

RESTRICTED

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# GENERAL AGREEMENT ON TARIFFS AND TRADE

CONTRACTING PARTIES

23 October-16 November 1962

## REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION UNDER ARTICLE XVIII:12(a) WITH

### C E Y L O N

1. In accordance with the provisions of Article XVIII:12(a), the Committee conducted the consultation with Ceylon regarding the recent intensification of quantitative restrictions. As proposed in GATT/AIR/287 of 10 August 1962, the Committee, in examining the balance-of-payments position of Ceylon, took into account that the CONTRACTING PARTIES will have to consider at their twentieth session the recent duty increases put into effect by Ceylon for safeguarding its balance of payments and also the request by the Government of Ceylon for an extension of the waiver permitting temporary duty increases on bound items, granted by Decision of 10 April 1961.<sup>1</sup> In conducting the consultation, the Committee had before it: (a) the basic document for the consultation, BOP/17; (b) Ceylon Government Gazettes Nos. 13228 and 13246 containing the Notifications relating to the recent intensification of quantitative restrictions and increases in duties (distributed under cover of document L/1824); (c) the Second Annual Report by Ceylon under the Decision of 10 April 1961 (L/1834); and (d) the IMF documents noted in paragraph 2 below. The consultation was completed on 24 September 1962.

### 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 International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision relating to the last consultation with Ceylon under Article XIV of the Fund Agreement and the background material prepared in connection with that consultation. The Fund has also provided a supplementary paper, dated September 10, 1962, to supply background information on recent developments. It is possible that minor corrections will be made to the supplementary paper. If so, they will, of course, be made available to the CONTRACTING PARTIES. At this time I should like to express the Fund's thanks to the authorities of Ceylon for the provision of material which facilitated the preparation of the supplementary paper.

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<sup>1</sup>A record of the discussion relating to the recent duty increases will be distributed separately.

"The general level of the various restrictive and tariff measures currently applied by Ceylon does not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves. The additional revenue to be derived from previous and newly-increased import duties is not expected to prevent a substantial budget deficit in the fiscal year ending September 1963. Regarding alternative corrective measures which may be available, the Fund expects soon to conduct its 1962 consultation with Ceylon and to transmit to the CONTRACTING PARTIES the Executive Board decision relating to that consultation when it becomes available."

Opening statement by the representative of Ceylon

3. In his opening statement the representative of Ceylon explained that, although the intensification of quantitative import restrictions which had been notified to the CONTRACTING PARTIES did not constitute a substantial intensification of restrictions, his Government had nevertheless decided to consult with the CONTRACTING PARTIES regarding this measure and also to provide an opportunity to contracting parties to discuss with Ceylon various restrictive measures which it had been necessary to introduce since the last consultation in February 1961.

4. Describing developments in Ceylon's economy and in its foreign reserve position, the representative of Ceylon explained that, despite the stringent import policy followed by Ceylon in 1961, which had resulted in the lowest level of imports in that year since 1957, and considerable efforts by Ceylon to expand exports, the country's exchange reserves had not shown the expected improvement. In fact, the disappointing development of Ceylon's foreign reserve position had primarily been due to factors beyond Ceylon's control. The volume of exports had increased by almost 4 per cent in 1961 as compared with 1960, but total export earnings in 1961 of Rs. 1,733 million had been lower by Rs. 99 million as a result of a deterioration by 8.7 per cent in export prices as compared to the previous year. During the first half of 1962, Ceylon's export prices had shown a further decline by 4 per cent, the decline being particularly pronounced in the case of coconut products and tea. As a result of these developments, the index of Ceylon's terms of trade, which had been at 102 in 1960, deteriorated to 94 in 1961 and to an average of 90 for the first half of 1962.

5. The severe restrictions on imports introduced in 1961 resulted in a drop in imports by Rs. 257 million, as compared to the previous year, to a total of Rs. 1,703 million. This helped to slow down the decline in Ceylon's external assets. It did not, however, suffice to arrest the decline. Notwithstanding a drawing from the IMF of the equivalent of Rs. 53.8 million, the country's foreign assets had fallen by Rs. 9.6 million by the end of 1961 to Rs. 531.7 million. During the first seven months of 1962, Ceylon's reserves registered a further decline of Rs. 17 million despite another drawing of the equivalent of Rs. 53.8 million from the IMF and a further increase in net foreign short and long-term indebtedness. Because the continuing decline in export prices

precluded the possibility of augmenting reserves from increased export earnings and because of the increasing demand for imports of capital goods and raw materials as economic development gathered momentum, the Government had found itself compelled in July 1962 to extend selective import controls and to take further measures for restraining import demand for non-essential items. These measures were notified to the CONTRACTING PARTIES under cover of document L/1824.

6. The representative of Ceylon explained that the Government was aware that Ceylon's balance-of-payments difficulties could not be solved exclusively through the intensification of restrictions or by duty increases. Consequently, the Government was continuing its efforts to check inflationary pressures through appropriate fiscal and monetary measures including the reduction and eventual elimination of the inflationary component of the budget. For this reason, under the new budget introduced in Parliament on 26 July 1962, the surcharge on income tax had been increased from 15 to 20 per cent, new excise duties had been introduced and additional duties were being levied under the Motor Traffic Act. The budget had also made provision for a reduction of 25 per cent in the subsidized rice ration and a  $7\frac{1}{2}$  per cent sales tax on a wide variety of consumer goods. Because of considerable difficulties in implementing these measures the proposal to cut the subsidized rice ration was abandoned and the sales tax was rescinded soon after it was introduced. The withdrawal of the sales tax had led to the introduction instead of a 20 per cent increase in tariffs covering a wide range of imports. Imports affected by this measure had accounted for Rs. 863 million or 51 per cent of total imports in 1961. Finally, on 15 September, the Government had found it necessary to subject a further forty-seven items of a non-essential nature to individual import licensing.<sup>1</sup>

7. In concluding his opening statement, the representative of Ceylon stated that the measures recently introduced were conceived as temporary and that it was his Government's hope that Ceylon's foreign reserve position would soon improve so that it could revert to its traditional liberal import policy.

#### Balance-of-payments position and prospects

8. The Committee thanked the representative of Ceylon for his detailed statement and expressed appreciation and understanding of the difficulties with which Ceylon was 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 foreign asset holdings. Members of the Committee enquired in this connexion about prospects for a reversal of the trend of declining export prices for Ceylon's major export commodities. The representative of Ceylon explained that, although there had recently been a slight increase in rubber prices, export earnings from this commodity were not expected to increase significantly over earnings in 1961, since the volume of rubber exports

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<sup>1</sup>For a list of the items affected see BOP/17/Add.1.

was expected to remain at the low level of the previous year. At the same time, export prices of tea and coconut products had continued to be weak and there was the distinct possibility of a further decline. In clarification of a question regarding trends in the world market for tea, the representative of Ceylon explained that since the mid-1950's, the price of tea had shown a slight but continuous decline. The pressure on prices was largely due to the greater rate of expansion of world production than of world consumption. Moreover, the sharp decline in export prices for coffee tended to lower export prices for competitive products such as tea.

9. Members of the Committee noted that for a large part of its food requirements Ceylon continued to be dependent on imports. Imports of rice alone had, in recent years, accounted for 10 to 14 per cent of total import outlays. Similarly, fish products had accounted for a large proportion of import outlays. They enquired about possibilities for an expansion of production of these items and other food items so as to decrease the country's dependence on such imports. The representative of Ceylon explained that measures for increasing production of foodstuffs had, indeed, been given high priority in the three-year implementation programme for economic development which would soon come into effect within the framework of the Ten-Year Plan. The Government had already launched a drive for increasing rice production under the guaranteed price scheme.

Encouragement was being given to the fisheries industries through public investment in improved harbour and other facilities. While the Government was hopeful that the measures for increasing domestic production of foodstuffs would soon provide results, it could not be expected that production would increase so rapidly as to provide significant relief for Ceylon's balance of payments in the near future.

10. Members of the Committee noted that during 1961 there had been a net outflow of capital from direct investments amounting to Rs. 7.9 million in contrast to an inflow of Rs. 3.1 million in the previous year. They pointed out in this connexion the contribution which private foreign capital could make to an improvement in Ceylon's balance-of-payments position and to economic development and enquired about the Government's policy towards private foreign capital. The representative of Ceylon stated that his Government was aware of the fact that private foreign capital could make an important contribution to the country's economic development and the balance of payments. The Government welcomed private foreign investment in all fields other than those reserved for the public sector. Its policy assured to private foreign investors the right to remit profits and dividends and to repatriate capital in respect of all new and approved investments. A proposal to secure these facilities by legislation was under consideration. In accordance with this policy, the Government had entered during 1962 into an Investment Guarantee Agreement with the United States regarding United States investments in Ceylon and a similar agreement with the Government of the Federal Republic of Germany was under consideration. It was the Government's hope that these agreements would offer added incentives to private investors.

Alternative measures to restore equilibrium

11. Members of the Committee expressed appreciation of the statement by the representative of Ceylon that his Government was aware of the importance of avoiding inflationary monetary expansion. They noted however, that, despite increases in taxation and various other measures designed to restrain monetary expansion, the budget for 1962/63 still envisaged a deficit of Rs. 465 million. They stressed that, while providing some relief in the short term, quantitative restrictions or the increases in duties could not be considered as a satisfactory alternative to fiscal and monetary measures for eliminating inflationary pressures in the economy and eliminating the balance-of-payment disequilibrium. They 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 underemployment of resources. The Committee felt, however, that notwithstanding these difficulties, effective measures for restraining inflationary pressures were of utmost importance. The Committee expressed the hope that the authorities of Ceylon would find it possible to rely increasingly on fiscal and monetary measures as an alternative to direct import restrictions.

12. The representative of Ceylon agreed that quantitative restrictions did not constitute a sound basis for solving in the long term the country's balance-of-payments difficulties. A lasting solution of this problem depended primarily on the successful implementation of the country's economic development programme. Notwithstanding past difficulties in the implementation of certain measures, the Government was determined to avoid further inflationary expansion and to reduce, as far as possible, excess purchasing power in the hands of the public. As had been pointed out earlier, the recent increase in tariffs by 20 per cent for most categories of imports, apart from the direct effect which it was expected to have in reducing excess import demand, had also been taken for fiscal reasons. The additional revenue thus to be derived was expected to yield an amount approximately equivalent to what would have been derived from the  $7\frac{1}{2}$  per cent sales tax which the Government had originally intended to levy. Regarding the continuing large deficit in the Government's budget, the representative of Ceylon explained that it was hoped that the inflationary component of the deficit in the next fiscal year could be limited to approximately one third of the overall budget deficit.

System and methods of the restrictions

13. The Committee expressed understanding of the difficulties confronting Ceylon in implementing its development programme and in protecting its foreign exchange reserves in the face of adverse factors affecting the country's export trade and the balance of payments. The Committee expressed regret, however, that import restrictions had been progressively intensified over the last eighteen months.

14. Members of the Committee expressed concern over what appeared to be an element of discrimination, though undoubtedly unintentional, in Ceylon's import control system. For example, the practice of licensing imports of such items as textiles and cement subject to the provision that c.i.f. prices of the commodities concerned must not exceed a specified value clearly had an inhibiting effect on imports from distant countries and on trade with countries which had traditionally supplied higher quality goods. They expressed the hope that the authorities of Ceylon would explore the possibility of eliminating any element of discrimination and the consequent distortion of the pattern of trade which might result from the present licensing policy. In his reply, the representative of Ceylon stated that discrimination was more apparent than real. He stated that it was true that under a trade agreement with India, Ceylon had allowed certain imports of textiles from that country despite the fact that the c.i.f. price was above that specified in the relevant Import Notice. Although at first sight there appeared to be an element of discrimination, one had to bear in mind that what was allowed from India was the importation of handloom textiles which should be regarded as falling into a special category in contrast to mill-made textiles. He assured the Committee that he would not fail to bring the concern expressed by members of the Committee regarding possible discriminatory effects of the present import control measures to the attention of his Government.

15. Members of the Committee also pointed out that, in their view, the distinction made for licensing purposes between imports from different areas might have the effect of discouraging imports from certain sources. In any event, this distinction seemed hardly justifiable on balance-of-payments grounds. Rather, it would appear that the practice of reserving imports from certain areas to Registered Ceylonese Traders only, and of issuing licences for certain imports in those areas to other importers only to the extent that total imports of certain essential goods would otherwise be inadequate, might in certain instances discourage buying in the cheapest market and thus impede the best utilization of Ceylon's foreign exchange resources.

16. The representative of Ceylon explained that in the view of his Government the distinction between different areas in the operation of licensing controls did not in practice have any discriminatory effect. The differentiation was made for the purpose of ensuring that new trade would increasingly be in the hands of firms or individuals qualifying as Registered Ceylonese Traders. Care was taken by the Government in implementing its policy of Ceylonization of trade to avoid hardships for established importers not qualifying as Registered Ceylonese Traders or Indent Agents.

17. In reply to questions regarding the operation of the licensing controls, the representative of Ceylon explained that goods importable under Open General Licence by Registered Ceylonese Traders could also be imported by other importers without any limitation as to value or quantity except from the Ceylonized area or other reserved areas, as applicable. He explained further that, as far as he was aware, no distinction was being made in practice in licensing imports from the dollar area and the so-called EEPU area but he undertook to have the matter reviewed with a view to removing any distinction

which might exist. This matter would be reviewed. Regarding quota allocations, the representative of Ceylon explained that quotas were issued to Registered Ceylonese Traders and other traders alike based on imports in a specified previous period. This system of allocation had in the past tended to favour importers other than Registered Ceylonese Traders. In clarification of another point, the representative of Ceylon explained that where quota restrictions applied, quotas were established by the Government with an overall ceiling which took account of the availability of exchange reserves, import priorities, and estimated import needs for the goods concerned. In accordance with the relevant provisions of the General Agreement, and, as suggested by the Committee during the last consultation, the level of the quotas was made public so as to ensure full utilization of import quota facilities.

18. Referring to a recommendation by the Committee made during the last consultation regarding the importance of permitting at least token imports of items subject to balance-of-payments restrictions, members of the Committee noted that since the last consultation the number of products subject to virtual import prohibition had further increased. They urged the authorities of Ceylon to review their import policy with regard to these items and, in the interest of maintaining established channels of trade and as required under the relevant provisions of the General Agreement, to permit at least token quantities to be imported. The representative of Ceylon stated that his Government had always endeavoured to permit imports of at least minimum commercial quantities even where it was felt that imports of the products concerned should be severely limited for balance-of-payments reasons. In some cases however there were practical difficulties in the allocation of a small volume of imports among traders. Regarding goods in transit or for which firm import orders had been given prior to the imposition of restrictions on these products, the representative of Ceylon explained that such imports were generally admitted into the country without difficulty. In the past there had been a number of cases where abuses had occurred or where importers, in anticipation of import restrictions, had placed excessively large import orders which had led to considerable over-importation of the goods concerned. In similar cases in the future it might not be possible to permit the import in full of the goods affected.

19. In response to a question concerning the requirement of a 50 per cent cash deposit for certain products, the import of which was permitted only on a letter of credit basis, the representative of Ceylon explained that this requirement which had been introduced in August 1960 was not primarily intended for controlling imports. Only in a few instances was the establishment of a letter of credit for imports affected by this requirement subject also to prior approval by the Exchange Authorities.

20. In reply to questions concerning the treatment of imports from countries with which trade was conducted under bilateral agreements, the representative of Ceylon stated that private imports from bilateral partners were in no way accorded more favourable licensing treatment. Importers were free to choose their imports from any source purely on commercial considerations, subject only to the regulations governing the Ceylonization of the trade. At present, State trading was mainly confined to food items, where the primary objective was to ensure adequate supplies and fair distribution to consumers at low prices. Generally, imports under State trading were on the basis of commercial considerations, but in some cases it might be necessary to qualify this to take account of commitments under certain bilateral arrangements.

21. In reply to a question concerning the proportion of imports subject to import restrictions, the representative of Ceylon explained that since the last consultation, when the proportion of imports (1960 basis) subject to restrictions had amounted to approximately 25 per cent, the proportion of imports subjected to restrictions had increased by approximately 10 per cent, so that at present approximately 35 per cent of imports, on the basis of imports in 1960, were subject to quotas, individual licensing controls or import prohibition. In addition to these measures, tariffs on all items except on foodstuffs and petroleum had been increased in July and August 1962.

#### Effects of the restrictions

22. Members of the Committee pointed out that, as a result of the substantial increase in restrictions, there was increased danger of inefficient industries being established under the cover of protection afforded by controls imposed for balance-of-payments reasons. They expressed the hope that in formulating and implementing their licensing policies, the authorities of Ceylon would keep this problem in mind. The representative of Ceylon stated that his Government already had this under careful scrutiny.

#### General

23. 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 by the International Monetary Fund that "the general level of the various restrictive and tariff measures currently applied by Ceylon does not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves". The Committee welcomed the statement by the representative of Ceylon that, as soon as practicable and to the extent permitted by an improvement in the reserve situation, the Ceylon Government would revert to their traditional liberal import policy. The Committee also noted the recognition on the part of the Ceylonese Government that the achievement of balance-of-payments equilibrium depended on effective measures for curbing inflationary pressures and excess monetary expansion. They felt that there

was scope for reducing import demand through appropriate fiscal and monetary measures and expressed the hope that it would be possible for the Government of Ceylon to rely increasingly on such measures and to reduce the need for direct restrictions on imports.

24. 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 the suggestions made by the members of the Committee during the consultation to the attention of his Government which, no doubt, would give them careful consideration.

ANNEX

IMF Executive Board Decision of 26 February 1962.

ANNEX

International Monetary Fund Executive Board Decision  
Taken on 26 February 1962 at the Conclusion of the  
Consultation between the Fund and Ceylon

1. The Government of Ceylon has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.
2. In 1960 gross national product increased by 5.2 per cent and production of most principal crops increased substantially. The high level of agricultural production has been generally maintained in the first half of 1961. Industrial activities have also been rising since late 1960.
3. In 1960-61, the government cash deficit was larger than in any of the preceding four years and it was mainly financed as before by borrowing from the Central Bank, though there was some increase in recourse to non-bank resources. The Fund notes that Ceylon has taken measures to increase tax revenues in 1961-62 and urges the Government to reduce the budgetary deficit with a view to avoiding inflationary financing and to continue firm monetary measures.
4. The balance of payments deficits experienced in 1960 and 1961 were largely the result of inflationary fiscal policies and more recently of a deterioration in the terms of trade. The payments deficits have served as a principal offset to domestic monetary expansion but foreign exchange holdings have been drawn down to a low level. In the first half of 1961, the payments deficit was reduced as a result of stricter credit and trade restrictions.
5. In view of the continued deterioration of the balance of payments position, Ceylon has substantially increased its restrictions on imports during 1961. The Fund is concerned about the trend toward intensification of restrictions, and urges Ceylon to regard the elimination of internal inflationary pressures as basic to the strengthening of the payments position. The Fund believes that Ceylon should take steps to reduce its reliance upon bilateral payments arrangements.
6. In concluding the 1961 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Ceylon.

