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CEYLON TEMPORARY DUTY INCREASES

Report by Ceylon Under Decision of 21 January 1967

I. Background to Ceylon's balance-of-payments difficulties

For the past ten years the Ceylon economy has suffered from the effect of serious balance-of-payments difficulties. The difficulties which manifested themselves in the late 'fifties increased very rapidly in the early 'sixties and since then the mounting difficulties on external payments have forced the Government to adopt emergency measures to restrict the volume of imports and to expand the level of exports. The volume of imports is now regulated by means of a strictly enforced foreign exchange budget which limits the quantum of imports by commodities and sectors in consonance with anticipated export incomes and expected foreign aid. Tariffs are used primarily as a device for the protection of import substitution industries that have prospects of viability and discouraging inessential imports. Complementary measures are being taken to maximize the country's export earnings chiefly through the replanting and modernization of existing plantation industries, with great attention being paid to increases in productivity and cost reductions.

But the experience of Ceylon over the past decade has been that notwithstanding impressive increases in output of traditional export industries and the introduction of new products with a view towards diversifying exports there has been a serious deterioration in Ceylon's commodity terms of trade, both due to a fall in export prices and a rise in import prices over key sectors of exports and imports vital to the Ceylon economy. The prospects for Ceylon's balance of payments in the future decade are essentially tied to the fortunes of her principal exports, viz. tea, rubber and coconut, though some relief may be afforded through increased domestic production of rice and other subsidiary foodstuffs. Forecasts of world supply-demand position for Ceylon's principal export products do not however give room for optimism and the indications are that Ceylon will in this context be forced to continue her restrictions on imports through resort to quantitative and qualitative trade controls if further pressures on Ceylon's balance of payments are to be avoided. The resort to trade controls appears to be imperative particularly since there is no further scope for financing Ceylon's imbalances in payments through the use of external reserves. Further since Ceylon's short-term external liabilities have increased very rapidly in recent years increasing amounts of foreign exchange have to be set apart each year for the discharge of these liabilities according to schedule.

In 1966, largely due to a sharp fall in the prices of tea, rubber and coconut, combined with a shortfall in the volume of exports of tea and coconut, export incomes declined as much as Cey Rs 235 million. Payments for merchandise imports have in contrast rapidly increased over the period from approximately Cey Rs 1,764 million in 1957 to about Cey Rs 2,022 million in 1966; imports are estimated at Cey Rs 2,231 million in 1967. In recent years there has also been a tendency for the invisibles account of the balance of payments to move adversely, partly due to a reduction in earnings from Ceylon ports and also due to an increase in private transfers and repatriation of investment income.

The ability to finance a payments programme far in excess of current export earnings has been made possible by receipts of foreign aid, the use of external reserves and the accumulation of short-term liabilities. Thus the external aid (inclusive of loans and grants), received by Ceylon has increased from Cey Rs 50 million in 1957 to Cey Rs 224 million in 1966. Ceylon's external assets have declined from Cey Rs 1,062 million in 1957 to Cey Rs 318 million in 1966, while Ceylon's official short-term liabilities have increased from Cey Rs 0.2 million to Cey Rs 332.5 million over the same period and have since then increased to Cey Rs 483.9 million. Increasing amounts of these short-term liabilities fall due for payment over the next few years. While it is true that generally speaking external aid inflows provide valuable support to the balance of payments and therefore obviate the need for imposing stringent controls, in Ceylon's case, however, external aid inflows have barely compensated for the sharp decline in Ceylon's terms of trade, combined with the repayments of short and long debt.

The deterioration in Ceylon's terms of trade has seriously reduced Ceylon's capacity to import. Simultaneously the volume of funds devoted to capital amortization on public and private account have almost quadrupled from Cey Rs 29 million to Cey Rs 114 million over the period. Likewise there has been a doubling of interest payments from Cey Rs 11 million to Cey Rs 21 million over the years 1957-1966. Further, it is only since 1966 that commodity aid in reasonable amounts has been forthcoming. Accordingly the import licensing programme has been liberalized in those sectors relating to commodity aid. Where, however, the aid received is primarily in the form of project aid or where commodity aid is concentrated over a narrow periphery, the possibilities for relaxation of import controls of a quantitative or qualitative nature are very remote in the context of the present stage of the Ceylon economy. Moreover, reliance on external trade controls would continue to be imperative if Ceylon's scarce external resources are to be harnessed for financing development.

II. Balance-of-payments prospects for 1967

Estimates of the balance of payments of Ceylon for the year 1967 are given in the annex. It is observed that export income is expected to be approximately Cey Rs 1,723 million. This is only Cey Rs 49 million higher than the very low earnings of Cey Rs 1,674 million in 1966. Imports in 1967, however, are estimated to be in the region of Cey Rs 2,231 million. Ceylon is expected to have an invisibles account deficit (excluding grants) of Cey Rs 37 million. Capital payments in 1967 are estimated at Cey Rs 72 million. The deficit to be financed in 1967, therefore, works out to Cey Rs 617 million.

This large deficit will be financed from the following sources: (a) gross drawings from the International Monetary Fund totalling Cey Rs 123 million, (b) project aid amounting to Cey Rs 60 million, (c) commodity aid of Cey Rs 331 million (of which a sum of approximately Cey Rs 256 million represents a spillover of aid receivable under the First and Second Aid Programmes); aid to be received under the Third Aid Programme (the Tokyo Meeting) is estimated at Cey Rs 75 million for 1967, (d) short-term financing facilities estimated at Cey Rs 93 million, (e) private foreign capital estimated at Cey Rs 10 million.

(a) Exports

Merchandise export earnings are estimated at Cey Rs 1,723 million. Income from tea and rubber is expected to increase in 1967, as compared with 1966, principally due to an increase in the volume of exports, though the decline in output of tea in the first half of 1967 may modify the extent of the anticipated improvement unless compensatory increases occur in the second half; the average prices of these two commodities are expected to decline further in 1967, in continuation of the trends that have prevailed in the last few years. In the case of tea, world over-supply in relation to demand has been the principal cause of the price decline. The recent increase in the internal excise duty and the lowering of the export duty on tea in India is also likely to provide an incentive for the export of quality teas by that country, so that greater pressures on price may be anticipated. The threat by South Africa to curtail her tea imports from Ceylon by 20 per cent is another factor that may adversely affect earnings from tea. The recent disturbances in the Middle East have also exercised a depressing effect on Ceylon's income from tea exports.

The prospects for rubber are also not too encouraging. Rubber prices are now the lowest in eighteen years and a continuation of strikes in the United States tyre industry and depressed economic activity in the United Kingdom and Germany leave hardly any room for optimism. The supply-demand position for rubber is likely to be aggravated by increased exports from Malaysia and Indonesia. Competition from synthetic rubber continues to be intense and sales of Stockpile Rubber from the United States stocks have continued. Recent press

reports seem to indicate that the United States intends to reduce the volume of stockpile releases of rubber in 1967. In regard to coconut products, earnings in 1967 are expected to be lower than in 1966. World markets in this commodity are rather uncertain just now and buyers seem to be holding back in anticipation of the availability of increased supplies from Indonesia.

(b) Imports

The value of allocations for merchandise imports in 1967 at Cey Rs 2,231 million is approximately Cey Rs 46 million in excess of the value of licences issued in 1966. The increased value of imports has been made possible partly as a result of an anticipated increase in export earnings as compared with the previous year and partly due to a commodity aid spillover of Cey Rs 256 million from last year and new commodity aid totalling Cey Rs 75 million arising from the Aid Meeting held in Tokyo in February, this year. In addition Ceylon has drawn a net sum of Cey Rs 105 million from the International Monetary Fund - Cey Rs 92.8 million under the Fund's Compensatory Financing Scheme for fluctuations in export earnings and Cey Rs 29.8 million representing the fourth and final instalment of the Second Standby Arrangement for US$25 million; Ceylon repaid a sum of Cey Rs 17.9 million to the Fund in February, 1967. Project aid in 1967 is estimated to be about Cey Rs 60 million. Ceylon has also negotiated financing of a short-term nature for imports valued at approximately Cey Rs 93 million.

The country has adopted an austere import programme, particularly in regard to consumer goods imports outlays on which have been reduced even below the very low per capita levels existing in 1966. The principal reductions in outlay have been in respect of textiles (47 per cent) drugs (32 per cent) and other foodstuffs (23 per cent). The allocations for development imports, particularly of intermediate and investment goods have been increased, principally as a result of the additional aid expected in 1967. However, the closure of the Suez Canal and the surcharge on the carriage of goods to and from Ceylon will in effect result in a further reduction of the quantum of goods imported since the increase in transportation costs will have to be met out of existing import allocations.

(c) Invisibles

The deficit on current invisibles (excluding grants) is expected to be around Cey Rs 37 million in 1967 as compared with Cey Rs 19 million in 1966. In the estimates, increased allocations have been made for the transfer of investment income consequent on the continuation of the relaxation of the moratorium on the transfer of profits. It is also anticipated that private transfers would also increase in 1967. However, in practice it is quite likely that the deficit on the invisibles account may be much larger than the original estimates, due to the imposition of a number of extraneous factors, of recent origin.

For example, the Conference Lines have recently imposed a surcharge of 17½ per cent on the carriage of cargo from the United Kingdom and continental ports to Ceylon. This would add approximately Cey Rs 15 to 20 million to Ceylon's freight bill. Again, the disruption caused by the closure of the Suez Canal is likely to increase the volume of congestion in the Port of Colombo. This is likely to increase the volume of demurrage payments, unless arrangements can be made to ensure the uninterrupted discharge of cargo. The passage of legislation in regard to the Indo-Ceylon Agreement on the repatriation of citizens of Indian origin is also likely to increase the volume of funds required for migrants' transfers, particularly if the numbers who wish to leave are bunched in the last quarter of 1967. It is tentatively estimated that these repatriates would transfer approximately Cey Rs 40 million each year for a period of ten years.

ANNEX

Ceylon's Balance of Payments Estimated for 1967

Rupees million

		Credit		Debit		Net
1.	Exports	1,723				
2.	Imports			2,231		-508
3.	Current invisibles, transportation and insurance	116		26		+ 90
	Foreign travel	8		16		- 8
	Investment income	11		71		- 60
	Profits and dividends 2		44		-42	
	Interest 9		27		-18	
	Government expenditure	25		21		+ 4
	Miscellaneous services	37		75		- 38
	Private transfer payments	6		31		- 25
	Total current invisibles	203		240		- 37
4.	Total current account	1,926		2,471		-545
5.	Capital payments					
	Long-term loans	-		44		- 44
	IMF repurchases	-		18		- 18
	Compensation to oil companies	-		8		- 8
	Contribution to Asian Development Bank	-		2		- 2
	Total capital payments	-		72		- 72
6.	Total current and capital payments	1,926		2,543		-617
7.	Financing					
	IMF drawings	123		-		+123
	Project aid	60		-		+ 60
	Commodity aid	331		-		+331
	Short-term liabilities	103		-		+103
	Total	617		-		+617

Source: Ministry of Planning and Economic Affairs, Foreign Exchange Budget, 1967 (July 1967).