1. In accordance with the provisions of Article XVIII:12(b) the Committee conducted the consultation with Ceylon. In conducting the consultation, the Committee had before it: (a) the basic document prepared by Ceylon (BOP/33) including the Ceylon Government Gazette which contains notifications of the import control system; (b) background documents provided by the International Monetary Fund. The consultation was completed on 22 May 1964. The present report summarizes the main points discussed during the consultations.

Consultations with the International Monetary Fund

2. Pursuant to the provisions of Article XV of the General Agreement, the International Monetary Fund had been invited to consult with the CONTRACTING PARTIES in connexion with this consultation with Ceylon. In accordance with the agreed procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Ceylon. The statement made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES a background paper dated April 27, 1964.

"With respect to Part I of the Plan for Consultations, relating to balance of payments position and prospects, and with respect to Part III, relating to system and methods of the restrictions, the general level of the various restrictive and temporary tariff measures being applied does not go beyond the extent necessary at the present time to stop a serious decline in Ceylon's monetary reserves.

"With respect to Part II of the Plan for Consultations, relating to alternative measures to restore equilibrium, pending the conclusion of its current consultation with Ceylon under Article XIV of the Fund Agreement, the Fund has no comments on alternative measures".
Opening statement of the representative of Ceylon

3. The representative of Ceylon, whose full statement is appended in the Annex, described recent developments in Ceylon's economy and trade. Briefly, 1963 had been a particularly difficult year; Ceylon had already experienced imbalance in its external accounts in prior years which had led to a decline in reserves and the need to impose restrictions to safeguard external assets. Worsening terms of trade had contributed to the deterioration of Ceylon's balance-of-payments position ever since 1955/56, but this movement culminated in 1963 in a 10 per cent decline in the one year. This decline was due entirely to the rise in import prices not accompanied by an increase in export prices. Important import price increases took place in sugar and other goods which Ceylon must import, while prices of major primary exports - tea, rubber and coconuts - did not rise. The essential imports could not easily be reduced in volume, and other imports had already been cut sharply in prior years. Thus, on balance, total payments for imports continued to exceed receipts from exports and other sources, causing a sizeable deficit in the balance of payments on current account and at the same time increased Ceylon's foreign commitments.

4. Internally, the higher prices of imported food led directly to a frustrating of the Government's effort to combat a tendency toward inflation to which heavy budget deficits had been contributing for some years. Imported food is all sold under subsidy and it had been planned to cut the internal deficit to about one fourth through reduction of these subsidies in the fiscal year 1963/64. With higher world prices, however, adherence to this plan would have meant a too sharp increase in food prices. Hence, though the budget for the fiscal year 1963/64 (Oct.-Sept.) envisaged a much smaller cash deficit, the deficit was now expected to be only slightly less than in the year before. That the deficit would not be larger was thanks in part to other economy measures which are meeting with somewhat more success despite great pressures to increase expenditure on development; vigorous efforts to raise additional revenue by direct and indirect taxation are important in this connexion.
5. Production in certain export sectors had been fostered with some success in tea and coconuts, but rubber production would not increase for another three or four years when new trees would begin to yield. Overall, Ceylon exports increased at the rate of 2.9 per cent per year in the last decade, but the import purchasing power of these exports increased by only 1.1 per cent per year. Efforts to grow more of Ceylon's rice requirements continued, and yields per acre are beginning to rise but much remains to be done. Industrial development, especially in Ceylon's light consumer industries, to some extent a by-product of import restrictions, had been an important feature both psychologically and from an economic standpoint, and Ceylon realized that it was now time to be in to select out for development those industries which could be viable in the long run.

6. In monetary policy, Ceylon's objective has been to counteract the effects of an expansion in the supply of money and of restriction of imports on prices. Heretofore, stocks have lessened these pressures, so that Ceylon had not experienced any real inflation, but it was expected that this problem will become more significant. It will be extremely difficult to contain the pressures along with an adequate development programme if the external background continues to be unfavourable.

Balance-of-payments position and prospects

7. The Committee thanked the representative of Ceylon for his detailed statement and expressed appreciation and understanding of the difficulties with which Ceylon was currently faced, including the recent deterioration of the country's terms of trade. The Committee expressed the hope that the various measures taken by Ceylon would prove effective in redressing the unfavourable development of the country's external position. Members of the Committee noted that the preliminary figures for the balance of payments of Ceylon for 1963 indicated a decrease in the value of exports to Rs.1,725 million in comparison to Rs.1,763 million in 1962. Imports fell from a value of Rs.1,906 million in 1962 to Rs.1,854 million in 1963. Taking account of an increased deficit in invisibles the total deficit on current account amounted to Rs.146 million about the same as in 1962. The
representative of Ceylon explained that the deficit on service had increased considerably in the last year totalling Rs.22 million in 1963 as compared to Rs.8 million in 1962 and this increased service deficit was attributed to reduced earnings from port expenditure and bunkering during strikes in the port of Colombo. In respect to donations, he stated that in 1963 the surplus had decreased to Rs.5 million as compared to Rs.7 million in 1962. In reply to a question from the Chairman as to whether this trend continued in the first quarter of this year, the representative of Ceylon mentioned that the balance-of-payments position continued to worsen but a break was noticeable in lower sugar prices and they hoped that the situation might further improve in the coming year. The Committee was informed that the Government was taking measures to develop tourism in Ceylon and in recent years receipt from tourism had increased somewhat. Members of the Committee noted that the inflow of capital had increased to Rs.11 million in 1963, as compared to Rs.2 million in 1962. The outflow of capital amounted to Rs.4 million in 1963, so that the net inflow totalled Rs.7 million. This figure indicates the extent of the increased reliance on long-term capital from abroad.

8. In response to a question concerning the tax treatment of foreign remittances, the Committee was informed that a tax of 20 per cent had been imposed on foreign remittances to curb the outflow of foreign exchange through foreign travel. He said that profits from foreign investments were freely transferable and assured the Committee that the tax was not applied to all remittances.

Alternative measures to restore equilibrium

9. Members of the Committee expressed appreciation for the statement made by the representative of Ceylon that his Government was aware of the tendency toward a rise in prices. They noted, also, that the expected cash deficit of some Rs.200 million in the expenditures for 1963/64 was slightly smaller than in earlier years and that despite the pressure to increase current expenditure the deficit had not increased over those of previous years, partly because of the Government's vigorous efforts to raise revenue. The Committee expressed understanding of the particular difficulties with which Ceylon was faced in
implementing measures for fiscal and monetary restraint as long as there continued to be under-employment of resources. The Committee noted with satisfaction the measures Ceylon was undertaking to curb the domestic demand and expressed the hope that despite the inevitable impetus which had been given to the development of industries, further efforts would be made towards rationalization of these industries from the long-term aspect.

10. The representative of Ceylon, in his statement, gave a full account of his Government's fiscal and monetary policy as well as a report on production plans. The Ceylonese Government was much aware of the problem of rationalization of the new industries and significant efforts were being made to promote industrial exports.

11. In reply to a question on the operations of the recently installed sugar mills to meet the sugar requirements, and their contribution to meeting Ceylon's sugar requirements he explained that the factories had just been completed and that not enough raw sugar was available for processing to enable the sugar mills to contribute very much to Ceylon's sugar supply. There were substantial problems to be resolved in increasing raw sugar production, concerning water supply, change to sugar cultivation from other products and labour supply. Thus, so far they were substantially dependent on imports.

System and method of the restriction

12. The Committee recognized the difficulties confronting Ceylon in protecting its foreign exchange reserves in the face of adverse factors affecting its terms of trade and in implementing its development programme.

13. Members of the Committee expressed concern on the use of tariffs as well as import restrictions in Ceylon. It was explained that the application of tariff measures continued to be maintained in spite of its failure as a means of restraining imports in order to siphon off some of the excess domestic demand.
14. Members of the Committee inquired about the decline in imports under Open General Licence and under special quota. The representative of Ceylon replied that it had been necessary to shorten the list of items under Open General Licence and that implementation of the policy on special quotas had not been drawn up yet; it was the intention of the Government to permit import of non-essential items in small quantities, provided the balance-of-payments position improved. Lists of special quota items would be published when decisions had been reached.

15. In response to a question concerning the definition of the term "Ceylonized areas", it was explained that these areas comprised countries with which Ceylon's trade came to a standstill during and immediately after the war and that trade in these areas was reserved for Ceylonese traders only.

16. In reply to a question regarding bilateral arrangements, the representative of Ceylon explained that his Government did not believe in bilateral arrangements, but in order to promote new trade with centrally-planned economies, they were obliged to support bilateral arrangements. The socialist countries adopted the system of bilateral arrangements for the conduct of their trade with other countries, and therefore Ceylon could not abandon use of bilaterals unless the system was changed by the industrialized socialist countries, and by other State-trading countries such as the United Arab Republic, with whom Ceylon had bilateral arrangements.

17. Members of the Committee enquired if Ceylon was considering the establishment of a State-trading corporation. It was indicated by the representative of Ceylon that his Government did not foresee any definite plan at present although the matter had been under consideration.
Effects of restriction

18. The Committee expressed its appreciation of the efforts of Ceylon to increase productivity of its domestic industries but nevertheless indicated their hope that efforts to rationalize industry would be pressed forward. The representative of Ceylon indicated that his Government was in fact now screening industries both for essentiality of the proposed product and for their ability to produce on a competitive basis and for their export potential.

General

19. The Committee thanked the representatives of Ceylon for the frank and co-operative manner in which they had engaged in the consultation and expressed understanding of the problems with which Ceylon was confronted. The Committee noted the statement made by the representative of the Fund that "the general level of the various restrictive and temporary tariff measures being applied does not go beyond the extent necessary at the present time to stop a serious decline in Ceylon's monetary reserves". The Committee noted the various fiscal measures taken by the Ceylonese Government to curb the large import demand and raise revenue.

20. The representative of Ceylon thanked the Committee for the understanding and sympathetic manner with which the consultation had been conducted. He stated that he would bring the views and suggestions made by the members of the Committee during the consultation to the attention of his Government which would give them careful consideration.

Annex: Statement by the representative of Ceylon.