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Panel on Article XVIII Applications

REPORT OF THE PANEL ON ARTICLE XVIII APPLICATIONS BY CEYLON

I. PROCEDURAL ARRANGEMENTS

1. In accordance with its terms of reference, the Panel considered, with the assistance of the representatives of Ceylon and of other contracting parties, the notification submitted by the Government of Ceylon under Article XVIII of the General Agreement. The Panel had before it the application made by Ceylon on 26 July 1957 (L/652), a statement addressed to the CONTRACTING PARTIES in support of the application (SECRET/89), the text of the Industrial Products Act of Ceylon No. 18 of 1949, as well as further written statements submitted by the Ceylon delegation (W.12/9 and W.12/11).
2. The Ceylon Government signed, on 30 October 1957, the Protocol Amending the Preamble and Parts II and III of the General Agreement; upon that date, the amended text of Article XVIII became applicable to Ceylon. Accordingly, the notification by Ceylon was considered by the Panel in accordance with the terms of the revised Article.
3. With the concurrence of the Ceylon and other interested delegations, it was agreed that the time-limits laid down in paragraphs 15, 17 and 18 of Article XVIII should be computed as from the date on which the new Article XVIII became applicable to Ceylon, as this date was the earliest on which the Ceylonese notification could be considered under the revised text. Accordingly, the time-limit set in paragraph 17 for the concurrence of the CONTRACTING PARTIES will expire on 28 January 1958 and the time-limit set in paragraph 18 for the conclusion of the consultations with the parties concerned will expire on 29 December 1957. As regards the time-limit set in paragraph 15, it was agreed that the question did not arise in this case, since there was general agreement that consultations between the CONTRACTING PARTIES and Ceylon were desirable.
4. Before proceeding with the examination of the notification, the Panel had to consider whether Ceylon was eligible under paragraph 4(a) of Article XVIII and thus entitled to have resort to Section C of the Article. The Panel considered first whether Ceylon was a country the economy of which could only

support low standards of living. The gross national product per caput for Ceylon in 1955 is estimated at \$128;¹ although this figure is higher than the gross national product per caput of countries such as Burma and India, it is lower than the corresponding figure for Greece, Cuba and the Dominican Republic and very substantially below the figure of industrialized countries in Western Europe. As regards the second question, whether Ceylon is a country whose economy is in the early stages of development, the Panel has taken as a general indication the share of manufacturing, mining and construction in the gross national product; in the case of Ceylon, this share (including mining which is a primary industry) is about 10 per cent, a figure lower than that of Burma and Greece and very substantially smaller than that of industrial countries.²

5. The Panel then addressed itself to the consultation provided for in paragraph 16 of Article XVIII. As defined in this paragraph, the consultation involves the consideration of three points:

- (a) the purpose of the proposed measure;
- (b) whether alternative measures available under the Agreement could achieve the objective envisaged; and
- (c) the possible effect of the measure proposed on the commercial and economic interests of other contracting parties.

6. First, the Panel endeavoured, in the light of the provisions of paragraphs 1, 2 and 13 of Article XVIII, to see whether the objectives of each measure proposed was to assist the establishment of a particular industry as defined in the relevant Note to Annex H, if such industry was established with a view to raising the general standard of living of the Ceylonese people and if the measure proposed was required to promote the establishment of that industry.

7. As regards the first criterion, the Panel examined, in the light of the data submitted by the Ceylon delegation, whether there was already a domestic production of the articles covered by each Ceylonese application, or, if such a production existed, whether the programme involved a substantial transformation of an existing industry, or a substantial increase in production for an industry which satisfied at present only a small fraction of the domestic demand. As regards the second criterion, the Panel had at its disposal estimates prepared by the secretariat³ with respect to the added national income which the new production was likely to bring about in the form of an economic exploitation of natural domestic resources, and of increased wages and profits, and with respect to the impact of the import substitution on the internal price level. It also

¹ Source: Statistics of National Income and Expenditure, statistical papers Series H, No. 10, United Nations, January 1957.

² Source: *Ibidem*

³ Document W.12/27

took into account the indirect effects which the diversification of the economic structure of Ceylon and the new employment opportunities offered by the development of new lines of production would have on the general economic and social structure of Ceylon, and therefore on the general standard of living of that country. In this connexion, it took fully into account the note contained in paragraph 42 of the Report on Quantitative Restrictions approved in 1955 during the Review of the Agreement.¹

8. The Panel then considered with the Ceylon delegation the alternative measures which might be available under the Agreement, such as tariffs (or tariff quotas) and subsidies, and took into account the practical difficulties which reliance on these measures might create for the achievement of the objective proposed by the Ceylon Government.

9. Finally, as regards the possible effect of the measures on the commercial or economic interests of other contracting parties, the Panel had at its disposal estimates prepared by the secretariat² concerning the probable effects of the measures not only on the imports of the products covered by the applications but also on imports of other products, such as raw materials, capital equipment and spare parts which would be required from the establishment or expansion of domestic production and consumer goods for which an increased demand should normally result from increased wages, salaries and profits.

10. Whenever an application involved items the duties on which were bound under the GATT, the Panel considered whether the conditions laid down in paragraphs 13 to 16 were fulfilled, then invited the Ceylon delegation to enter into consultations with the parties interested in accordance with paragraph 18 of Article XVIII. The Panel was informed that Ceylon had originally negotiated the concession on plywood chests with Denmark, Finland, Sweden and the United States, the concession on piece goods of mixed materials with France, Italy and the United States, and the concession on various manufactures of mixed materials with the United States. India and Japan claimed a substantial interest in various items under consideration; a claim which was recognized by the Ceylon delegation; the Panel deemed these two countries to have a substantial interest for the purposes of paragraph 18 of Article XVIII. The Ceylonese delegation entered into consultations with all the countries mentioned above.

11. At the time the Panel ended its hearings, it had not been informed that these consultations had been successfully completed. It recommends, therefore, that the Intersessional Committee should be given necessary powers to complete the procedure provided for in paragraph 18 of Article XVIII.

¹ Basic Instruments and Selected Documents, Third Supplement, p. 182.

² Document W.12/27

12. In the course of the hearings of the Panel, the Ceylonese Government agreed to modify its applications in certain respects. The Panel refers in the following paragraphs to these changes which would reduce the restrictive effect of some of the measures proposed.

II. EXAMINATION OF THE INDIVIDUAL APPLICATIONS

A. Sarongs

13. As regards sarongs, the Ceylon Government did not ask for the concurrence in a new measure or the renewal of a former release; its intention was to broaden the scope of the Decision approved by the CONTRACTING PARTIES on 16 November 1956 so as to include products which are not cotton sarongs but which nevertheless compete with the sarongs sold by the Ceylon producers. The object of the application was therefore to extend the operation of the Decision approved by the CONTRACTING PARTIES on 16 November 1956 so as to cover not only items:

- 841-05.14 Cotton sarongs, millmade
- 841-05.15 Cotton sarongs, handloom

but also the following products:

- Ex 652-02.01 Cotton piece goods bleached
- Ex 652-02.02 Cotton piece goods dyed
- Ex 652-02.03 Cotton piece goods colour woven
- Ex 652-02.04 Cotton piece goods printed
- Ex 652-02.99 Cotton piece goods others
- Ex 653.05 Piece goods in which the weight of artificial silk and synthetic fibre including any admixtures where the artificial silk content is not less than 50 per cent by weight, n.e.s.
- Ex 652-02.05 Piece goods of cotton mixed with less than 50 per cent of other materials
- 841-05.22 Manufactures of mixed materials - cotton mixed with less than 50 per cent of any other material sarongs, millmade
- 841-05.23 -do- sarongs, handloom Manufactures of artificial and silk synthetic fibre (including any admixtures thereof where the artificial silk content is not less than 50 per cent by weight n.e.s.)

14. As the object of the application was simply to redefine the scope of the release already granted, the Panel limited its consideration of the question whether the extension proposed was necessary to achieve the objective pursued by the Ceylon Government when it applied for a release in 1956.

At that time Ceylon intended to protect its domestic production of sarongs so as to enable it to reach within five years an output of 8.5 million square yards. After the measure was introduced, the Ceylon Government found that abnormal imports of sarong cloth in rolls and sarongs and sarong cloth of other materials had defeated the purpose. The production of domestic sarongs did not expand as was contemplated and part of the production remained in stocks because of an abnormal competition which was not contemplated in 1956. The Ceylon Government thinks it therefore necessary to regulate, on the one hand, the imports of some cotton piece goods which can easily be cut into sarongs and, on the other hand, the imports of sarongs and sarong cloth of other materials.

15. The Panel considered whether the effect of the extension required by the Ceylon Government would not be to intensify the restrictive effect of the release already granted. It noted the statement of the Ceylon delegation to the effect that before 1956 there was no trade in sarong cloth and a very small trade in rayon sarongs and sarong cloth, and that the present imports were the result of a diversion of trade designed to defeat the regulation of imports of cotton sarongs.

16. While recognizing that the Ceylon Government had no intention of restricting the imports of such goods over and above what was necessary to avoid the diversion mentioned above, the Panel was of the opinion that the application of the Industrial Products Act should be carefully defined so as to apply only to sarongs and such piece goods of cotton or other materials as could be easily identified as sarong cloth. With this object in view it would be appropriate to limit the operation of the five-year release to sarongs and piece goods with a repetitive pattern characteristic of sarongs and which can be cut into sarongs. As regards cotton piece goods (bleached) and cotton piece goods (other), these products could be used either for the manufacture of sarongs and for other uses; and the Ceylon delegation agreed that the Ceylon customs administration should devise practical arrangements to avoid that the application of the Act to these products be unduly restrictive. Accordingly, the Panel proposes that, for these items, the Decision of the CONTRACTING PARTIES be limited to one year, subject to review at the Thirteenth Session, in the light of the administrative arrangements which the Ceylon Government would propose in order to avoid unnecessary restrictions on piece goods which can be imported for other purposes.

17. As regards the items the duty on which is bound under the GATT, the Ceylon delegation entered into consultations pursuant to paragraph 18 of Article XVIII, but these consultations had not been completed at the time this Report was approved by the Panel. The Panel recommends that the CONTRACTING PARTIES should concur in the measure proposed, subject to the terms and conditions laid down in paragraph 1 of the Draft Decision and on the understanding that Section 1 of the Draft Decision would become operative only when the procedure set forth in paragraph 18 of Article XVIII has been completed.

B. Plywood chests

18. The CONTRACTING PARTIES granted, on 13 August 1949, a release to Ceylon for the application of the Industrial Products Act to plywood chests for a period of five years and a maximum domestic availability of 492,000. This release was extended on 2 March 1955 for a further period ending on 14 March 1958 and subject to the same conditions as before. The Ceylon Government has applied for a further extension of that release and requested that the maximum amount of domestic availability be raised to 650,000 chests, the maximum standard ratio being of one local to four imported, instead of one to seven as before.

19. The Panel considered this request for renewal in the light of paragraph 53 of the Report on Quantitative Restrictions approved at the Review Session.¹ It noted that the domestic production at the present time supplied only 13 per cent of the national market and was of the opinion that the increase in production from approximately 350,000 units in 1956 to 650,000 constituted a substantial expansion of an existing industry supplying relatively a small proportion of the domestic demand as defined in the relevant Note to Article XVIII.

20. As regards the effects of this expansion of production on the general standard of living in Ceylon, the Panel noted that the wood to be used as a raw material was locally available, with the exception of small quantities of coloured wood, which have to be imported, and that this local wood could not be used for other economic purposes. The additional employment opportunities at the plywood factory would cover about 100 workers, representing an increase in wages of about Rs.150,000. During the past year or so, the industry has shown substantial net profits and it is to be expected that these profits would continue to increase in proportion to the increase in output. On the basis of the wages paid and the profits earned during the last year, the carrying out of an extension programme is likely to increase the national income of Ceylon by about Rs.550,000. To this should be added the additional income gained in the felling of trees and the preparation of the wood for the factory, as well as the indirect effects which the additional income earned by the workers and employees of the factory may have on the turnover of, and income earned in, the domestic industries supplying consumer goods. Against this should be set the effect which the substitution of domestic chests for imported ones may have on the price level. Although quality differences make it difficult to arrive at very definite conclusions, it would not seem that the substitution proposed would not be such as to affect appreciably the general level of prices, or to involve any appreciable increase in the average purchasing price for the users.

21. The extension programme therefore appears to be likely to lead to some improvement in the general standard of living, although this influence would be very small. It should be stated, however, that the productivity of the local factory has improved substantially from 1952 to 1957; the selling price came down from 10 Rupees in 1952 to 9.30 in 1953 and 8.35 in 1957. The Ceylon delegation indicated that the reorganization of the factory and the increase in output would enable the industry to improve further its competitive position,

¹Basic Instruments and Selected Documents, 3rd Supplement, page 186

an expectation which the Panel considers to be reasonable. On the basis of its examination of all the factors involved, the Panel came to the conclusion that the proposed expansion of production appears to be consistent with the criteria laid down in paragraph 13 of Article XVIII.

22. The Panel then considered whether the Ceylon Government could not resort to measures consistent with the General Agreement to achieve the proposed objective. The Ceylon delegation explained that, although the local product enjoyed a small price advantage over European chests, it was difficult to sell it because of consumer resistance. The estates which use plywood chests arrange their purchases through agencies which are accustomed to buy chests abroad and it would take a number of years before the local product could overcome this traditional preference. The imported chests, although slightly more expensive, are more resistant and are therefore more appropriate for long-distance shipments; finally they fetch a higher price when sold second-hand by the importers abroad. The Ceylon delegation stated, however, that, as was indicated in the case of Japanese chests, consumer resistance was not the only factor.

23. The Ceylon Government had considered the possibility of protecting the local industry by means of tariffs or subsidies. As regards tariffs, it came to the conclusion that, since local production covered only a small part of the demand, the price effect of a tariff sufficiently high to enable the local product to compete with imported chests would substantially increase the cost of the chests which have to be imported in any case, and therefore the average cost of chests to the main users, who are exporters of tea, rubber and copra. This increase would affect the competitiveness of those exports and have an adverse effect on the economic situation of Ceylon. As regards the institution of tariff quotas, the Ceylon delegation did not think that this would provide a practical solution. That technique had not been tried out in Ceylon and the Ceylon delegation feared, that it would involve the same administrative difficulties as the operation of quantitative restrictions. An additional difficulty would result from the frequent and sharp fluctuations in the demand for chests, which would make it practically impossible to fix the level of the tariff quotas from year to year.

24. On the other hand, the Ceylon Government did not think that subsidies would be appropriate; apart from other considerations it felt that since the local industry had to be protected mainly against consumer resistance, the lowering of the selling price of the domestic product by means of a subsidy could not achieve that objective.

25. The Panel recognized that the tariff quotas might be difficult to apply in the circumstances existing in Ceylon and that tariffs and subsidies might not be entirely satisfactory to achieve the proposed objective so long as the domestic production supplied only a fraction of the demand. It considers, however, that these techniques, if not applicable in present circumstances, should replace the application of the Industrial Products Act as far as the conditions warrant it. The Ceylon Government should take advantage of the

expected improvement in the competitiveness of the local product to make the import licensing standards more liberal and to consider an elimination of the measure even before the end of the new five-year period. The protection granted to the local producers by the Industrial Products Act confers a kind of monopoly, which enables them to sell their production without having to feel competition from imported products and the only incentive to increased productivity and improved quality is the enforcement of standards and prices through the Act. Such method of protection may not be the best one to enable the industry to become rapidly competitive. In the annual reports which the Ceylon Government will be required to submit to the CONTRACTING PARTIES, consideration should be given to this point and some indication should be given on the progress made by the industry in improving its productivity. The Government might also be asked to state what relaxation of the protective measures, e.g. by a change in the standard ratio, could be expected during the following year and whether it can already indicate by which date it believes that the measure could be eliminated or, at least, replaced by a method of protection consistent with the General Agreement.

26. Finally, the Panel tried to assess the possible effects of the measure on the commercial and economic interest of other contracting parties. It noted that, even after domestic production increases, imports will continue to account for a substantial part of the total supply. On the assumption of an unchanged total demand for tea chests, the maximum effect of the import substitution might be to reduce the demand for imports at the end of the five-year period by about 200,000 chests a year, as compared with the present imports, implying a reduction in the value of such imports by some \$360,000, in which case the sales of domestic chests would fall short of the maximum production planned. For this reason, the outlay for equipment and spare parts would in this case amount to only about \$250,000 for the five-year period. If the demand regains a level comparable to that of 1954 and 1955, the measure would not lead to any reduction in imports but would prevent imports from rising as rapidly as would be the case in the absence of the measure proposed. On the other hand, the expansion of the local production would involve additional imports of equipment and spare parts which might amount to about \$300,000 for the five-year period. The increase in the national income would bring about additional imports of consumer goods which may exceed \$30,000 towards the end of the period. Although the reduction in imports of tea chests due to the introduction of the measure would partly be offset by the indirect effects on the imports of other products, the total Ceylonese imports would be reduced by an amount which should not be larger than \$160,000 per year during the five-year period if the demand for chests remains at the present level. Should that demand revert to the 1954-1955 level, there would, however, be a net increase in total imports of about \$500,000 per year.

27. While the Panel endeavoured to assess the overall effect of the proposed measure on the general economic and commercial interests of contracting parties exporting to Ceylon, in accordance with the terms of paragraph 16 of Article XVIII,

the countries interested in the export of tea chests - an item the duty of which is bound under the General Agreement - examined the effects of the measure on their interests in the course of consultations with the Ceylon delegation. The Panel was not informed of the result of that consultation at the time it completed the examination of the Ceylonese applications.

28. The Panel recommends that the CONTRACTING PARTIES should concur in the measure proposed, subject to the terms and conditions laid down in paragraph 2 of the Draft Decision, and on the understanding that paragraph 2 of the Draft Decision would become operative only when the procedure set forth in paragraph 18 of Article XVIII is completed.

C. Crown Corks

29. The Ceylon Government proposes to assist the establishment of a factory to manufacture this product in Ceylon. The Panel considered that this application met the first requirement laid down in paragraph 13, i.e. that the measure would promote the establishment of a new industry. As regards the effects of this new factory on the general standard of living, the Panel noted that the manufacture of crown corks would be an appropriate, if modest, starting point for the setting up of a metal-working industry, and would facilitate the creation at a later stage of a tin-printing industry. It recognized that Ceylon, which apart from rubber, cotton and copra had very few natural resources available for processing, had to rely for its development on value-adding industries. The factory, because of an intensive use of machinery, could give direct employment to only twenty-five workers and would create incomes of some Rs. 45,000 yearly (including wages and a reasonable remuneration of the capital invested in the factory). In addition, some favourable impact on industrial progress could be expected from the spreading of skills and "know-how" which this activity would entail. It was stated by the Ceylon delegation that the price which the consumer would have to pay would not be higher than the price paid for the imported product. Even if the expectations would not prove correct, the additional income derived from the establishment of the factory would appear to be sufficient to offset an increase in the cost of the product to the users by 10 per cent. The Panel considered that the establishment of that new industry could not be expected to make any appreciable contribution to the general standard of living in Ceylon, but that this appeared to be one of the marginal cases covered in paragraph 42 of the Report on quantitative restrictions approved at the Review Session.¹

30. The Panel went on to discuss the question whether alternative measures were available under the Agreement to achieve the proposed objective. The Ceylon delegation stated that private capital of local origin would be forthcoming only if the Government were prepared to grant assistance to overcome consumer resistance. This assistance could not take the form of a tariff,

¹ BISD 3rd Supplement, page 182

for, in view of the low value of the product, the present 17.5 per cent ad valorem tariff would need to be increased manifold. Other measures consistent with the GATT offered the same administrative difficulties as those outlined in the case of tea chests. The Ceylon Government was confident that, after three years, the quality of the local product would be recognized and the industry firmly established without need for further assistance under the Act. The Panel noted that the maintenance of a certain flow of imports of crown corks would act as an incentive to the local factory, which would be under pressure to improve its productive efficiency and quality up to the level of the imported article. It suggested that the Ceylon Government should impress upon the local manufacturer that the application of the Industrial Products Act would not exceed the proposed period of three years. The Ceylon delegation agreed to bring down the maximum standard ratio from five local to one imported, to three to one; the Panel welcomed this change which would enable competition from foreign products to exercise some influence over the quality and price of the local products.

31. The Panel then addressed itself to the possible effects of the measure on the commercial and economic interests of other contracting parties. It noted that the reduction of imports to be expected from the measures would be mitigated by the importation of cork and metal and of all the machinery required for the equipment of the factory. While the reduction in imports of crown corks would amount to approximately \$80,000 a year, the additional imports with respect to machinery, raw materials and consumer goods do not appear to be large enough to make up for this reduction; the net falling off in imports would, however, be small.

32. As the protection afforded to the domestic industry by the application of the Industrial Products Act appears amply sufficient, the Panel suggests that the Ceylon Government consider the possibility of suspending, during the period of the release, the levy of the import duty of $17\frac{1}{2}$ per cent. This duty, if maintained, would constitute for the exporter (or the domestic consumer) an additional burden which does not appear necessary for the achievement of the objective pursued; the suspension of that duty would also reduce the effect of the import substitution on the overall domestic level of prices. The Panel recommends that the CONTRACTING PARTIES concur in the measure proposed as modified by the Ceylon delegation, subject to the terms and conditions laid down in the Draft Decision.

D. Cycle tyres and tubes

33. This application relates to the establishment of a new branch of production in an existing industry. In 1956, the Ceylon Government had obtained a release for the establishment of a bicycle industry, and it now intends to manufacture also cycle tyres and tubes. The Ceylon representative explained that the production of bicycle tyres and tubes would be combined with tyre retreading, a process using similar equipment and already carried out in Ceylon. Carbon black also used for retreading and indigenous rubber would be the main component materials. The Panel agreed that the application met the first requirement of paragraph 13 as set out in the Note to that paragraph.

34. Concerning the effects of the proposed measure on the standard of living, the Panel observed that the additional opportunities in the new factory itself, without taking into account the workers who would be employed in packaging and distribution services and other subsidiary activities, would bring employment for some eighty persons, i.e. an increase in wages of about Rs. 120,000 yearly. It could be estimated that, if profits and indirect effects are also taken into account, the setting up of this new branch of products might contribute some Rs. 300 to Rs. 500,000 to the Ceylonese national income. The scale of production and the use of adequate resources of machinery and technical skill would permit the local tyre (including the tube) to be marketed at Rs. 7 wholesale and Rs. 8 retail. In 1956, the average c.i.f. price of the imported product amounted to Rs. 5.50. Therefore, if the duty of 30 per cent ad valorem is taken into account, the import substitution would appear to involve no increase - or even a slight fall - in the total cost to the consumers but a reduction in the revenue derived by the Government from that import duty. On the basis of present consumption and price figures, the net effect on the general standard of living would be negligible, the Panel recognizes, however, that the project may have in the future favourable effect on the economic structure of the country.

35. The Panel then examined whether alternative measures were available under the Agreement to achieve the proposed objective. The Ceylon delegation explained that, although there would be a price advantage for the local product vis-à-vis the imported article, the local product would be difficult to sell because of strong consumer resistance. The duty on imported bicycle tyres and tubes, which already amounted to 30 per cent, could not be raised for it would, pending full-scale production, penalize the consumers of these products. As already set out, alternative measures such as subsidies or tariff quotas were not practicable.

36. The Panel agreed that some form of temporary restrictive protection might be required to overcome consumer resistance, but, as the intention was rapidly to supply a major part, if not the whole, of the domestic demand, the argument advanced against reliance on a tariff would lose much of its force as soon as production develops. It sincerely hoped that the Ceylon Government would be in a position to terminate the application of the Industrial Products Act as soon as practicable, perhaps even before the end of the three-year period.

37. The Panel noted, moreover, that a duty of 30 per cent (general) was already levied on imported tyres and tubes; although this duty was considered as a revenue duty, the Panel wishes to point out that, as soon as a substantial local production starts, the domestic industry will enjoy an incidental protection of 30 per cent apart from the protection granted through the application of the Act. At the same time, the import substitution would reduce substantially the revenue drawn from that duty. The Panel is of the opinion that the continuation of the tariff and the application of the Act would afford a protection in excess of what appears to be necessary.

It welcomed the change proposed by the Ceylon delegation in the standard ratio; this change would allow some competition of foreign products and therefore act as an incentive for the industry to improve the quality and price of its products; the Panel suggests, however, that the Ceylon Government considers the possibility of suspending the import duty during the period of application of the Act to cycle tyres and tubes. If the loss in revenue appears too heavy for the Ceylon Government it might consider the introduction of an internal tax applied equally to domestic and imported products, on tyres and tubes or any other product which would be likely to produce the revenue necessary to make up for the suspension of the import duty.

38. The Panel finally considered the possible effects of the measure on the commercial and economic interests of other contracting parties. It appeared that the measure, when fully implemented, could be expected to reduce imports of cycle tyres and tubes by some \$150,000 a year. On the other hand, imports of machinery and spare parts during the three years of currency of the release could be estimated at \$120,000. Moreover, the establishment of the local industry, by its effect on the national income, is likely to create an additional demand for imports of consumer goods which could be estimated at about \$20 to \$30,000 per year. The net effect of the measure on the overall import trade of Ceylon would appear to be a reduction of total imports by about \$80 to \$100,000 a year.

39. The Panel recommends that, although the measure would probably affect trade to a not negligible extent, the CONTRACTING PARTIES do not object to the measure proposed as modified by the Ceylon delegation, in view of the short duration of its application and the terms and conditions laid down in the Draft Decision.

E. Cotton Textiles

40. The Panel examined with particular attention the application submitted by the Ceylon Government in this respect, as the proposed measure applied to a very large sector of industry and involved essential consumer goods the price of which influenced directly the general standard of living. Moreover, the effect on trade of that measure would be substantial, as the imports affected accounted for more than 5 per cent of the total imports of Ceylon. The project had two aspects. First, a substantial transformation of a modern manufacturing industry and a substantial expansion of a traditional cottage industry which supplied at present a relatively small proportion of the domestic demand. The industry consists now of one spinning and weaving mill, some 200 power looms and 7,000 handlooms. Plans for the future included two spinning mills - one State-owned and the other private - and an increase in equipment outside these mills which will bring the total of power looms to 1,500 and that of handlooms to 14,000; these looms are owned by artisans or small co-operative societies which will receive financial assistance from the Government for the purchase of the new equipment. Moreover, the proposed measure would concentrate the production of textiles on the thirteen items covered by the application, and therefore involve a very substantial reduction in the production of other textile products which would then be purchased abroad. Both the spinning and weaving mill and the cottage industry supply at present about 9.2 million yards of the thirteen items in question against imports of 85 million yards. The intention is to step up production gradually to 60 million yards in 1962. The proposed measure meets the first requirement of paragraph 13 as it provides for the substantial expansion of an existing industry supplying a relatively small proportion of the domestic demand.

41. The next question considered by the Panel was the effect that this important plan was likely to have on the standard of living. So far as labour is concerned, the scheme would enable the industry to provide additional employment for 2,100 wage earners in the manufacturing industry, and for 16,700 persons in the cottage and co-operative industries. The increase in earnings for these persons would amount to Rs. 13-15 million. If other direct effects are taken into account, it is estimated that the national income would increase by about 0.3 to 0.4 per cent. On the other hand, the substitution of domestic products for imported goods would have a substantial effect on the average price of the thirteen items: however, since it is intended to reduce the production of other textiles, the effect on the general cost of living would be much less substantial. On the basis of available data, it would appear that the effect of the substitution would be to raise the general level of retail prices by 0.8 to 0.9 per cent. In other words, on the basis of the present price situation and taking account only of the direct effects on employment and income, the proposed measure would slightly raise the nominal national income, but, as a result of the price increase, the national income in real terms would fall slightly. If, however, account is taken of the indirect effects on the income of other groups of the community, it appears quite possible that the proposed measure could result at least in the maintenance of, if not contribute to an improvement in, the general standard of living, particularly if the present cost of the domestic product were substantially reduced in the near future. The Ceylon delegation was confident that the plans of the Government would result in such a price reduction by means of increased productivity. Whereas the Panel felt that this expectation was reasonable in the case of the new or enlarged mills, it expressed some doubts as to the possibility of a rapid improvement in productivity in the case of the small enterprises which rely on hand and power looms. The experience of other countries has shown that a cottage textile industry, even if assisted by governmental measures as those proposed in Ceylon, cannot be expected to compete successfully with a modern manufacturing industry.

42. In view, however, of the advantages which the scheme would have on the conditions of life in villages and in the country in general, and the need for finding adequate employment for a large number of inhabitants, the Panel came to the conclusion that the scheme is consistent with the general purpose of paragraph 13; but, in its opinion, the Government should pay particular attention to the urgent need of improving the efficiency of production both in the mills and in the handloom and power loom centres. Moreover, the Government should see to it that the protection granted at any time should not exceed what is absolutely necessary, in view of the importance of textile products in total consumer expenditures.

43. As regards the practicability of alternative measures, the reasons advanced by the Ceylon delegation did not differ from those which were indicated with respect to the other products discussed above. In this case, the Panel was of the opinion that so long as the domestic production accounted for a small part of the total supply, the difficulties pointed out by the Ceylon delegation were real, but it feels that, in this case, probably more than any other application submitted by the Ceylon Government, the shift to a tariff should be considered as early as possible, and in any case before domestic production reaches the figure of 60 million yards. Although the present tariff is comparatively low, the Panel suggests that the Ceylon Government might well consider the possibility of a

temporary suspension of these duties so long as the Industrial Products Act remains in operation for the thirteen textile items; this suspension would not only reduce the incidental protection granted to the domestic producer, but also affect formally the average price of the products for the consumer. It may be that the Government will find that such suspension would involve a serious loss in revenue; the Panel suggests that the operation of the scheme would in any case bring about a substantial reduction in the imports of those products, and therefore a corresponding loss in revenue. The Government should consider as early as possible which alternative source of revenue could be tapped in order to make up for that loss.

44. In view of the importance of the Scheme, the Panel considered in detail the effects which the plan was likely to have on the trade of the exporting countries, particularly India and Japan. The Note submitted by the secretariat gives a detailed analysis of the reduction of imports to be contemplated, due account being taken of the regular increase in consumption and of the additional imports which the carrying out of the plan would bring about in the form of additional purchases of capital equipment and spare parts and cotton and of increased imports of textiles, the production of which would be curtailed, and of additional imports of consumer goods. There is a real possibility that the main suppliers and, in particular, India and Japan, might find in those additional imports compensation for the reduction in imports of the products covered by the application although the new purchases may not necessarily be made in the countries which have so far supplied those products. If total textile consumption as well as the national income increases in Ceylon at only half the present rate, i.e. by 5 per cent per annum, the probable effects of the proposed measure on the import trade of Ceylon would be to increase total imports by about \$2½ to \$5 million towards the end of the period.

45. The Panel welcomed the decision of the Ceylon Government to reduce the standard ratio of five to one as originally proposed, to a ratio of two to one. In the opinion of the Panel, this change would allow foreign products to compete to a certain extent with local products on the Ceylonese market. The representative of one contracting party interested felt that the ratio was still too high. While recognizing that there would be advantages in increasing further the area of competition, the Panel considered it might be unwise at this stage to modify the maximum standard ratio as now proposed by the Ceylon delegation; it recommends, however, that the Ceylon authorities should keep the matter under constant review so as to keep the actual ratio at a level which permits sound competitiveness with the foreign products.

46. In the annual reports to be submitted by the Ceylon Government, the CONTRACTING PARTIES would probably wish to have detailed information on price trends on the domestic market and the way in which the Industrial Products Act is operated. After examining these reports, the CONTRACTING PARTIES might think it appropriate to suggest to the Ceylon Government certain improvements which might be introduced in the practical operation of protective measures applied.

47. As regards one item -- bed-sheets -- the duty on which is bound under the General Agreement, the Ceylon Government entered into consultation with the contracting parties concerned. At the time it completed its hearings, the Panel had not been informed of the result of that consultation. The Panel recommends that the CONTRACTING PARTIES should concur in the measures proposed, as modified by the Ceylon delegation, subject to the terms and conditions laid down in paragraph 5 of the Draft Decision and on the understanding that paragraph 5 of the Draft Decision would be operative only when the procedure set forth in paragraph 18 of Article XVIII is completed.

III. OTHER QUESTIONS

48. As the Ceylonese applications are the first to be considered by the CONTRACTING PARTIES under the revised text of Article XVIII, the Panel thinks it useful to draw the attention of the CONTRACTING PARTIES to some procedural arrangements which it may be necessary to consider at this Session.

49. The new article sets a number of fixed time-limits for the procedure before the CONTRACTING PARTIES. This system can only work satisfactorily if the notification provided for in paragraph 14 of that Article is accompanied by all the data which are necessary to enable the CONTRACTING PARTIES to conduct a fruitful consultation with the applicant contracting party; moreover, the CONTRACTING PARTIES may wish to confirm that the Intersessional Committee has the necessary authority to act for the CONTRACTING PARTIES if a notification under Article XVIII has to be dealt with at a time when the CONTRACTING PARTIES are not in session. The Panel suggests that the secretariat revises, in the light of the examination of the Ceylonese applications, the questionnaire which has been used so far by the CONTRACTING PARTIES in the operation of Article XVIII. The revised questionnaire could then be submitted for approval by the Intersessional Committee.

50. Paragraph 6 of the new text of Article XVIII provides that the CONTRACTING PARTIES shall review annually all the measures applied pursuant to the provisions of Sections C and D of that Article. The Panel suggests that the review be made on the basis of reports submitted by the countries concerned and should contain detailed information on the developments in the production, prices and imports of the products concerned. In the case of Ceylon, this information should include, inter alia, the actual figures applied in the course of the preceding year for the domestic availability and the standard ratio between local and imported products. Moreover, the report should, as far as possible, give some indication on the standards which the Government intends to apply in the following year for the operation of the measure and on the prospects of relaxing or eliminating the restrictions or the replacement of those restrictions by alternative measures available under the Agreement.

51. Before concluding its report, the Panel wishes to express its appreciation of the collaboration given by the Ceylon delegation in the course of its hearings. The new text of Article XVIII involves a number of changes in the former procedures and a change of emphasis in the examination of the applications by the CONTRACTING PARTIES, and the Panel had to ask from the Ceylon delegation a number of additional data which were not required under the former text.

52. The consultation under the new Article involves, not only an assessment of the possible effects of the measure on the imports of the products covered by the application; it has a broader object and appears to require an analysis of the effects of the measure on the economic and commercial interests of other contracting parties as a whole which involves a study of the probable impact on the total imports of the country concerned. On the other hand, the CONTRACTING PARTIES have also to examine the purpose of the proposed measure and

its consistency with the criteria laid down in paragraph 13 of Article XVIII; this aspect of the consultation goes beyond the usual scope of trade discussions and requires an objective analysis of a number of economic facts and factors. In the course of its work, the Panel has acquired the conviction that such an analysis may be of particular value for the applicant country. The exchange of views which take place in the course of such consultation should contribute to a better understanding by the exporting countries of the legitimate requirements of economic development on and by the applicant country of the need, in the interest of economic development itself, to reduce to a minimum the restrictive effect of the measure proposed.

IV. DRAFT DECISION

53. The Panel submits to the CONTRACTING PARTIES, for consideration and approval, the following draft Decision. As indicated in the report, the sections of the Decision relating to items the duty on which is bound under the General Agreement will become operative only when the procedures provided for under paragraph 18 of Article XVIII have been completed. As regards 1(b) and 5(b), the Panel recommends that the release should be valid until the end of 1958, on the understanding that, if the administrative arrangements to be proposed by the Ceylonese Government at the Thirteenth Session are considered to be satisfactory, the validity of the release would be extended to the period provided for in 1(a) and 5(a) respectively.

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DRAFT DECISION CONCERNING THE APPLICATION BY CEYLON OF MEASURES PURSUANT TO SECTION C OF ARTICLE XVIII

CONSIDERING that the Government of Ceylon has notified, pursuant to paragraph 14 of Article XVIII, the special difficulties which it meets in the establishment or substantial expansion of particular industries, and its intention of applying the Industrial Products Act to the imports of certain products in order to remedy these difficulties, and that the Government of Ceylon is eligible under paragraph 4(a) of Article XVIII to have recourse to the provisions and procedures set out in Section C of that Article;

CONSIDERING FURTHER that there is, in present circumstances, no measure consistent with the provisions of the General Agreement which is practicable in order to give the governmental assistance required to achieve the objective proposed consistently with the terms of paragraph 13 of Article XVIII, and that the Government of Ceylon has conducted consultations with the CONTRACTING PARTIES interested as provided for in paragraph 18 of that Article,

the CONTRACTING PARTIES

CONCUR in the application of the Ceylon Industrial Products Act No. 18 of 1949 to the products specified below, subject to the terms and conditions laid down in the following paragraphs. The Government of Ceylon is accordingly released of its obligations under the relevant provisions of the General Agreement to the extent necessary to give effect to this Decision.

1(a)	841-05.14	Manufactures of cotton sarongs, millmade
	841-05.15	Manufactures of cotton sarongs, handloom
	841-05.22	Manufactures of mixed material - cotton mixed with less than 50 per cent of any other material - sarongs, millmade
	841-05.23	Manufactures of mixed material - cotton mixed with less than 50 per cent of any other material - sarongs, handloom

Products falling within the following tariff description in so far as they are piece goods with a repetitive pattern characteristic of sarongs, which can be cut into sarongs:

Ex 652-02.02	Cotton piece goods (dyed)
Ex 652-02.03	" " " (colour woven)
Ex 652-02.04	" " " (printed)
Ex 653-05	Piece goods in which the weight of artificial silk and synthetic fibre, including any admixtures where the artificial silk content is not less than 50 per cent n.e.s.
Ex 652-02.05	Piece goods of cotton, mixed with less than 50 per cent of other materials
841-05.04	Manufactures of artificial and silk synthetic fibre (including any admixtures thereof where the artificial silk content is not less than 50 per cent by weight n.e.s.) - sarongs.

This release replaces the release granted on 16 November 1956 by the CONTRACTING PARTIES on cotton sarongs, millmade and handloom (841-05.14 and 841-05.15). It is valid until 13 October 1962; provided that for the purpose of issuing import licences under that Act, the domestic availability used in calculating the standard ratio shall not exceed 8.5 million square yards and the standard ratio between the local product and the corresponding imported product, the proportion of three to one.

1(b) Products falling within the following tariff descriptions in so far as they can be used for the manufacture of sarongs:

Ex 652-02.01	Cotton piece goods (bleached)
Ex 652-02.99	Cotton piece goods (others)

The release in respect of the products specified above is valid until 31 December 1958; it will be reviewed at the Thirteenth Session in the light of administrative arrangements to be proposed by the Ceylon Government in order to avoid unduly restrictive effects on imports of these piece goods which are not used for the manufacture of the products specified in 1(a) above.

2. 631-02.01 Tea and other chests and shooks including fittings other than metal

The release in respect of the product specified above is valid for a period of five years from 14 March 1958, provided that for the purpose of issuing import licences under the Industrial Products Act, the domestic availability used in calculating the standard ratio shall not exceed 650,000 chests and the standard ratio between the local product and the corresponding imported product the proportion one to four.

3. 699-29.04 Crown corks

The release in respect of this product specified above is valid for a period of five years from the day on which the product is brought under regulation under the said Act; provided that, for the purpose of issuing import licences under the act, the domestic availability used in calculating the standard ratio shall not exceed 4,500 cwt. and the standard ratio between the local product and the corresponding imported product, the proportion of three to one.

4. 629-01.04 Pneumatic rubber tyres for pedal cycles
 629-01.22 Pneumatic rubber tubes for pedal cycles

The release in respect of the products specified above is valid for a period of five years from the day on which the products are brought under regulation under the said Act; provided that for the purpose of issuing import licences under the Act, the domestic availability used in calculating the standard ratio shall not exceed 200,000 tyres and 200,000 tubes and the standard ratio between the local product and the corresponding imported product the proportion of three to one.

- 5(a) Ex 652-02.99 Grey Cloth
 (Drill)
 (Shawls)
 (Poplin)
 (Long cloth)
 (Dothies) cotton,
Ex 652-02.02 (Sheeting) not mixed
Ex 652-02.03 (Casement)
Ex 652-02.04 (Shirting)
 (Tussore)
 (Ticking)
 (Gingham)
Ex 654-04.99 Bed linen

The release in respect of the products specified above is valid for a period of five years from the day on which the products are brought under regulation under the said Act; provided that, for the purpose of issuing import licences under the Act, the domestic availability used in calculating the standard ratio shall not exceed 60 million yards and the standard ratio between the local product and the corresponding imported product the proportion of two to one.

5(b) Products falling within the following tariff description in so far as they can be used for the manufacture of the products specified in 5(a) above.

Ex 652-02.01

Cotton piece goods (bleached)

The release in respect of the products specified above is valid until 31 December 1958; it will be reviewed at the Thirteenth Session in the light of administrative arrangements to be proposed by the Ceylon Government in order to avoid unduly restrictive effects on imports of those goods which are not used for the manufacture of the products specified in 5(a) above.

6. In accordance with paragraph 20 of Article XVIII, the application of the Industrial Products Act to the importation of the products specified in this Decision shall comply with the provisions of Article XIII of the Agreement and the provisos set forth in paragraph 10 of Article XVIII.

Points for Decision

Paragraph 11
Paragraph 48
Paragraph 49