CEYLON'S BALANCE-OF-PAYMENTS POSITION

Supplementary Information Supplied by the Government of Ceylon

Conforming to the trend of the previous decade, the balance-of-payments situation in 1970 continued to be unfavourable. The current account (exclusive of official transfers) had a deficit of Cey Rs 468 million, which compares favourably with the previous year's exceptionally high deficit of Cey Rs 843 million, but in the capital account the payments had increased from Cey Rs 392 million to Cey Rs 056 million. The net effect of these developments was an external resource gap of Cey Rs 1,124 million which was second only to the 1969 gap of Cey Rs 1,235 million.

(a) Merchandise account

In 1970, the merchandise account recorded a deficit of Cey Rs 325 million as against a deficit of Cey Rs 746 million in 1969. There were two factors that were largely responsible for the narrowing down of the deficit on this account. First, export earnings at Cey Rs 2,011 million recorded on an exchange transactions basis, showed an increase of Cey Rs 102 million over the previous year. Secondly, import payments were contained at Cey Rs 2,336 million which was less by Cey Rs 319 million over 1969.

(b) Services account

The improvement in the merchandise account would have provided considerable relief on account of current payments if it were not for the worsening of the deficit in the invisibles account. The deficit of Cey Rs 97 million on these transactions increased to Cey Rs 143 million in 1970.

This situation arose partly due to the classification of bunker oil supplies as exports in 1970, in contrast to the previous practice of including such earnings as port, transportation in the services account. The deficit was largely due to the sharp increase in interest payments on the external debt. These payments which amounted to Cey Rs 68 million in 1969 had increased to Cey Rs 101 million by 1970.

There were, however, favourable developments in the services account. Earnings from tourism, for instance, which had been rapidly increasing since 1967 reached Cey Rs 22 million in 1970. The amounts earned during the two years 1969 and 1968 were Cey Rs 17 million and Cey Rs 11 million respectively. This is also the first
time that a surplus has been achieved on account of foreign travel. Economies were also effected in payments for other miscellaneous services which declined by Cey Rs 13 million over the previous year. But these favourable developments proved to be of marginal significance in view of the unparalleled increase in interest payments.

(c) Capital account

Despite the deterioration in the services account the current account deficit was contained at Cey Rs 468 million which was less by Cey Rs 375 million over the earlier year. But this improvement was offset to a considerable extent by the sharp increase in capital payments. These payments at Cey Rs 656 million were nearly double the level of payments in 1969. Of this, Cey Rs 629 million was on account of debt repayments. The corresponding figure for 1969 was Cey Rs 361 million.

It was due to the unprecedentedly high level of capital repayments that the need for external resources too remained at a relatively high level. The external resource gap in 1970 amounted to Cey Rs 1,124 million.

In financing a resource gap of the magnitude recorded in 1970 recourse had to be made, as in 1969, to a high level of overseas borrowing. Drawings on long-term loans amounted to Cey Rs 384 million and the short-term debts incurred by the Government and the Central Bank totalled Cey Rs 667 million. While long-term finance declined by 29 per cent over the previous year, drawings on short-term credit arrangements showed an increase of 28 per cent. However, even this level of borrowing proved insufficient to meet the entire resource gap. It was therefore necessary to utilize the entire allocation of Special Drawing Rights totalling Cey Rs 78 million while official grants amounting to Cey Rs 75 million were also made use of for this purpose. A modest addition nevertheless was made to the external reserves amounting to Cey Rs 26 million, while Ceylon's liability on account of payments agreements was also reduced by Cey Rs 75 million.

A main cause for concern in the balance-of-payments developments in 1970, more than the size of the resource gap, is the shift in the source of imbalance. In the past, a high level of external resources had to be mobilized mainly to meet the deficit in the current account and to amortize a moderate level of external debt. A noticeable change that has occurred in 1970 is, that of the resource gap of Cey Rs 1,124 million, Cey Rs 468 million or only 41.6 per cent consisted of the deficit in the current account. The balance of Cey Rs 656 million was on account of capital payments. Even in 1969 when a larger resource gap of Cey Rs 1,235 million occurred, only 31.7 per cent was utilized to meet capital payments and the balance went to meet the current account deficit.

A further source of anxiety was Ceylon's heavy reliance on short-term debt for financing balance-of-payments deficits. The Central Bank has, in the past, arranged several lines of credit with foreign banking and financial institutions, with the object of augmenting the supply of liquid assets available for meeting any sudden unfavourable change in the country's payments situation. Although
arranged for contingencies, considerable use has had to be made of this form of credit in recent years merely for bridging the recurring gap between external payments and receipts.

External assets

Notwithstanding the large external resource gap the gross external assets of Ceylon increased from Cey Rs 377 million in 1969 to Cey Rs 403 million in 1970. Net of sterling loans sinking fund contributions, reserves amounted to Cey Rs 367 million.

Of the total external assets the international reserve of the Central Bank accounted for Cey Rs 194 million while the assets of the Government and Government agencies totalled Cey Rs 58 million. The balance of Cey Rs 151 million comprised the external reserves of the commercial banks.

The increase in external assets during the year 1970 was made possible by drawings on external loans and the allocation of Special Drawing Rights by the International Monetary Fund. Net drawings on loans, inclusive of transactions with the IMF, amounted to Cey Rs 19 million while Ceylon's allocation of SDR's amounted to Cey Rs 78 million.

The rules of reconstitution of SDR's require that on the average, 30 per cent of a country's allocation remain unutilized. When account is taken of the required replenishment of SDR's amounting to Cey Rs 23 million, and the net drawings on external loans, the reserves should actually be regarded as having declined by Cey Rs 3 million over the 1969 level.

The balance-of-payments situation that emerged in 1970 is largely the cumulative effect of almost the continuous deficits which were financed by drawing down of external reserves and later, by resorting to large-scale overseas borrowing particularly of a short-term nature. The net external assets declined from Cey Rs 1,194 million in 1956 to the present level of Cey Rs 367 million. At their current level the reserves are inadequate to meet a sudden and unexpectedly large difference between external payments and receipts. The low level of reserves was thus a further source of considerable concern to the monetary authorities in 1970.

Measures taken

Several policy measures were introduced during the year which can contribute to the restoration of the country's external finances to a healthier basis. In several official announcements the Government has tried to impress on the public the seriousness of the balance-of-payments situation and the need for conserving foreign exchange. Some of the measures introduced in the budget should also help contain the expansion of demand for imports. Among the more important of these are:

(a) the reduction in the proportion of the budget deficit financed through bank borrowings;
(b) the increase in interest rates on Government securities and savings deposits;

(c) the increase in the rates of contributions to the Employees' Provident Fund, and

(d) the compulsory savings scheme.

The Government has also tried to give due weight to balance-of-payments considerations in the formulation of the country's industrial policy. For example, it has been decided that in granting official approval to new industrial projects, those industries which will make a positive contribution to the balance of payments, either by saving on imports (in particular by using domestic raw materials), or developing new exports, are to receive priority. Along with the measures, the import substitution programme in agricultural production continues to receive particular emphasis.

With a view to enhance the country's foreign exchange earnings the offer of a premium exchange rate for exports other than the three traditional products continued to operate in 1970.

Trends in exports and imports

(a) Exports

Export earnings, based on customs data, showed an increase of Cey Rs 117 million from Cey Rs 1,916 million in 1969 to Cey Rs 2,033 million in 1970.

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\begin{array}{|c|c|c|c|}
\hline
\text{Commodity} & \text{Value (Cey Rs million)} & \text{Percentage of total} \\
\hline
\hline
\text{Tea} & 1,062 & 1,120 & 55 & 55 \\
\text{Rubber} & 431 & 440 & 22 & 22 \\
\text{Coconut products} & 221 & 237 & 12 & 12 \\
\text{Minor products} & 161 & 198 & 8 & 10 \\
\text{Total domestic exports} & 1,875 & 1,995 & 98 & 98 \\
\text{Re-exports} & 41 & 38 & 2 & 2 \\
\text{TOTAL:} & 1,916 & 2,033 & 100 & 100 \\
\hline
\end{array}
\]

Source: Ceylon Customs Returns.

It was partly the result of a higher volume of exports and partly the better prices fetched by some of the export products. The export volume index increased from 98 in 1969 to 102 in 1970 while the export price index increased from 117 to 118 (1967 = 100).
The increase in the volume of exports was in tea, rubber and the minor products. According to customs data the volume of tea exported in 1970 amounted to 460 million lb. as against 445 million lb. in 1969. It is noteworthy that this increase was achieved despite a decline in tea production during the year from 484 million lb. to 468 million lb. This was made possible by a decrease in the stocks of manufactured tea from 87 million lb. to 45 million lb.

Production of rubber which showed only a marginal increase in 1969 expanded sharply in 1970 while the volume exported also registered a significant increase. Rubber production in 1970 totalled 351 million lb. as against 333 million lb. in 1969. Export volumes were 354 million lb. and 315 million lb. for the respective years. The volume exported of minor products showed a marginal increase of 3 per cent over 1969. With regard to the three major coconut products the volume exported declined from 896 million nut equivalent to 880 million.

The improved export performance in 1970 was partly the result of better prices fetched by tea and coconut products. The average f.o.b. price for all teas was Cey Rs 2.44 per lb. in 1970 compared to Cey Rs 2.39 in 1969. The sharp increase in the price of coconut products, the index of which reached 150 as against 137 in 1969 (1967 = 100) was sufficient to offset the decline in export volume.

The prices of rubber and minor products, however, showed a marked decline over the 1969 level. The average price for all rubber exports declined from Cey Rs 1.37 per lb. to Cey Rs 1.24 per lb.

The price index for minor products declined from 113 to 111 (1967 = 100). The overall effect of these price movements was a marginal increase in the export price index from 117 in 1969 to 118 in 1970.

(b) Imports

The value of imports recorded on an exchange transactions basis declined from Cey Rs 2,655 million in 1969 to Cey Rs 2,336 million in 1970. (The corresponding figures according to customs returns are Cey Rs 2,543 million and Cey Rs 2,313 million respectively.) While the volume index of imports showed a reduction from 108 in 1969 to 102 in 1970 (1967 = 100), the import price index indicated a further increase from 134 to 140.

The backlog of demand for imported goods that had accumulated as a result of a number of years of import restrictions began to clear up along with the reintroduction of the Open General Licence imports under the Foreign Exchange Entitlement Certificate Scheme of May 1968. The value of imports reached a record level of Cey Rs. 2,655 million in 1969. By mid-1970, however, it was clearly evident that the O.G.L. Scheme could not be sustained in the absence of a sharp increase in export income. In August, therefore, the Scheme was cancelled and imports made under the facility were transferred to the B Quota list subject to import licensing.
(c) **The terms of trade**

A factor that has been in continuous operation ever since 1960 that has tended to seriously impair Ceylon's import capacity is the adverse movement in the terms of trade. This had declined from 148 in 1960 to 88 by 1969 and to 84 by 1970. It is clear that it was the sharp increase in import prices rather than the decline in the prices fetched by export products that was responsible for the deterioration in the terms of trade.

### The Movement in the Terms of Trade and Deficits in the Current Account Attributable to it

<table>
<thead>
<tr>
<th>Year</th>
<th>Export price index (1967=100)</th>
<th>Import price index (1967=100)</th>
<th>Terms of trade</th>
<th>Current account balance</th>
<th>Effect of terms of trade</th>
</tr>
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<tbody>
<tr>
<td>1960</td>
<td>122</td>
<td>83</td>
<td>148</td>
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<td>1970</td>
<td>118</td>
<td>140</td>
<td>84</td>
<td>503</td>
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</tbody>
</table>

Source: Central Bank of Ceylon.

Ever since 1965 when the impact of the fall in the terms of trade was greatest the amount of foreign exchange the country "lost" by this unfavourable movement was greater than the deficits in the current account of the balance of payments. In other words, if the prices of exports and imports continued to remain at their 1959 level, the actual volume of exports and imports which took place during the years 1965 to 1970 would in fact have resulted in surpluses rather than the deficits in the current account.

It is only in the long run that the measures so far taken could help in restoring a degree of equilibrium in the country's external finances. In the meantime, there is an urgent need to reduce Ceylon's heavy reliance on overseas borrowing, particularly short-term credits, which have been a principal source of financing balance-of-payments deficits in recent years. With the debt service payments absorbing Cey Rs 629 million or 31 per cent of export earnings in 1970 and continuing to remain high in the coming years large allocations of foreign exchange have to be made on this account.
A further deterioration of the balance of payments under the strain of such commitments can only be averted by creating a surplus in the current account in the forthcoming years sufficient to meet large capital payments that are falling due. This can only be achieved through a sizable improvement in export earnings and/or the maintenance of import payments at a relatively low level.

Since export demand is determined primarily by factors beyond Ceylon's control no more than a marginal improvement can be envisaged through promotional measures. This is more so since Ceylon continues to depend on the three traditional products tea, rubber and coconuts for nearly 90 per cent of her export income. The outlook for these commodities in the world markets is no longer promising and give cause for considerable concern. The increase in earnings in 1970 cannot be interpreted as a sharp break with the past trend. It was largely the effect of higher prices received for tea resulting from the shipping difficulties in Calcutta and the depletion of stocks in London. Moreover, expressed in terms of US dollars the 1970 level of export earnings is much less than that recorded for several years prior to 1968.

The earnings from non-traditional exports, however are likely to increase under the stimulus imparted by the premium exchange rate offered through the Foreign Exchange Entitlement Certificates Scheme. But these earnings still constitute only a small proportion of the country's export receipts.

Furthermore, Ceylon would not have been able to sustain the 1970 level of imports even on the basis of her enhanced export income, if it were not for the availability of foreign assistance and suppliers' credits amounting to Cey Rs 569 million. This has been the situation particularly since 1966.

As evident from Table I the continuous deterioration in the terms of trade has tended to compound the balance-of-payments problem faced by the country.

In view of these developments it is difficult to anticipate any relaxation of the existing controls on imports in the absence of a substantial improvement in the country's export earnings.