterating local export goods or for reasons of public health etc. under Article XX. The remaining items were restricted for balance-of-payments reasons. In applying restrictions the Government always gave due consideration to the need to reduce to a minimum any incidental protective effects that they might have on local production. On the question of discrimination, the Ceylon representative called attention to the statement of the IMF representative, noted in paragraph 4 above, that "Ceylon has taken action which resulted in a virtual elimination of discrimination against imports from the dollar area".

8. The representative of Ceylon stated in conclusion that the intention of his Government was to simplify the present system of import restrictions while continuing to pursue its policy of assuring fair opportunities for Ceylonese citizens to participate in the import and export trade. In the view of the Ceylon Government the implementation of this policy of "Ceylonization" involved no quantitative limitation of imports.

Problems relating to the balance-of-payments situation

9. As the recent deterioration in Ceylon's balance of payments was partly due to the decline in export prices for tea - a commodity which represented over 60 per cent of the country's total exports in 1956 - members of the Working Party showed considerable interest in the future prospects for the tea market and in any measures which might have been adopted in Ceylon for improving the quality, or for increasing the production, of this export commodity. Since reference had been made to the importance of price stability the Ceylon representative was requested to comment on the value and effects of long-term contracts as a measure for achieving that end. The Ceylon representative stated that through the use of improved methods in the production of tea there had been an increase in yield. The absence of an effective intergovernmental agreement on commodity trade meant that there was little likelihood of the prices of such goods as tea attaining any measure of stability. However, as this was a problem of general interest and was on the agenda of the CONTRACTING PARTIES, the Ceylon delegation would prefer to withhold comment at this consultation, and to clarify Ceylon's position during the plenary discussion on the commodity problems.
10. On the basis of the data supplied by the Fund, which showed that, as a result of a substantial influx of private capital from the United Kingdom, there was a much lower net outflow of private capital from Ceylon in 1956 as compared with the level in the previous year, a member of the Working Party invited the representative of Ceylon to comment on the effects of this trend on the country's balance of payments. The representative of Ceylon called attention to the high level of net outflow of capital in recent years (Rs. 37 million in 1953, 49 million in 1954 and 56 million in 1955). Following the improvement in 1956 the net outflow had risen again in the first half of 1957 to an annual rate of Rs. 28 million. Foreign investment, however, played only an insignificant role in Ceylon's balance of payments. In the view of a member of the Working Party the volume of capital that might flow into Ceylon would depend greatly on the policy of the Government not only in regard to the control of capital movements but also in regard to restrictions on imports. The representative of Ceylon noted that in both of these respects the policies pursued by Ceylon could not be regarded as placing any hindrance on the import of investment capital. The import of capital goods was virtually free from restriction and subject to low rates of duty. In addition, the exchange controls applying to outward remittances of capital, interest and profits were of an extremely liberal nature.

11. A member of the Working Party wondered whether, in view of lack of capital inflow and the inherent instability in commodity prices, it was really possible for Ceylon to maintain its policy of liberalization on a continuing basis. The representative of Ceylon said that the basic policy of his Government was to diversify the economy and increase production through developing the resources of the country while at the same time assuring an adequate supply of consumer goods essential to the population. In consonance with these objectives his Government would, however, always aim at acting in compliance with the General Agreement.

12. Some members of the Working Party expressed appreciation of the progress that had been made by the Government of Ceylon in relaxing import restrictions and particularly in substantially reducing discrimination. A member of the Working Party, however, pointed out that Ceylon's external reserves were at a substantial level equal to the value of five months' imports at the current rate. Referring to the short list of goods the import of which was being restricted, he wondered whether the removal of the restrictions on these items would have any significant effect on the balance of payments. The representative of Ceylon said that in view of the rapidly deteriorating position of Ceylon's balance of payments, it was necessary to proceed very cautiously in relaxing import restrictions further.

Governmental policy and internal measures affecting balance of payments

13. Members of the Working Party asked a number of questions in this field, including for example: what were the relative proportions of consumer goods and capital goods benefiting from the recent liberalization measures; whether the import and economic development policies of Ceylon were formulated on the basis that the standard of living of the country could be rapidly raised or whether the Government felt that the resources available were merely adequate
to meet the rising demand resulting from the increase in population; whether
the longer-term policy of the Government was to balance external payments by
increasing exports, or by limiting imports. The Ceylon representative noted
that the recent increase in imports consisted principally of consumer goods
although the import of capital goods had also been higher than before. Apart
from the restrictions applied for certain other purposes as noted in the basic
document, the restrictions which were made necessary by the country's balance-of-
payments situation had been applied with due regard to securing imports which
were essential to the economy; neither the need of the population for consumer
goods nor the requirements for industrial and agricultural development were
neglected. In considering the problem of developmental measures necessary for
raising the standard of living account must be taken of the very high rate of
increase in population in Ceylon which was among the highest in the world. The
current development plans included the cultivation of rice and sugar which were
destined for local consumption. To the extent that the present cultivation
programme succeeded, the import of rice might be reduced. The efforts made in
raising the quality and increasing the yield of tea, rubber and coconuts were,
on the other hand, aimed at expanding exports. On the industrial side the
present plans for the setting up of new factories, for example in the textile
industry, would eventually have the effect of replacing a proportion of imports.
It was hoped that the expansion of exports would be at a much higher level than
the expansion of import-substituting production, and the country's external
payments would thus be balanced at a higher level than at present.

14. The view was expressed by a member of the Working Party that it would be in
the long-term interests of the country if governmental assistance for development
were given to industries that could be expected eventually to become self-
sustaining and capable of meeting foreign competition; the expansion of
uneconomical production would only place a burden on the country and hinder the
rise in the standard of living. A member drew attention to the growing deficit
in Ceylon's budget which, in his view, would enhance the tendency towards
inflation. It was stated by a member of the Working Party that increases in
imports beyond a country's capacity to pay should not be regarded merely as a
problem for the balance of payments but rather as a symptom of internal
disequilibrium. Restrictions on imports would not strike at the root of the
problem but would merely serve to build up further internal demand. A government
faced with balance-of-payments difficulties should concentrate on internal
measures while liberalizing imports as much as possible rather than reduce the
inflow of goods from abroad. The hope was expressed that the problems now faced
by Ceylon were of a temporary nature and that the Government would soon be in a
position to eliminate the remaining restrictions.

15. The Working Party heard certain personal views expressed by a member on the
effect of State participation in industrial development on the inflow of capital,
and a statement by the representative of Ceylon outlining the difficulties in
making a start in industrial development in Ceylon without governmental inter-
vention. The latter pointed out that a population accustomed to agrarian life
had little inclination to enter into industrial enterprise, and that governmental
intervention was indispensable at the initial stage of industrialization. Once
the process had gained momentum the Government could place emphasis on assisting
development in the private sector rather than on direct participation in
industrial enterprise. The proposed expansion of the textile industry based on
private capital under governmental assistance was a case in point. His Government was fully aware of the country's need for foreign capital, and the general policy had been to encourage foreign investment in the country. The aim was to foster a happy partnership between foreign investors and local entrepreneurs.

16. A member of the Working Party paid tribute to the people of Ceylon for their contribution to the world economy, and pointed out that the amelioration of a country's external financial position depended not only on its ability to produce, but sometimes also on conditions beyond its control. In the case of Ceylon, stability in the world markets for its principal export products was essential, and responsibility also rested with those countries which were the important markets for those products.

System and Methods of Restrictions

17. On the basis of the secretariat document, the Working Party discussed the system and methods of the restrictions in force in Ceylon. It was noted that only about thirty items remained on the list of goods for which licences were not being issued. Some of these items were, however, being imported under State trading and some were controlled for reasons such as public health or security. Only a few items were restricted for balance-of-payments reasons. The restrictions were applied without discrimination except for four items the import of which from the dollar area either was not permitted or was limited to token quantities. Most of the goods which, according to the Ceylon delegation, were not subject to import restriction, were included in Open General Licences and could be imported freely. The Working Party noted, however, that the open general licence applying to the dollar area was substantially shorter, and that more imports from that area required individual licences. The representative of Ceylon explained that this differentiation in procedure had been maintained either for statistical reasons or for the implementation of the Government's policy of "Ceylonization" of the import and export trade.

18. The representative of Ceylon described the background of that policy and explained why the measures at present taken for that purpose, while having no restrictive effects on imports, appeared to be discriminating against imports from countries. It was noted that as a legacy of the past a substantial proportion of the country's external trade had been found at the time of Independence to be in the hands of foreign firms. Having achieved Independence it was natural for the people to wish to participate more fully in this important branch of the economy. In preference to more drastic measures, such as outright expropriation of foreign firms, the present method of Ceylonization had been adopted. This aimed at achieving the desired end of diverting trade to nationals while affecting to the least possible extent the interests of established firms. By and large the area in which importers and exporters of Ceylonese nationality were encouraged to participate at present was limited to "new trade" in the sense of trade with countries with which there had previously been no substantial transactions, or with which trade had been substantially interrupted during the war. In certain other cases, e.g. in the trade with the United States, the aim was to enable Ceylonese citizens to benefit from any
expansion of trade between two countries. The differences in the procedures for admitting imports from different countries only showed the transitional nature of the present arrangements; the methods would be more uniform once the Ceylonization policy was completed. There could be no question of discrimination because there was no effective restriction on imports, and the application of such internal regulations should not be regarded as being in conflict with the provisions of the General Agreement.

19. At the request of a member of the Working Party the representative of Ceylon supplied the following figures which, he considered, gave evidence that the measures had no restrictive effects on trade.

Ceylon Imports from two "Ceylonization" countries
(Rupees million)

<table>
<thead>
<tr>
<th>Year</th>
<th>Germany</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>1954</td>
<td>22</td>
<td>76</td>
</tr>
<tr>
<td>1955</td>
<td>26</td>
<td>98</td>
</tr>
<tr>
<td>1956</td>
<td>38</td>
<td>114</td>
</tr>
</tbody>
</table>

20. Members of the Working Party commented on the rather cumbersome nature of the whole system of Ceylon's import restrictions. They were aware that the complicated system had resulted from modifications and changes made in the course of years to meet the requirements of new situations, but felt that in the interests of foreign exporters as well as the local trading community the system could be simplified and made more intelligible to the ordinary people. Representatives of countries in the dollar area also suggested that the Ceylon Government should explore ways of achieving the declared purpose of Ceylonization without having to retain the discriminatory features in the licensing procedure. The representative of Ceylon stated that the procedures applicable to Ceylonization policy were, in the nature of the case, unavoidable. He agreed, however, that as regards other aspects of the licensing system efforts will be made to simplify procedures, wherever possible.

21. As described in the basic document, imports into Ceylon from the dollar area were treated as follows: apart from the thirty items which could not be imported from any source, the two items which could not be imported from the dollar area, the two items which could be imported in token quantities only, and the goods on OGL No. 2, which could be imported freely from the dollar area, all other items could be imported from that area either (i) under licences which were issued freely or (ii) under licences which were issued freely to registered Ceylonese traders, and to other importers on the basis of past trade. In response to a member's request for clarification, the Ceylon representative confirmed

(a) that the licences referred to in (i) above were issued freely to any importer who applied for them, and

(b) that the import from the dollar area of goods which were listed in OGL Nos. 1 and 4 (which applied to non-dollar areas) would be treated under the procedure described in (ii) above.
The representative of a country in the dollar area stated that some exporters in his country seemed to be either uncertain or unaware of the fact that commodities on non-dollar OGL's could be imported into Ceylon from the dollar area under freely issued licences as described above. It was suggested that the Ceylon Government might give adequate publicity to its import policy and procedures so as to remove any uncertainty on the part of traders. The representative of Ceylon stated that all import regulations were published in the Government Gazette and that the new regulations resulting from the review of the present regulations would, no doubt, also be published in this manner.

22. The Working Party was gratified to hear the statement made by the Ceylon delegation that the import control procedures would be simplified and that the Government would review the list of goods subject to restriction.

Effects of the Restrictions

23. Reference was made to the list of goods given in the basic document which might be benefiting from the incidental protective effects of the restrictions, and to the statement that "for a number of commodities, mostly those which are being produced locally, it is stated in the Gazette notification that no licences will be issued". A member of the Working Party observed that in order to reduce incidental protective effects to the minimum, the import of goods which were also produced locally should be permitted rather than prohibited so as to expose local producers to foreign competition. The representative of Ceylon assured the Working Party that his Government was aware that the development of uneconomic industries would not be in the long-term interest of the country. Such protection as might be considered necessary for the promotion of new industries would be provided through means consistent with provisions of the General Agreement.

24. It was noted that, notwithstanding the fact that Ceylon was still entitled to maintain import restrictions under Article XII, a number of products had in fact been made the subject of releases under Article XVIII for developmental purposes. The Working Party felt that the successive applications and notifications lodged by Ceylon under Article XVIII were a clear indication of the Government's full awareness of its obligations under the Agreement, and its intention to abide assiduously by its provisions.
ANNEX I

Statement by the Representative of Ceylon

I propose to begin my statement by making a few general observations on the Ceylon economy. The Ceylon economy, as you are no doubt aware, is highly dependent on foreign trade. Its exports, the production of which constitutes a very considerable proportion of the Gross National Product, consist of a few primary commodities whose fortunes are determined primarily by economic conditions prevailing in the markets abroad. Its imports, which account for approximately 80 per cent of its total foreign exchange disbursements, consist predominantly of basic foodstuffs and other essential consumer goods, the demand for which is in the main inelastic.

The problem of insulating the economy from external disturbances that affect the demand for its exports is, therefore, one of the major problems of the economy. In view of the considerable inelasticities of supply of products intended for domestic consumption as well as for export, a period of prosperity is in general marked by buoyant incomes, reflecting not so much rising production as rising prices, and by a surplus in the balance of payments. A period of recession, on the other hand, tends to be characterized not only by a sharp fall in domestic incomes but also, since the demand for imports does not fall correspondingly and adjustment of imports is not as rapid as the change in incomes itself, by a deficit in the balance of payments. The need to conserve foreign exchange in the one period for use in the other is, therefore, an obvious one.

It is one of the major aims of monetary and fiscal policy to modify or neutralize the impact of these external influences on the domestic economy and thereby ensure stability in the level of incomes. It is important to emphasize, however, that underlying this problem of stability is the more basic one of long-term economic development, of expanding and diversifying the economy with a view to reducing its present structural dependence on the export of a few primary commodities.

I now turn to the balance-of-payments situation and prospects. I can do no better than point to the excellent analysis of our position given in the background papers submitted to the Working Party by the International Monetary Fund, and I would like to draw your attention in particular to the supplementary paper dated 30 August 1957. I do not, therefore, propose to go into details. You will observe that our economic situation during 1956 has not been as favourable as it was in 1955. The over-all position of the balance of payments at the end of 1956 has resulted in the very small increase in our foreign assets of Rs.14 million, as compared with an increase of Rs.254 million in 1955. This has been due primarily to the smaller trade surplus earned during the year. Total export earnings have declined by as much as Rs.205 million as compared with 1955. This decline has been due in very large part to reduced earnings
The significance of this fact will be appreciated when it is realised that tea accounted for 60 per cent of our total exports in value last year. The decline in the receipts from rubber has also been an important contributory factor. On the other hand, our imports have increased by as much as Rs.169 million over 1955 despite a 10.4 per cent worsening in the terms of trade, an increase representing an expansion of 9.4 per cent in import volume. This increase in imports, notwithstanding these adverse circumstances, reflects in part the high level of liberalization achieved in the field of import restrictions.

The balance-of-payments situation in the first half of this year has been even less satisfactory. The provisional data available in respect of this period point to a surplus of Rs.32.5 million only on merchandise account, and a deficit of Rs.94 million on total current account. Our external assets have declined by Rs.195 million during the first half of this year. The decline has been of the order of Rs.19 million per month in the first quarter, and Rs.46 million per month in the second quarter. While it is hazardous to predict the course of movement of these assets with any degree of assurance, their persistent decline in the recent period has underlined the need for caution. My Government is, therefore, keeping the situation under close and continual review.

The effects on the balance of payments of the present import restrictions cannot be said to be of great proportions. Nevertheless, it is not feasible to assess with any degree of accuracy the full effects on the balance of payments of any relaxation or elimination of the present restrictions. The factors I have already mentioned argue for considerable caution in this regard and certainly do not justify the adoption of such a course.

I now come to the restrictive effect of balance-of-payments policy on external trade. There are a vast number of items coming under import control and the present regulations create the impression that the existing system is a highly complicated one. In actual fact, the system of restrictions is a very simple one. As it is fully described in the secretariat document I shall confine myself to outline its main features.

The most important items for which no import licences are issued relate to major commodities of food like rice, wheat flour and sugar. The primary consideration is that adequate supplies are secured at reasonable prices. Past experience has indicated that it is highly dangerous to the community to leave the import of these commodities in private hands. The fact that the Government is the importer has no restrictive effect on the actual importation of these commodities. The full requirements of the island are imported from the cheapest available source.

Others for which no licences are issued include such items as coconut oil and citronella oil, which are exported from Ceylon on well-established commercial standards. These items were introduced in the past in order to
prevent the import of these commodities for the purpose of adulterating Ceylon products. The remaining items have been restricted definitely for conserving exchange.

So far as discrimination against the dollar area is concerned, the position is summarized in the following statement already made by the representative of the International Monetary Fund: "Ceylon has taken action which resulted in a virtual elimination of discrimination against imports from the dollar area."

It is the intention of the Ceylon Government to simplify the present regulations, but at the same time pursuing its policy of increasing the opportunities for Ceylonese citizens to participate in the import and export trade. The implementation of this policy imposes no quantitative limitation of any kind on the flow of imports into Ceylon.

It is widely recognized that balance-of-payments restrictions are not a permanent feature of the economy and that the incidental protection they afford will disappear with their elimination. In determining the incidence of particular restrictions the need to reduce to a minimum, in conformity with our obligations under the General Agreement as well as in the interests of the consumer, the incidental protective effects of such restrictions has always been an important consideration.