

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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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. This deficit had been partially financed by 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 Foreign Exchange Entitlement Scheme introduced in May 1968. 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 for these transactions. This meant that non-traditional exports and tourist expenditures in Ceylon enjoyed a premium and that the less essential imports paid for through Foreign Exchange Entitlement Certificates (FEECs) bore the additional rupee charge of the certificate, which amounted to 44 per cent of the face value of the certificates up to 13 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 obtained 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 continuing restrictions and high internal taxes in certain developed countries. 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 par value exchange rate were all strictly essential products and those liberalized under the FEEO 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 supply sources 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 FEEO system. Members noted that payments for about one third of Ceylon's imports were now effected through the FEEO 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 FEEO and were further increases in the cost of the FEEO'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 FEEO 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 FEEO'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 FEEO system to the unofficial 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, but the leakage of foreign exchange earnings from tourism had been substantially reduced. It was also brought out that the non-traditional exports had increased, in the first quarter of 1969, by nearly 50 per cent over the same period in 1968, to some \$8 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 FEEO's had resulted in diminished foreign-currency proceeds from such operations. In some cases, despite the fact that major exports were not eligible to benefit from the FEEO premium export rate, the extra cost involved in 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 other countries practising certain types of 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. A number of questions were raised regarding Ceylon's bilateral trade agreements. The representative of Ceylon indicated that he could give no assurance that Ceylon would reduce reliance upon such agreements, for they were, with the exception of an agreement with Mainland China, entirely permissive agreements with purely indicative lists. They were non-discriminatory and had been concluded only to provide a framework within which trade with certain countries might be developed. Prices were in all cases free world-market prices. It was pointed out by the representative of Ceylon that, of the agreements listed in BOP/91, that with Iran had been a special arrangement for a particular transaction and was no longer operative. As for the bilateral agreement between Ceylon and Mainland China, which provided for an exchange of rubber for rice, one member questioned what the future of these rubber exports would be when self-sufficiency in rice was achieved. The representative of Ceylon stated that when imports of rice were no longer necessary, Ceylon could either purchase other products from Mainland China in exchange for its rubber or dispose of it on the world market.
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.
15. One member recalled that in the course of the non-tariff-barrier exercise in the Committee on Trade in Industrial Products his government had noted a tendency for developing countries to evolve complex import procedures and had suggested that developing countries review their import procedures with a view

to possible simplification. He asked that Ceylon, along with other developing countries, do so. The representative of Ceylon drew the attention of the Committee to the simplification of import procedures introduced in connexion with the recent exchange reform.

Conclusion

16. 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.

Opening Statement by the Delegate of Ceylon

The balance of payments of Ceylon which had been under strain over the past decade continued to deteriorate in 1968 and was associated with a sharper decline in the terms of trade than in previous years. The export price index registered a drop of five points, over 1967, while the import price index showed an increase of four points, consequently, the terms of trade declined by seven points in 1968 over the previous year.

The export earnings, both visible and invisible, increased from Cey Rs 1,912 million in 1967 to Cey Rs 2,229 million in 1968, an increase of 16.6 per cent. The value of imports rose 16.6 per cent, from Cey Rs 1,985 million in 1967 to Cey Rs 2,341 million in 1968. The deficit in the balance of payments on account of these current account transactions was higher than in 1967. I must mention, however that these figures reflect difference between the exchange rates in 1968 and that prevailing in the first eleven months of 1967 prior to the devaluation of the Ceylon rupee by 20 per cent on 22 November 1967.

These broad trends in the balance of payments were considerably influenced by two major monetary reforms which were instituted in 1967 and 1968. I have just referred to the devaluation of the Ceylon rupee. The second was the Foreign Exchange Entitlement Certificate Scheme which was introduced on 6 May 1968 in consultation with the International Monetary Fund. Details of the Certificate Scheme have been referred to in document BOP/91 dated 16 May 1969 and the annexes referred to therein. In effect, this Scheme resulted in a further depreciation in the exchange rate for a range of transactions.

Two exchange rates were introduced. "The official" exchange rate i.e. the rate introduced on 22 November 1967 is applicable to essential imports covering a large range of items directly affecting the cost of living. These include the food imports by the Food Commissioner, other foodstuffs, drugs, fertilizers, petroleum products, imports by Government Departments and by local authorities, imports by non-industrial Government Corporations, cottage industries and co-operatives, imports for the manufacture of drugs, items of educational and medical use not produced domestically and all agricultural implements. Certain imports for new hotel projects approved before the introduction of the Certificate Scheme also qualify for the official rate. Transactions covering the major export commodities, tea, rubber and coconut products are also effected at the official rate.

All other imports, exports and inward remittances and tourist expenditure are made at a "floating" rate; imports have to bear the additional rupee charge of the certificate value while receipts from the exports of minor commodities, inward remittances and tourist expenditure, enjoy the premium on the certificate.

The Scheme had two main objectives. The first to permit the diversification of exports and the other to liberalize imports by allowing the market mechanism to regulate the flow of imports rather than by relying on quotas and stringent controls which had operated earlier. Thus a considerable number of BTN tariff items, approximately 350, consisting mainly of raw materials and producers goods were placed under open general licence. Complementary measures were implemented in the monetary fiscal and the production sectors, with a view towards providing the necessary incentives for increasing output. These measures were designed with a view to rectifying the imbalance in payments and consequently, reducing the pressures on Ceylon's external reserves which had persisted over the past several years.

The price of the Foreign Exchange Entitlement Certificate has, with effect from 18 June 1969, been increased from 44 per cent of the face value of the Certificate referred to in document BOP/61 to 55 per cent. The increase in the FEEC rate was necessary in order to maintain equilibrium in the market. The increase represents a realistic appreciation of market forces.

Changes in the monetary policy were a necessary commitment of the exchange reform. Continuing deficit budgets and expansionary policies had resulted in excessive liquidity in the economy. The devaluation of November 1967, and the exchange reform of May 1968 called for a restrictive monetary policy. It was essential that the economic growth of the country should not be stifled by incorrect monetary policy. The creation of credit had, therefore, to be restrained so that it did not outstrip the needs of the productive sectors and encourage consumption or lead to the speculative building of stocks. Interest rates were moved up. Bank rate was increased from 5 to 5½ per cent and commercial banks interest rates rose correspondingly and moved up with the bank rate. The Central Bank also imposed ceiling on bank credit to the private sector; but measures were taken to avoid restricting unduly the growing and vital sectors of the economy. Thus for instance, credit under the new agricultural credit scheme for food production, the Tea Factory Development Scheme and the credit for exports were excluded from the operations of the ceiling.

On the fiscal side, measures were taken to contain as far as possible, the inflationary impact of Government finance by reducing to the minimum the resort to borrowing from the banking system. Excise duties on tobacco and arrack were increased and adjustments in the business turnover tax were also affected by increasing the tax from 5 per cent to 10 per cent in respect of certain manufacturing industries and broadening the base of the tax to include incomes from professions and services at a rate of 1 per cent. Simultaneously, the customs reform introduced in August 1968, changed the basis of customs valuation from wholesale market value to c.i.f. value. Import duties on a large range of essential raw materials and equipment for agriculture and industrial development were either eliminated or reduced. The customs reform is still under review and is expected to be completed during the course of 1969.

Having referred to the major exchange reforms and the accompanying changes in the monetary policy effected by the Government which have a direct bearing on the balance-of-payments position I would like to draw your attention to the broad trends in Ceylon's trade and payments in 1968.

Export earnings for 1968 at Cey Rs 1,975 million shows a substantial increase of Cey Rs 325 million over 1967. This excludes re-exports of Cey Rs 59.1 million. The increase in rupee export value was partly due to increases in the average rupee prices of tea and coconut products and partly due to an increase in the volume of rubber and coconut products. Export earnings from tea in 1968, in rupee terms, amounted to Cey Rs 1,162 or Cey Rs 101 million more than in 1967. The total quantity of tea exports in the year were 460 million pounds or 18 million pounds less than the previous year. Although total export earnings in rupee terms were higher in 1968, the foreign price of tea declined.

Both volume and value of rubber exports improved in 1968. 328 million pounds of rubber valued at Cey Rs 331 million were exported in 1968 as against 291 million pounds valued at Cey Rs 282 million in 1967. Favourable weather conditions resulted in a larger volume of coconut product exports in the year. In terms of nuts 1,096 million nuts were exported in 1968 as against a 940 million nut equivalent in 1967. The shortage of lauric acid oils and desiccated coconut resulting from a shortfall in output in other producing areas resulted in higher prices for coconut products in 1968. Consequently, the total export earnings from the export of coconut products in 1968 amounted to Cey Rs 331 million as compared with only Cey Rs 167 million in 1967. The value of other domestic exports was also higher, Cey Rs 152 million in 1968 as compared with Cey Rs 121 million in 1967.

The value of imports at Cey Rs 2,341 million in 1968 was Cey Rs 356 million more than in 1967.

In rupee terms, these figures of export earnings and import payments were the highest ever recorded in Ceylon's balance of payments. The higher levels of export and import value in 1968 were chiefly a result of the devaluation of the Ceylon rupee by 20 per cent in November 1967. Import values in 1968 were also considerably increased as a result of an increase in the c.i.f. prices of all major categories of imports, especially the price of rice which increased from £47 per ton in 1967 to £70 per ton in 1968, and also due to the arrival of larger imports in 1968 under the commodity aid arrangements. The liberalization of imports by placing a wide range of items under open general licence also contributed to the increase in the import bill in 1968.

The deficit in the merchandise account in 1968 is estimated at Cey Rs 366 million and represents an increase of 9.2 per cent over the deficit of Cey Rs 335 million in 1967. In interpreting these figures, due allowance must be made for the difference between the exchange rates in 1968 and the pre-devaluation rates effective for the first eleven months of 1967. Thus export

and import values when converted to US dollar terms indicate that the value of exports recorded a decline from \$347 million in 1967 to \$332 million in 1968. At the same time, the value of imports showed a sharper decline from \$417 million in 1967 to \$393 million in 1968. Thus, the deficit in merchandise account, in dollar terms, narrowed from a deficit of \$70 million in 1967 to a deficit of \$61 million in 1968.

In 1968 Ceylon's balance on invisibles account, inclusive of transfer payments showed a surplus of Cey Rs 20 million or \$3 million as against a surplus of Cey Rs 46 million or \$10 million in 1967. The deterioration in the invisibles account was due to the combined effect of a fall in earnings and a rise in payments. Total invisible earnings declined from Cey Rs 262 million in 1967 to Cey Rs 254 million in 1968, while total invisible payments increased from Cey Rs 216 million to Cey Rs 234 million over the same period. The decline in the surplus has been primarily due to a substantial decrease in port and harbour dues and to an increase in investment income payments consequent upon the liberalization of moratorium releases in respect of current incomes and to increase in Government expenditure.

When the merchandise deficit is adjusted for the smaller surplus on invisibles account in 1968, the current account on Ceylon's balance of payments showed an overall deficit of Cey Rs 346 million in 1968 as compared with a deficit of Cey Rs 289 million in 1967. The "basic balance" which is derived by setting off the current account balance against net transactions on long-term capital decreased from Cey Rs 128 million in 1967 to Cey Rs 122 million in 1968. In dollar terms the basic deficit declined from \$26 million in 1967 to \$20 million in 1968. This deficit in the balance of payments was financed by recourse to various short-term borrowing arrangements. A net sum of Cey Rs 165 million or US\$27.7 million was drawn from the International Monetary Fund and Cey Rs 29 million or US\$4.9 million was obtained from foreign banking sources.

The total external resources available to Ceylon in 1968 amounted to Cey Rs 2,811 million or US\$472 million as compared with Cey Rs 2,402 million or US\$504 million in 1967. The external resources available in 1968 at US\$472 million was US\$105 million higher than currently earned income. The mobilization of external resources of this magnitude was made possible as a result of a substantial increase in the flow of foreign assistance and to a moderate increase in short-term liabilities. The external resources available to Ceylon in 1968 were made up of 78 per cent by currently earned foreign exchange, 12 per cent by various capital inflows and 10 per cent by increasing short-term liabilities. On the last occasion when consultations were held with Ceylon in November 1966, attention was drawn to the declaration of Government policy on foreign investment embodied in a white paper which welcomed foreign participation in investment, tax concessions, facilities for remittance and repatriation of capital, etc. Efforts have been continued to create a more favourable climate to attract foreign investment. With the introduction of the exchange reforms in May 1968, the remittance abroad of current earnings from investment is freely permitted. A Foreign Investment Approvals Committee has also been set up to examine foreign investment proposals and a considerable number of projects have been approved by the Committee. These include such fields as automobile assembly, agro-chemicals and cotton textiles manufacture.

Planning activity has also been strengthened. The Ministry of Planning and Economic Affairs is currently engaged in preparing an overall development plan which would provide output and investment targets for each of fifty sectors of the economy. The Ministry has also begun work on establishing a Central Progress Control Room where the overall progress on development programmes and projects would be monitored so that prompt corrective action can be taken where needed.

The total capital expenditure in the budgets for the last three fiscal years, 1966/67, 1967/68 and 1968/69 have been steadily increased from Cey Rs 625 million to Cey Rs 715 million and Cey Rs 876 million respectively. About 40 per cent of the total Government capital investment in 1968/69 will be in the agricultural, irrigation and power sector, and 23 per cent in industry. The highest priority in the agricultural sector is for the development of irrigation, as for the remainder, the principal items of expenditure are subsidies for rubber replanting and coconut and cocoa rehabilitation schemes, colonization schemes and fertilizer subsidies. About half the expenditure for industry is set aside for a textile mill project, a cement factory, a paperboard mill, and an omnibus cum truck chassis factory. New projects on which work will commence in 1968/69 include a fertilizer factory. Expenditure on transport and communications will be about 14 per cent of the total capital expenditure and that on social services about 13 per cent.

A scheme of priorities is followed for development and emphasis is placed primarily on the growth of the domestic agricultural sector. The agricultural programme which has been followed for the last three years is mainly designed to achieve self-sufficiency in non-export agricultural products such as rice and subsidiary foodstuffs.

This policy has been successful and the domestic agricultural sector has had three continuous prosperous years. In 1968 rice production reached a peak of 900,000 tons as compared to 769,000 tons in 1967. The marked increase in output in the food sector was largely the result of incentives given to the farmer in the form of improved agricultural inputs, price incentives and the extension of institutional credit. The transformation of the traditional form of agriculture has brought about significant changes not only in output and yields but also in the achievement of self-reliance and steady economic growth in the farming sector. The beneficial effects on foreign exchange expenditure resulting from the significant increase in the domestic production of rice were however denied to Ceylon by the sharp increase in the price of imported rice which I have referred to earlier.

At the same time, the export agricultural sector has been strengthened by subsidiary schemes for planting and replanting tea, rubber and coconut. A fertilizer subsidy scheme and a factory development scheme have been introduced to assist the tea industry. The rubber replanting scheme, with high-yielding trees, which was introduced in 1953 and which was to have been terminated in 1967 has been extended for two years. Fifty per cent of the total acreage under rubber has been replanted. Coconut producers receive assistance through the grant of fertilizers at subsidized rates.

The emphasis placed on development by the present Government and the monetary and exchange reforms instituted in 1968 have resulted in a high rate of growth. The gross national product at constant prices (i.e. in real terms) was 8.3 per cent in 1968 as compared to an increase of 4.4 per cent and 4.2 per cent in 1967 and 1966 respectively. When allowance is made for population growth of 2.2 per cent in the year, the rise in per capita real product of 6.1 per cent in 1968 is the highest growth rate achieved so far. But for the decline in the terms of trade, of 7 per cent, real income would have risen at a corresponding rate.

A high level of activity was seen in most of the economic sectors. Real output in agriculture rose by 6.9 per cent which was due to the stimuli provided by the Government in recent years as well as to favourable weather conditions. Growth was most marked in construction and manufacturing. The value of real output of these sectors rose by 27.1 per cent and 7.7 per cent respectively. Both these sectors had been inhibited in recent years by the lack of availability of imported building materials for construction and raw material for industry. The liberalization of imports in May 1968 of a large range of essential intermediate and investment goods led to the expansion of activity in these two sectors of the economy.

The Government has introduced far-reaching measures in trade and payments policies, the devaluation, exchange reform and import liberalization. But, though these measures have resulted in a high degree of economic growth, the decline in prices of Ceylon exports, particularly tea, has placed continuing strain on the country's balance of payments.