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Economic Committee Papers - Ceylon - Future Bank / IDA Operations

OFFICE MEMORANDUM

TO: Mr. J. Burke Knapp

FROM: I. P. M. Cargill

SUBJECT: CEYLON - Future Bank/IDA Operations

DATE: June 21, 1966

At the Aid Meeting in London, in response to enquiries from the donor countries, I said that we would be prepared to consider providing assistance for suitable projects. The Meeting had been convened to consider Ceylon's need for a further instalment of import assistance, which was not of the type that the Bank normally provides. At the meeting held in July 1965, and again this time (and with greater emphasis), the donor countries urged that Ceylon should take early action to move over from program assistance to project aid. Dr. Corea said in London that he hoped to have a larger element of project aid request to present at the next meeting. For my part, I made it clear that I expect program assistance to be a major need up to at least the middle or end of 1967. However, such projects as Ceylon may be able to bring to our attention over the next few months can be considered.

The various sector missions that had, since September 1965, looked at different parts of various "development schemes" in Ceylon did not succeed in finding many suitable projects. Whatever the number of these projects, certain general considerations of policy need to be disposed of. The first issue is the minimum conditions under which we can agree to resume financial assistance to Ceylon. Our analysis of Ceylon's problems even before the Aid Meeting of July 1965 had led us to the conclusion that energetic action by the Government was needed on four main fronts, namely, (a) to make further progress towards monetary stability, (b) allocation of imports in favor of investment projects rather than towards encouraging consumption, (c) augmenting resource generation and (d) improvement of investment allocation. The Stand-By Agreement signed by Ceylon last year with IMF and the action taken by the Government did succeed in bringing about much needed improvements in respect of (a) and (b). Along other directions progress was imperceptible up to the beginning of this year. Various committees had been set up with the object of preparing short-term development plans and formulating fiscal policies for the Cabinet's consideration, but all this activity had not much practical result when our last economic mission arrived in Colombo in January. I found the position sufficiently disheartening at the beginning of February to tell the Executive Directors representing members of the Aid Ceylon Group that, while we were planning to hold the second meeting in May, the plans were contingent upon our receiving from the Government satisfactory assurances with respect to economic and financial policies. It was clear to me that if Ceylon could not report any further progress since the Group's first meeting ten months earlier the aid-giving countries could justifiably ask why the second meeting should be called at all. In my memorandum of March 14 to Mr. Woods, I repeated that we might have to consider extricating ourselves from the exercise.

In April last, IMF had a mission out in Colombo to negotiate a new Stand-By Agreement. The Bank was shown the draft letter of intent after I had left on my European tour before the London meetings. The various measures that the Government proposed to take do not amount to giant steps, but they are steps in the right direction. The undertaking to contain the net food subsidies to their present levels required political courage - although there was no real long-term alternative. The assurances to bring expansionary budget deficits to lower levels, to review the pricing policies of public corporations and to moderate expenditures on welfare services indicate a significant change in attitudes that we welcome.

However, all these undertakings amount to a promise of future action. The only commitment made about the timing is that a public announcement will be made not later than the end of that calendar year - although the possibility of announcing them in the budget speech in mid-July is quite likely. I have no reason to doubt the sincerity of the promises, but I do not think we can entirely rule out the risk that political considerations may lead to either a delay or a great deal of watering down. I will feel more reassured when I see the Government definitely embark on these new policies. If satisfactory indications appear in the Finance Minister's speech introducing the budget (which is expected next month), I propose to go ahead with processing such projects as are available. If, on the other hand, the budget speech makes no mention of these matters, I would write to the Government asking where it stood. A third - and extreme - situation would arise if the speech indicated that the Government had gone back on the substance of the promises. In that event, I would have to tell Ceylon that the Bank was not in a position to proceed as expected.

As I have said above, at the moment there are very few projects for the Bank to look at. The one that is most advanced is a possible loan or credit to DFCC in the amount of \$4 million. This may be ready for consideration by the Loan Committee within a month or so. Another possible item which may be ready for appraisal before the end of the year is a fishery project (total cost \$12 million; foreign exchange component - \$8.4 million). A third area where the Bank can help is road transport; this is a high priority item, and technical assistance could be given by us in helping to draw up a master plan for the highway system, leading to project financing. The various missions we have sent out recently to Colombo have identified a few other projects suitable for external aid, such as railway dieselization, public bus transport, modernization of tea factories, water supply, education and power. Many of these may be of interest to individual donor countries on a bilateral aid basis. The rest could be of interest to us, but, in writing to Ceylon about what I think we could do in the near future, I can mention these only as sectors where additional project preparation has to be carried out by the local agencies.

Assuming that we undertake new operations in Ceylon, the second issue that arises is the form our assistance should take, i.e., IDA credits or Bank loans. In the past we have had reservations about Ceylon's eligibility on grounds of performance. If these are removed, as discussed earlier, it seems to me that we should consider Ceylon to be IDA-worthy. The per capita income is \$142. The net external assets at the end of 1965 were less than

\$60 million. Although this represents a three-fold increase from the position one year earlier, the reserves must still be considered to be uncomfortably low. It is true that the current servicing liability on external debt is around 2% of export earnings, but the overall economic situation and prospects are still so close to the critical margin that every little bit would help. In these circumstances, I feel that the burden of servicing external debt should be kept small, at least for the next few years. We should, therefore, term Ceylon as a soft-blend country, and this is the policy I have recommended in a memorandum to the Economic Committee which will meet this week or next to consider it. In my view, this approach is justifiable in Ceylon's present situation. If and when there are enough projects for donor countries to consider, I would want to recommend the same approach to them.

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