

(H) THE BALANCE OF PAYMENTS AND EXTERNAL ASSETS

Tables 27 to 31 in Appendix II set out Ceylon's balance of payments and external assets data in recent years. These statistics are compiled according to exchange control data of actual foreign exchange receipts and payments.

Principal Trends

In 1963 the current account deficit in Ceylon's balance of payments increased slightly from Rs. 143.8 million in 1962 to Rs. 146.4 million. The increase was due to a deterioration in the invisible account, which more than offset a small improvement in the deficit on merchandise account. The deficit on merchandise account fell from Rs. 142.9 million in 1962 to Rs. 129.6 million in 1963, despite the adverse movements in the terms of trade. In contrast the deficit of Rs. 0.9 million on invisibles account in 1962 was increased to Rs. 16.8 million in 1963 largely because of reduced earnings from the port of Colombo.¹

The current account deficit of Rs. 146.4 million in 1963 was financed by increasing external liabilities and by drawing down external assets. A significant development in 1963 was the increase in net receipts of long-term capital from Rs. 38 million in 1962 to Rs. 79 million in 1963. It is now generally accepted that all developing countries have to depend on foreign assistance in the form of long-term borrowings in order to supplement their resources for development expenditure. In recognition of this fact it is often considered that such long-term capital receipts should be netted against the current account deficit as an appropriate criterion of the basic balance of payments position of a country.² On this criterion the "basic deficit" declined from Rs. 106 million in 1962 to Rs. 67 million in 1963. The sources of finance of this basic deficit were an increase in short-term liabilities of Rs. 31 million, consisting of credits received under bilateral trade and payments agreements and a decline of Rs. 42 million in external assets, particularly in the international reserve of the Central Bank.

TABLE II H-1
Ceylon's Balance of Payments(a)

| Year | Ex-ports | Im-ports | Trade Balance | Net Invisibles | Balance on Current Account | Net Long-term capital (b) | Net Short-term capital (c) | Errors and omissions | Rupees Million | |
|-------|----------|----------|---------------|----------------|----------------------------|---------------------------|----------------------------|----------------------|--|-------------------------|
| | | | | | | | | | Change in External Assets (minus sign denotes decline) | Assets at end of period |
| 1957 | 1,669 | 1,764 | - 95 | -100 | -195 | -18 | - 1 | — | -214 | 1,062 |
| 1958 | 1,624 | 1,713 | - 89 | - 64 | -153 | + 8 | +32 | -16 | -129 | 933 |
| 1959 | 1,773 | 1,958 | -185 | - 23 | -208 | + 8 | — | + 1 | -199 | 734 |
| 1960 | 1,796 | 2,006 | -210 | - 10 | -220 | +22 | -24 | +29 | -193 | 541 |
| 1961 | 1,707 | 1,794 | - 87 | - 7 | - 94 | +11 | +93 | -19 | - 9 | 532 |
| 1962 | 1,763 | 1,906 | -143 | - 1 | -144 | +38 | +47 | +31 | -28 | 504 |
| 1963† | 1,725 | 1,854 | -129 | - 17 | -146 | +79 | +31 | - 6 | -42 | 462 |

Source: Central Bank of Ceylon.

- (a) Based on exchange control data on foreign exchange receipts and payments.
 (b) Include net movements of private and official long-term capital.
 (c) Consists of changes in liabilities under bilateral trade and payments agreements, PL. 480 counterpart funds, commercial banks liabilities to foreigners and drawings from the Fund.
 (d) Include drawings of Rs. 53.8 million each in April, 1961 and February, 1962.
 †Provisional.

- Further details on invisibles transactions are given on page 108.
- If there is a net outflow of long-term capital, it would of course then have to be added to the deficit on current account to reflect the basic balance of payments position.

Merchandise Account

Over nine-tenths of the current account deficit of Rs. 146 million in 1963 resulted from the deficit on merchandise account. The merchandise deficit of Rs. 129 million, however, was Rs. 14 million less than in 1962. The decline in the trade deficit occurred since the value of import payments was reduced by approximately Rs. 52 million as compared with the previous year, reflecting the impact of the intensified import controls instituted from the third quarter of 1962. Export receipts, however, also declined by Rs. 38 million to Rs. 1,725 million. Hence export receipts financed only 93 per cent of the value of imports.

The decline in the value of merchandise imports in 1963 resulted mainly from the intensification of the quantitative restrictions on imports from late 1962. Private imports (including state corporation imports) declined by Rs. 145 million to Rs. 1,134 million. In contrast government import payments for food were Rs. 66 million higher than in 1962 largely because of the increase in the world price of rice, flour and particularly sugar. Other government imports, e.g. machinery and materials, also rose by Rs. 27 million in 1963.

The contraction in total import outlay would have been considerably larger but for the adverse movements in world prices of imports. The general import price index rose by 10 per cent in 1963. The rise in prices was felt in nearly all major categories of imports—food (9 per cent), all consumer goods (13 per cent) and capital goods (6 per cent). The price index of essential food imports, which account for approximately 40 per cent of Ceylon's total import outlay, was in fact the highest since 1957. With such increases in world prices of essential consumer goods, an increase in their domestic production would release a substantial amount of valuable foreign exchange resources for the financing of investment goods required for development.

Export receipts in 1963 were adversely affected by the decline in prices of tea (4 per cent) and rubber (6 per cent) combined with a contraction in the export volume of rubber (7 per cent) and major coconut products (22 per cent). The strike in the Port of Colombo towards the close of 1963 also had some adverse impact on the level of export earnings in 1963. The effect of these adverse factors was, however, compensated in part by a small increase (1 per cent) in the volume of exports of tea during 1963.

Over the period 1956 to 1963 Ceylon's export earnings have suffered considerably on account of adverse trends in the world prices for her principal exports. Thus between 1956 and 1963 export prices have declined by 13 per cent. Tea prices have declined by 18 per cent and rubber prices by 23 per cent. Export volume however increased by 15 per cent between 1956 and 1963.

The terms on which exports can be exchanged for imports are also of importance. Ceylon's terms of trade have shown a tendency to move adversely. Consequently increases in the volume of Ceylon's exports have not made as significant a contribution as would have been the case if the terms of trade had not been unfavourable. As a result of the adverse movement in Ceylon's terms of trade the importing power of Ceylon exports has remained more or less static since 1956 despite the increases in the volume of exports.

Invisibles Account

Table II H-2 below indicates the principal changes in the invisibles account of Ceylon's balance of payments.

TABLE II H-2
Current Invisibles 1962 and 1963

| | 1962 | | Net | 1963(a) | | Net. |
|--|--------------|--------------|--------------|--------------|--------------|--------------|
| | Credit | Debit | | Credit | Debit | |
| Services | 222.5 | 230.5 | - 8.0 | 206.0 | 228.1 | -22.1 |
| Non-monetary gold movement (net) | — | 1.9 | - 1.9 | — | 1.9 | - 1.9 |
| Foreign travel | 5.6 | 19.9 | -14.3 | 5.6 | 22.0 | -16.4 |
| Port expenditure and non-freight transportation and insurance .. | 120.4 | 49.5 | + 70.9 | 110.3 | 45.7 | + 64.6 |
| Investment income | 19.7 | 66.2 | -46.5 | 16.4 | 68.8 | -52.4 |
| Government expenditure | 30.8 | 32.6 | - 1.8 | 24.8 | 25.1 | - 0.3 |
| Miscellaneous | 46.0 | 60.4 | -14.4 | 48.9 | 64.6 | -15.7 |
| Donations | 43.7 | 36.6 | + 7.1 | 41.5 | 36.2 | + 5.3 |
| Private remittances and migrants' transfers | 6.9 | 36.6 | -29.7 | 6.1 | 36.2 | -30.1 |
| Official donations | 36.8 | — | + 36.8 | 35.4 | — | + 35.4 |
| Total | 266.2 | 267.1 | - 0.9 | 247.5 | 264.3 | -16.8 |

Source: Central Bank of Ceylon.

(a) Provisional.

The current invisibles account in 1963 showed a deficit of Rs. 16.8 million as compared with a deficit of Rs. 0.9 million in 1962. The change in the invisibles balance was principally a result of a decrease of Rs. 6.3 million in the traditional surplus on the item "port expenditure and non-freight transportation and insurance" and an increase of Rs. 8.0 million in the combined deficits on investment income and foreign travel.

The reduced surplus on the item "port expenditure and non-freight transportation and insurance" was the result of a decline of Rs. 10 million in earnings on bunkering and other facilities provided to foreign ships. It is estimated that there was a decline of approximately 15 per cent in the number of ships that called at Ceylon ports in 1963. The increased deficit on investment income was the result of reduced earnings on the declining external asset and the increase in interest payments on foreign loans. Dividend payments at Rs. 51 million remained more or less at the same level as in 1962. Interest payments on foreign loans have increased from Rs. 8 million in 1956 to Rs. 16 million in 1963. The balance under 'government expenditures' improved slightly in 1963 despite a reduction of about Rs. 3 million in the expenditures of foreign embassies in Ceylon. This was the result of a fall of Rs. 8 million in Ceylon Government's expenditures abroad on non-merchandise account, primarily as a result of a curtailment of Ceylon embassy expenses abroad and the completion in 1962 of the payment of compensation to the U.K. Government for the naval and air bases taken over by the Government of Ceylon.

Financing Account

The financing account of Ceylon's balance of payments is set out in Table II H-3. The financing deficit increased by Rs. 6.1 million to Rs. 194.7 million in 1963. Since the deficit on merchandise account was reduced by approximately Rs. 13 million in 1963 the increase in the financing deficit arose mainly out of an increase of Rs. 14 million in the deficit on services and an increased outflow of short-

term capital in the form of a reduction in outstanding liabilities of companies with special account facilities.¹ A more significant development in 1963 on capital transactions was, however, the net inflow of private long-term capital. This is the first recorded instance in many years of a net inflow of foreign private capital into Ceylon.² The gross inflow of private foreign long-term capital in 1963 was Rs. 8.5 million and was mainly associated with the development of new industries in Ceylon. The gross outflow of private long-term capital was Rs. 4.3 million, which compares with the average of Rs. 40 million in the years prior to 1957, in which year restrictions were introduced on the repatriation of foreign capital invested in Ceylon. These restrictions have been progressively tightened with the result that gross capital transfers from Ceylon have continued to decline even after 1957—in 1961 and 1962 they amounted to Rs. 12 million and Rs. 10 million respectively.

TABLE II H-3

Balance of Payments in Financing Form for 1961, 1962 and 1963

Rupees Million

| | 1961 | 1962 | 1963(a) |
|---|---------|--------|---------|
| Goods | — 86.4 | —142.9 | —129.6 |
| Services | — 18.3 | — 8.0 | — 22.1 |
| Net private remittances and migrants' transfers | — 29.7 | — 29.7 | — 30.1 |
| Net private capital account | | | |
| (a) Direct investment | — 7.8 | — 1.2 | + 4.2 |
| (b) Net changes in special Accounts Balances | + 13.9 | — 0.6 | — 11.5 |
| Repayment of loans | — 4.9 | — 6.2 | — 5.6 |
| Gold contributions | | | |
| I.D.A. | — 0.9 | — | — |
| I.B.R.D. | — 1.4 | — | — |
| Total financing deficit | —135.5 | —188.6 | —194.7 |
| Financing Account | | | |
| A. Official and banking capital* | | | |
| 1. Change in gross external assets | + 9.6 | + 27.8 | + 41.6 |
| (a) Foreign exchange holdings | — 0.6 | + 34.7 | + 33.6 |
| (b) Payments agreement balances "due to Ceylon" | + 10.2 | — 6.9 | + 8.0 |
| 2. Changes in gross external liabilities | + 104.9 | + 92.9 | + 123.2 |
| (a) Payments agreement balances "due from Ceylon" | + 21.3 | — 11.6 | + 39.4 |
| (b) Long-term liabilities (i) | + 23.8 | + 45.9 | + 81.0 |
| (c) I.M.F. Drawing | + 53.8 | + 53.8 | — |
| (d) Others (ii) | + 6.0 | + 4.8 | + 2.8 |
| B. Official donations (iii) | + 40.6 | + 36.8 | + 35.4 |
| C. Errors and omissions | — 19.6 | + 31.1 | — 5.5 |

Source: Central Bank of Ceylon.

(a) Provisional.

- * A plus sign in the financing account signifies a decrease in assets or an increase in liabilities. A minus sign, an increase in assets or a decrease in liabilities.
- (i) Consists entirely of drawings on I.B.R.D., D.L.F., U.K., the Federal Republic of Germany, U.S.S.R., China and Yugoslavia.
- (ii) Includes changes in non-resident account balances of the Central Bank and Commercial Banks, balances of PL. 480 counterpart funds and balances of Ceylon's embassies abroad.
- (iii) Official donations refer to gifts received by the Government of Ceylon, such gifts are received principally in the form of goods, the main components being CARE milk and flour and Colombo Plan aid from Canada and Australia.

1. Transactions under these facilities reflect operations by Sterling Companies and other large trading firms with their head offices and principals directly and under the supervision of Exchange Control. Outstanding balances (due from Ceylon or due to Ceylon as the case may be) are settled periodically in the form of bulk remittances through the banking system.
2. The net inflow of private long-term capital recorded in the Balance of Payments statistics for 1960 reflected a repatriation of Ceylonese capital invested in estates in Malaya.

In recent years the financing deficits have been increasingly financed by the accumulation of external liabilities rather than by the use of external reserves. This pattern of financing reflects the increased inflow of development capital and the increase in imports financed through bilateral payments agreements and, fundamentally, the diminishing level of Ceylon's foreign exchange reserves. In 1963 a fifth of financing deficit was financed by a reduction in external assets, while 64 per cent was financed by an increase in external liabilities mainly long-term liabilities. Short-term liabilities which increased by Rs. 42.2 million consist mainly of increases in amounts due from Ceylon under payments account. Estimated official donations in 1963 of Rs. 35.4 million helped finance the balance of the financing deficit. The main components of the estimated receipt of official donations are CARE milk and flour from the U.S.A. (Rs. 23 million) and grants under Colombo Plan from Australia and Canada.

Gross foreign long-term borrowing in 1963 totalled Rs. 81.0 million of which Rs. 22.4 million was received from the World Bank. The rest of the loans drawn were obtained from the U.S.S.R. (Rs. 17.0 million), China (Rs. 13.4 million), the United Kingdom (Rs. 8.3 million), West Germany (Rs. 10.6 million), Yugoslavia (Rs. 4.3 million), Canada (Rs. 2.3 million) and the United States (PL. 480 loan of Rs. 2.5 million) and the Development Loan Fund (Rs. 0.1 million).

The foreign liabilities of Ceylon outstanding at the end of 1963 are indicated below.

TABLE II H-4

Ceylon's External Liabilities Outstanding¹ [Gross]

| Rupees Million | | | |
|--|-------|-------|---------|
| | 1962 | 1963 | Change |
| 1. Payments agreement balances due from Ceylon | 10.6 | 50.0 | + 39.4 |
| 2. I.M.F. drawing | 107.6 | 107.6 | — |
| 3. Sterling loans | 167.9 | 167.9 | — |
| 4. Other foreign loans drawn and outstanding | 187.8 | 263.2 | + 75.4 |
| Total | 473.9 | 588.7 | + 114.8 |

Source: Central Bank of Ceylon.

1. Liabilities payable in foreign exchange exclude balances of PL. 480 counterpart funds and non-resident balances with commercial banks. Such balances increased by Rs. 3.1 million in 1963 from Rs. 83.7 million to Rs. 86.8 million.

Regional Payments Pattern

As earlier mentioned, in 1963 Ceylon's aggregate current account deficit increased by Rs. 2 million to Rs. 146 million. On a regional payments basis, there were important changes in the pattern of deficits and surpluses. The traditional current account surplus with the Dollar Area fell by approximately Rs. 21 million to Rs. 170 million as compared with 1962. Ceylon's current account balance with the United Kingdom which showed an annual average deficit of Rs. 80 million during the period 1957-62 was transformed into a surplus of Rs. 39.3 million in 1963. The balance on current account with the rest of the Sterling Area (excluding India and Pakistan) also improved from a deficit of Rs. 37.8 million to a deficit of Rs. 5.3 million in 1963. In contrast, the traditional deficit with India and Pakistan worsened by Rs. 9 million, the deficit with Continental OEEC countries by Rs. 3 million and the deficit with

the rest of Ceylon's trading partners by Rs. 114 million. The deficit of Rs. 142.3 million with the last mentioned group reflected adverse balances of Rs. 73.5 million and Rs. 73.0 million in respect of Ceylon's trade with the centrally planned economies (including China), and Japan respectively. The surplus of Rs. 17 million in 1962 with centrally planned economies was converted into a deficit of Rs. 73.5 million in 1963, whereas the deficit with Japan has been approximately halved. The increased deficit with the centrally planned economies resulted from a 30 per cent increase in the value of imports combined with a decline of 12 per cent in the value of exports. In contrast in the case of Japan, exports showed a small improvement of Rs. 2.6 million but imports declined by Rs. 61.7 million (36 per cent) reflecting the effects of the intensification of import restrictions.

TABLE II H-5

Current Account Position by Currency Areas 1962 and 1963

| | Rupees Million | | | | | |
|--|----------------|----------------|---------------|--------------------|----------------|---------------|
| | 1962 | | | 1963 (Provisional) | | |
| | Credit | Debit | Net | Credit | Debit | Net |
| 1. Dollar Area | 303.1 | 111.7 | + 191.4 | 279.1 | 109.1 | + 170.0 |
| 2. Sterling Area | 1,039.0 | 1,301.5 | -262.5 | 1,030.6 | 1,157.7 | -127.1 |
| (i) U.K. | 629.9 | 702.0 | - 72.1 | 631.1 | 591.8 | + 39.3 |
| (ii) India and Pakistan .. | 104.2 | 256.8 | -152.6 | 82.5 | 243.6 | -161.1 |
| (iii) Rest | 304.9 | 342.7 | - 37.8 | 317.0 | 322.3 | - 5.3 |
| 3. Non-dollar, non-Sterling Area | 687.2 | 759.9 | - 72.7 | 662.5 | 851.8 | -189.3 |
| (i) Continental OEEC | 188.2 | 232.3 | - 44.1 | 189.2 | 236.2 | - 47.0 |
| (ii) Other | 499.0 | 527.6 | - 28.6 | 473.3 | 615.6 | -142.3 |
| Total | 2,029.3 | 2,173.1 | -143.8 | 1,972.2 | 2,118.6 | -146.4 |

Source: Central Bank of Ceylon.

Reserves

Ceylon increased her financing deficit to Rs. 194.7 million in 1963 as compared with a deficit of Rs. 188.6 million in 1962. In 1962, external assets financed 15 per cent of the deficit but in 1963, external assets financed over 20 per cent of the deficit. Hence external assets declined by Rs. 41.6 million to Rs. 462.3 million in 1963. This compares with a decline of Rs. 27.8 million in 1962 and only Rs. 9.6 million in 1961 before adjusting for an International Monetary Fund drawing of Rs. 53.8 million in each of these two years.

The level of external assets (excluding those assets set apart for sterling loans sinking funds) stood at Rs. 358.8 million at the end of 1963. Of this amount, the International Reserve of the Central Bank accounted for Rs. 114.2 million, commercial banks Rs. 105.3 million and Government and government agencies Rs. 139.3 million (representing mainly investments of Post Office Savings Bank, Ceylon Savings Bank and other government agencies' funds abroad). The liquid and near liquid funds of the International Reserve of the Central Bank at the end of 1963 were Rs. 48.2 million. Of this, the bilateral payments agreement balances due to Ceylon amounted to Rs. 15.3 million. Rs. 66.0 million of the total International Reserve consisted of investments in foreign securities.

Ceylon's external assets at the end of 1963 (excluding those assets set apart for sterling loans sinking funds) of Rs. 358.8 million, represent only 19 per cent of the value of imports in 1963. An open economy such as Ceylon finds its balance of payments extremely vulnerable to forces arising from the terms on which exports can be exchanged for imports and from fluctuations in the volume of exports and imports. Ceylon's experience over the last few years and particularly in 1963 indicates this extreme susceptibility of her balance of payments to changes arising from the instability of prices of exports and imports. In addition, in recent years it has been found that Ceylon's short-term liabilities have increased by substantial amounts, particularly the bilateral balances on payments agreements. The growth in these short-term liabilities and the marked variability in their levels over short periods, further underlines the need to maintain a reasonable minimum level of external reserves.

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