GENERAL AGREEMENT ON
TARIFFS AND TRADE

DRAFT REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS
ON THE 1969 CONSULTATION UNDER ARTICLE XVIII:12(b) WITH CEYLON

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 the basic document prepared by Ceylon (BOP/91) and two background documents dated 16 October 1968 and 19 June 1969, prepared by the International Monetary Fund. The consultation was held on 1 July 1969. The present report summarizes the main points discussed during the consultation.

Consultation 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 Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of November 1, 1968 taken at the conclusion of its most recent Article XIV consultation with Ceylon and particularly to paragraphs 2 to 4 which read as follows:

"2. Despite a further deterioration in the terms of trade, the growth of Ceylon's economy accelerated in 1967 reflecting chiefly marked increases in food and industrial production. The momentum appears to have been maintained in 1968. The Fund believes the emphasis on food production is appropriate, and hopes that the possibilities of import substitution in this field will continue to be vigorously exploited."
"3. Recently, domestic monetary conditions have been generally stable in part because the decline in net foreign exchange reserves exerted an important contractionary influence. There was also a sharp increase in quasi-money holdings. In the budget for the fiscal year commencing October 1, 1968, no resort to bank financing is envisaged. The authorities expect wage pressures to increase in the coming year. It is important for the success of the exchange reform that excessive monetary expansion and wage increases be avoided.

"4. Ceylon's terms of trade have deteriorated further, and the balance of payments position has remained difficult. The Fund believes that the devaluation of the Ceylon rupee in November 1967, and the exchange reform and import liberalization of May 1968 constitute major improvements in Ceylon's trade and payments policies. The Fund does not object on a temporary basis, to the maintenance of the multiple currency practice described in EBS/68/128 (of April 30, 1968) and EBS/68/251 (of September 27, 1968). The Fund believes that Ceylon should reduce its continuing use of bilateral payments arrangements."

"On May 3, 1968 the Fund approved a stand-by arrangement authorizing Ceylon to draw up to the equivalent of $19.5 million over a period of 12 months beginning May 6, 1968. As of May 1969, provisional data for 1968 indicate a deficit on goods and services of $61 million, compared with a deficit of $65 million in 1967. Gross holdings of foreign exchange rose from $75 million at the end of 1967 to $78 million at the end of 1968. However, short-term liabilities, mainly in the form of bilateral balances, also increased during the year, and net drawings on the Fund amounted to $28 million. The general level of restrictions of Ceylon which are under reference does not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves."

Opening statement of the representative of Ceylon

3. In his opening statement, the full text of which appears in an annex, the representative of Ceylon reviewed the developments in the balance-of-payments position of his country in 1967 and 1968, discussing in particular the deterioration in the terms of trade which brought about an increased rupee deficit on trade in 1968, even though the deficit was slightly less in dollar terms than had been the case in 1967. A smaller surplus on invisibles had also added to the deficit on current account so that there had been increased reliance on borrowing, especially under various short-term arrangements. Two major monetary reforms which he discussed had a significant effect on these developments. First the
20 per cent devaluation of the rupee in November 1967, and second the monetary reform introduced in May 1968, the Foreign Exchange Entitlement Scheme which gave rise to certificates (FEECs) that in fact represented a further depreciation in the exchange rate for a range of transactions. Under these arrangements, as explained in more detail in BOP/91, basic essentials were imported at the par value rate of exchange and major exports, certain invisibles and official capital receipts moved at the same rate. All other receipts and payments were channelled through the certificate market, resulting in a depreciated effective exchange rate. This meant that non-traditional exports and tourist expenditures in Ceylon enjoyed a premium rate and that the less essential imports paid for through FEECs bore the additional rupee charge of the certificate, which amounted to 44 per cent of the face value of the certificates up to 18 June 1969 and from then on to 55 per cent.

4. Certain internal monetary policy changes had also been effected, including new restraint on creation of credit; fiscal measures included a plan to reduce to a minimum governmental borrowing from the banking system, new excise duties and an adjustment in business turnover taxes. At the same time the basis for assessing duty had been changed to c.i.f. value rather than wholesale market value and import duties on many essential products were eliminated or reduced. Efforts to encourage foreign investment had been continued, and remittance of current earnings was now freely permitted. Planning activity, he reported, had also been strengthened and the steadily increased capital expenditure had been concentrated especially in agriculture, irrigation and the power sectors (together 40 per cent) with another 23 per cent devoted to industry. These priorities reflected new emphasis on attainment of self-sufficiency in non-export agricultural products such as rice and subsidiary foodstuffs, along with an effort to strengthen the major agricultural export sector. A high rate of growth had been achieved in 1968 - 6.1 per cent on a per capita basis, and real income would have matched that growth but for the decline of 7 per cent in terms of trade.
Balance-of-payments position and prospects and alternative measures to restore equilibrium

5. Members of the Committee complimented the representative of Ceylon on his very informative statement and on the various developments which gave hope that Ceylon might enjoy increased prosperity in the years ahead. They noted that in the short-term lower export prices for some of the major export products were causing difficulties, that there were reasons for concern about the slow rate of growth in consumption for one such product - tea - and they appreciated that the position of a country dependent on a very few staple exports was especially vulnerable. They welcomed Ceylon's moves toward increased liberalization of trade, however, and expressed the view that increased competition from imports might contribute, as increased internal competition had done, towards improving the efficiency of domestic production. They recognized too that higher international prices for goods which Ceylon was obliged to import had aggravated the problem and expressed interest in knowing to what extent liberalization had led to increased consumption, how luxury imports were restrained, and in particular what Ceylon had done to bring about an increase in personal savings, a development on which they especially commended Ceylon.

6. In reply to these and other specific points to which reference was made, the representative of Ceylon stated that Ceylon was indeed attempting to reduce its dependence on imports of food through increased domestic production of staple foods, especially rice, in which it was hoped that full self-sufficiency would be attained within five years. Imports of rice had already been much reduced. He did not expect that recent increased wheat imports represented any basic change in habits of consumers in his country, which would remain a rice-eating nation if the supply was adequate, as Ceylon confidently expected. Development plans in industry, he explained, were at present primarily of an import-substitution nature; increased attention, however, was being given to export-oriented industries as was evidenced by the textiles, leather goods and rubber goods industries. Ceylon was, moreover, promoting export diversification in non-traditional agricultural products to lessen its vulnerability to shifts
in world prices. With respect to tea, the representative of Ceylon agreed that tea consumption was not increasing as much as might be hoped, largely because of increased restrictions and levies in certain developed countries which practically negated the Kennedy Round duty concessions. These were obstacles which it would be difficult to overcome even by increased sales promotion. As concerned imports, there had been no undue increase in consumption of non-essentials since such goods were either not licensed at all, or were subject to discretionary licensing. Goods imported at the official exchange rate were all strictly essential products and those liberalized under the FEEDC system were raw materials and materials required by industry. A good many of the products liberalized in May 1968 were products competitive with Ceylonese products, and the trend was towards increasing the number of products liberalized so that the point about competition from imports was being taken into account. With respect to the measures taken to stimulate savings, the principal activity of the Government had been to open rural banks which offered attractive rates of interest for deposit of accumulated savings and which had also opened up increased credit possibilities to the rural population. A difficulty encountered here was that increased incomes in rural areas had encouraged increased spending for consumption purposes, but the net effect was considered encouraging in terms of an increase in savings and productive investment. Members of the Committee noted that danger of higher spending for consumption constituted a significant limitation on the help that could be obtained from such a measure.

7. The policy of encouraging Ceylonization of trade was questioned by some members of the Committee, who expressed misgivings as to whether this policy might not in the long-term conflict with Ceylon's objective of strengthening the productivity and profitability of major export producing enterprises, notably in tea and rubber. They also asked whether, with respect to traders, Ceylonization might not introduce an element of rigidity from reliance on established trade contacts and a bias against products based on new technology. The representative of Ceylon noted the comments which had been made but recalled that the policy which applied to the import trade was not a new one, that it was progressing slowly, taking all factors into consideration, and was proceeding in such a way as to build up initiative and experience on the part of the Ceylon traders. The
former geographical restrictions on non-Ceylon traders were no longer in force. He emphasized that there was no element of discrimination as to source of imports in the licensing system, and he stated that traders could select their best year as an alternative base for import allocations; exceptions were made to permit needed imports of new products where there was no past record to serve as a basis for allocations.

8. In response to questions concerning the potential of tourism as a source of foreign-exchange earnings, the representative of Ceylon stated that Ceylon was now fully aware of the potential of this new source of income and was aiming to attract more tourists.

System and methods of the restriction and effects of the restrictions

9. A number of questions were put concerning the very welcome import liberalization which had come with the introduction of the FEEC system. Members noted that payments for about one third of Ceylon's imports were now effected through the FEEC system. They expressed interest in learning what if any effect had been noted on domestic production and trade as a result of the liberalization of some 350 items, particularly in sectors dominated by State-trading monopolies; they also inquired how effective the scheme had been in increasing exports and whether the export effects were a reason for the recent increase in the premium accorded to such exports through the increase in the price of certificates from 44 per cent to 55 per cent of face value. Was it planned to include more products in the list of imports eligible for purchase on FEEC and were further increases in the cost of the FEEC's contemplated? Finally, they asked, had the question of definition of "100 per cent Ceylonese companies" been settled and were such industries given preferred status as permanently registered importers? The representative of Ceylon replied that the purpose of the FEEC system had been much broader than simply to stimulate exports and had been aimed also at liberalization of imports and introduction of a degree of flexibility into the economy. Before the introduction of the system, industries had generally been short of imported raw materials which they were now able to obtain, and the effect had been to expand all sectors of domestic activity, including construction. The scheme had been in effect only a year and
could naturally not have a direct effect on major exports to which it did not apply, but it had certainly made a good contribution. The recent increase in the price of FEEC's had been decided upon to attune the demand for foreign exchange to its true market value. As for the registration question, all importers were simply required to register and there was no special favoured position for "100 per cent Ceylonese" firms.

10. As for the relationship of the FEEC system to the black market in foreign exchange, to which reference was made, the elimination of such a market had not been the primary aim of the system, as explained above; however, the operation of the scheme had shown that a greater proportion of exchange receipts was now being received through official channels. It had been difficult to eliminate the illicit trade in gem stones. The leakage of foreign exchange earnings from tourism had been substantially reduced. It was also brought out that the new, non-traditional, exports had increased; in the first quarter of 1969, by nearly 50 per cent over the same period in 1968, to some $3 million and that this was a development which should be credited in part to the certificate scheme. Moreover, it was thanks to this scheme that profits had gradually been unblocked and could now be remitted abroad. Members of the Committee expressed their appreciation for these improvements although they noted that as regards profits and capital transfers, the FEEC's had resulted in diminished foreign-currency proceeds from such operations. In some cases, despite the fact that basic exports were not eligible to benefit from the FEEC premium export rate, the extra cost involved importing necessary items for the trade and in remitting profits, adversely affected the profitability of some of the major industries on which Ceylon's export trade depended.

11. Reference was also made to a licence fee required to be paid on imports of aid-financed imports, including goods purchased with the proceeds of loans from international institutions. This fee was stated to be at 15 or 20 per cent, according to category, although such goods were exempt from the FEEC-certificate requirement. As a result, members pointed out, aid-financed goods enjoyed a competitive advantage over similar goods obtained commercially unless some mechanism existed for eliminating the differential before the goods were sold to consumers.
12. The question was asked whether Ceylon had not experienced a phenomenon common to certain other countries practising severe import restrictions in that domestic resources were diverted, when luxury imports were excluded, to the production of precisely these products. The representative of Ceylon stated that there was little danger that it would happen since investment was directed by official incentives into approved industries.

13. Ceylon's use of bilateral trade agreements was also questioned. It was pointed out that, of the agreements listed in BOP/91, the agreement with Iran was a special arrangement for a particular transaction and was no longer operative. In response to a question by a member concerning the bilateral rubber for rice agreement with China, the representative of Ceylon states that this arrangement, which dated back to 1952, provided for the exchange of rubber for the essential imports of rice. When imports of rice were no longer necessary, Ceylon could either purchase other products from China in exchange for its rubber or dispose of it on the world market. As for other bilateral agreements, he indicated that he could give no assurance that Ceylon would reduce reliance upon them; these agreements were entirely permissive agreements with purely indicative lists. Prices were in all cases free world-market prices. They were non-discriminatory and had been concluded only to provide a framework for trade.

14. Members of the Committee took this opportunity to inquire whether it would not be possible for Ceylon to simplify and expedite the procedures in force for authorizing the sale of pharmaceutical products and clearing their importation, as traders in at least one country had reported very long delays, up to a year or more. The representative of Ceylon confirmed that there was a ministerial Committee which reviewed the capability and experience of foreign pharmaceutical supply houses and in this context sometimes had to call for an impartial investigation which might involve a delay of two to four months. One member recalled in this connection a tendency for developing countries to evolve complex import procedures; he asked that Ceylon, along with other developing countries, review all its import procedures with a view to possible simplification.
Conclusion

Members of the Committee expressed satisfaction at the large area of liberalization attained by Ceylon since the last consultation and looked forward to hearing of further success by Ceylon in directing development efforts so as to permit still further progress in this direction.