

INTERNATIONAL TRADE AND THE PEOPLE'S BANK

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Mr. S. de S. Gunetilleke who was the Bank's first Chief Manager (Foreign), retired recently as its Additional General Manager (International).

Background

Until 1961, the Co-operative Federal Bank was the apex bank of the co-operative movement in Sri Lanka. For several years before that there was a general feeling among those concerned with the development of the co-operative movement that the Co-operative Federal Bank was not making an adequate contribution to the advancement of the co-operative movement. This led to an indepth study by the Central Bank which concluded that the Co-operative Federal Bank had built-in weaknesses and that the co-operative movement needed to be served by a more dynamic bank conceived on entirely different lines. This resulted in the abolition of the Co-operative Federal Bank and the establishment of the People's Bank in 1961 as a more dynamic successor.

While the new Bank was freed from many of the constraints which had inhibited its predecessor, its charter, the People's Bank Act No.29 of 1961 clearly set out its purposes as being to develop the co-operative movement, rural banking and agricultural credit by providing financial and other assistance.

At the time the Bank was established in 1961, the economic activities of the three sectors which it was required to develop (except plantation agriculture) were wholly confined to the domestic market. Despite that, within a few years of its establishment, the Bank was able to secure for itself a significant share of the banking business related to foreign trade. Before we

proceed to examine the actual role which the Bank played in Sri Lanka's international trade during the first twenty five years of its existence, it will be both useful and interesting to examine the circumstances in which this seemingly strange development took place.

The statutory purposes of the People's Bank described earlier have been set out in Section 4 of the People's Bank Act as follows:

"The purpose of the Bank shall be to develop the co-operative movement of Ceylon, rural banking and agricultural credit, by furnishing financial and other assistance to co-operative societies, approved societies, Cultivation Committees and other persons".

At the same time, in order to achieve these objectives, Section 5(i) (b) of the Act granted to the Bank the power to 'engage' in the kind of business similar to those carried on by Bank of Ceylon under its own statute.

These statutory provisions relating to the purposes and the powers of the Bank remained substantially unchanged till June 1986 when the Hon. Minister of Finance and Planning introduced in Parliament several far-reaching amendments to the Act, including an amendment to Section 4 setting out the purposes of the Bank as being:

(1) to develop and assist—

- (a) the Co-operative Movement of Sri Lanka.
- (b) Rural Banking;
- (c) Agriculture; and
- (d) Industry; and

(2) to carry on the business of a

- (a) Commercial Bank;
- (b) Pawn broker; and
- (c) Merchant Bank

Over the years, there had been a clearly noticeable tendency for the distinction between the purposes or objectives and the enabling powers to be blurred in practice leading sometimes to the charge that the business arising from the powers have tended to overtake in importance the business concerned with the objectives. At the same time, there had grown a view in government circles that the Bank had become *de facto*, a commercial bank and that it was neither desirable nor feasible for the Bank to confine itself to its original purposes as stated in Section 4 of the Act. The far-reaching amendments to the Act introduced by the Hon. Minister in Parliament on 6 June 1986 was in pursuance of that view of the government.

Finance of foreign trade, involving as it does the lucrative business of buying and selling foreign exchange, is among the most remunerative of the commercial banking activities which the Bank was empowered to engage in. On the other hand, most of the activities which constituted the statutory purposes of the Bank were either only marginally remunerative or not remunerative at all. The Bank's first General Manager, Mr. Wilmir Solomons, being fully aware of this, proceeded to set up

a Foreign Branch of the Bank almost at the inception in order to boost the Bank's income generating capacity. However, he had a hard time winning over the Bank's first Chairman, Mr. Vincent Subasinghe, for this move. Mr. Subasinghe was a veteran co-operator who had been responsible for the outstanding successes in his native Sandalankawa for Co-operation as the road to economic advancement of the poor. For him co-operation was both a way of life and an article of faith, and he was extremely wary of the "corrupting" potential of commercial banking activity, and particularly foreign banking. He had a constant fear that if the People's Bank became interested in such activities and became pre-occupied with the pursuit of profit, it will soon lose interest in, or consign to second place, the purposes for which the Bank was set-up namely, to finance and develop the co-operative movement and the rural and agricultural sectors.

Mr. Subasinghe was encouraged in these misgivings by some very important and influential persons, among whom was Mr. C Loganathan, the then General Manager of the Bank of Ceylon. Mr. Solomons had been a Senior Executive at Bank of Ceylon, and Mr. Loganathan viewed with some alarm his efforts to build up the new People's Bank as a commercial bank which would rival Bank of Ceylon. An obvious method of preventing such a development was to ensure that the fledgling Bank would not engage in financing foreign trade or foreign exchange business. Being aware that the People's Bank Board, and particularly its Chairman, Mr. Subasinghe, had certain misgivings and reservations on this matter, he attempted to achieve his objective by

influencing them directly against the path on which Mr. Solomons had set the Bank. Some foreign banking business had come the way of the Co-operative Federal Bank through the Co-operative Wholesale Establishment (CWE) which was its largest customer. Being unable to undertake that work itself, the Co-operative Federal Bank had set up an arrangement for a commercial bank (the Eastern Bank) to attend to that business as its agent. Mr. Solomons terminated this arrangement soon after the People's Bank was established. Instead, he used the CWE foreign banking business as a nucleus for the Bank's own Foreign Branch which he had set up within a few months of the Bank commencing business.

Mr. Loganathan, who had known about the Co-operative Federal Bank's arrangement with the Eastern Bank, was not aware of its termination by Mr. Solomons, and he sought to abort People's Bank's entry into foreign banking by offering the Bank of Ceylon's services to undertake foreign business as the People's Bank's agent on lines similar to the arrangement with the Eastern Bank, but on more favourable terms. After some preliminary canvassing, this proposal was finally presented by Mr. Loganathan at a seemingly innocuous lunch which he hosted for the People's Bank Board. Mr. Solomons, who was also present and saw the proposals damaging implications for the People's Bank' was alarmed at its sympathetic reception by its Board. He responded by setting out in a Board Paper the damaging implications of Mr. Loganathan's proposal and the erroneous assumption on which it had been made. The Board's acceptance of Mr. Solomons' views as set out in the Board Paper gave the green light for the development of the Bank's foreign business, and

there has been no looking back since then.

The Rationale of the Banks' Foreign Business

It has already been noted that the Bank began to engage in foreign banking business in terms of powers vested in it by Section 5 (i) (b) of its Act which gave it the power, carrying out its purposes to engage in the kinds of business similar to the business of the Bank of Ceylon.

The experience of the Co-operative Federal Bank and the peripheral Provincial and District Banks had clearly demonstrated that a Bank which confined its operations to the co-operative sector could not build up a resource base strong enough to achieve its objectives because its constituency itself was economically weak.

Those who conceived the People's Bank as the successor to the Co-operative Federal Bank wished to remedy this weakness while at the same time ensuring that the focus of activity of the Bank will be the co-operative, agricultural and the rural sectors, and their development its objective. The solution was to give the new Bank power to engage in the whole range of commercial banking activity in order to achieve its purposes and objectives.

Achievements in International Trade

The impact of the Bank's foreign banking business on the country's foreign trade may best be examined under four distinct time periods.

1961 - 1965

The first of these roughly cover the

first five years of the Bank's existence – from 1961 through 1965. During this time, the Foreign Branch was feeling its way and moving very tentatively, trying to secure business on the one hand, and trying to secure acceptance by the international banking community on the other.

The CWE was a natural client of the Bank and it may be said that the Foreign Branch cut its teeth handling the CWE's very substantial import business and its rather limited export business. This was soon followed by the import business of the recently-formed Petroleum Corporation which had on its Board the Bank's own Chairman, Mr. Vincent Subasinghe.

While between these two state Corporations the Foreign Branch secured a volume of foreign business which was the envy of its competitors, business from other state corporations and from quite a number of private business houses and individuals soon followed.

Shortly after he had successfully piloted the People's Bank Act through Parliament as Minister in charge of Co-operatives, Mr. T B Illangaratne became Minister of Finance. The Bank was transferred to the care of the Ministry of Finance at the same time, and it has remained so ever since. More importantly from the point of view of the Bank's business, Minister Illangaratne ordered that all imports made by Government Departments, other than the Food Department, should be routed through the People's Bank. This, too provided valuable, though sometimes troublesome, business to the Foreign Branch.

At this time the Foreign Branch was just another of the Bank's growing number of branches, it was administered by Head Office through the Chief Accountant. This situation changed at the end of 1964 with the appointment of a Chief Manager to head the Foreign Branch and report direct to the General Manager.

The Government which took office in 1960 followed an aggressive industrialisation policy spear-headed by import substitution industries. In accordance with its overall policy, industrialisation was also regulated and subject to approvals. This resulted in many Sri Lankans who had made good in wholesale and retail trading moving on to industry. This involved a considerable amount of foreign banking business, initially to import raw materials, accessories and replacements on a continuing basis.

The Foreign Branch was actively involved in this providing not only the banking services but also advice and guidance on technical, financial and management aspects as well as encouragement and support when they faced difficulties.

Quite a number of them who were assisted in this way are among today's big industrialists.

1965 – 1970

The second time period referred to above was from 1965 through mid-1970, 1965 saw a change of Government and some far-reaching changes in economic policy. The strict import control regime of the previous government was relaxed through the liberalisation of Open General Licence (OGL) and the relaxation of exchange control along with the

introduction of a dual exchange rate through the Foreign Exchange Entitlement Certificates (FEEC) Scheme.

An incidental result of these two changes was the opening of the country's import trade to newcomers. Hitherto imports had been under a restrictive licencing scheme and import licences to the private sector for consumer goods and other trading items had been issued only on the basis of past import performance. This meant that a limited number of business which had established themselves in the import field prior to the tightening up of import control in the 1950's enjoyed a virtual monopoly over a steadily dwindling volume of imports. In practice, it also meant that a large number of Sri Lankans who had come into business in the post-independence period were shut out from import activity.

The liberalised OGL scheme of 1965 provided an opportunity to change all this, and the Bank's Foreign Branch actively assisted Sri Lankan businessmen to take advantage of this situation and get into import business for the first time. By this time the Bank had firmly established its image as the Bank for the common man, and it did not take long for small and medium-sized Sri Lankan businessmen to take advantage of the solicitude of the Foreign Branch and set themselves up in import business.

In this way came about one of the most remarkable achievements of the Bank in the field of Sri Lanka's international trade, namely, enabling small and medium-sized Sri Lankan businessmen to enter the field of

import business which had been firmly closed to them until then. It is a source of great satisfaction to the Bank that quite a number of those who were introduced to international trade in this way blossomed out into big businessmen accounting for a very large volume of import turnover.

1970 – 1977

In 1970 the political pendulum swung back, and economic policies of the government which came into office in that year constituted a radical departure from those of the previous period.

Responsive as always to government policies, the Bank gave support to the implementation of the new economic policies and programmes. The period 1970 to 1977 thus became the third distinct time period in the Bank's impact on the country's international trade.

This period witnessed a return, with much greater emphasis, to the government regulated and directed economic activities which characterised the period 1960 to 1965. This manifested itself in a heavy reliance on the public (State) sector for economic activity, and the wide-ranging involvement of state corporations in industry and trade.

The People's Bank Foreign Branch seized the opportunities provided by this change to secure for itself a wide range and high volume of foreign banking business. As part of the new policy, the private sector's share of imports was severely curtailed and the share of the newly set-up state corporations increased. Most of

these corporations chose the Foreign Branch as their bankers, and this diversion of import business to the state sector incidentally resulted in a big boost to the business of the Foreign Branch.

Most of the corporations that were set up to implement the new government's shift to the state sector were new to imports even though they had succeeded in securing the services of some executives who were experienced in their respective lines of business. In this situation, the Foreign Branch went out of its way to help these corporations upgrade their expertise and build up their experience in the intricacies of international trade. In those years, it was commonplace for senior executives of the corporations to consult the senior executives of the Foreign Branch even in such strictly non-banking matters as identifying suppliers and deciding on contract terms. The Foreign Branch was always willing to help, and there were instances when the Branch was specially opened on a holiday to despatch a crucial telex on behalf of a Corporation. This very close relationship between the State Corporations and the Foreign Branch was mutually beneficial and paid rich dividends to the Bank as well as to the Corporation concerned.

This period also witnessed a steady and continuing deterioration of the country's terms of trade and foreign exchange resources. This, and tacit disapproval of the new government's policies by the international banking community, made it increasingly difficult for the Sri Lankan banks to obtain credit lines from international banks. As is well known, a bank can successfully engage in foreign bank-

ing business only to the extent that it is able to get the co-operation and support of international banks. A very important element of that support are credit lines needed to service Letter of Credit business.

In the increasingly difficult foreign exchange situation of the country which characterised most of this period, the Foreign Branch used the connections (including close personal relationships) which it had built up with the international banking community to secure the banking it needed from them to service its foreign banking business, among which were some of the country's most critical imports. There were instances when only those connections and personal relationship enabled the establishment of a Letter of Credit covering some vital import.

This period also saw the progressive strengthening and growth of the indigenous industrialists and traders who were helped by the Foreign Branch to set up in business in the earlier years; though the scope for expansion in the import field was, naturally, very limited.

1978 – 1986

This brings us to the contemporary period which is the fourth and last of the time periods under which we consider the Bank's contribution to Sri Lanka's international trade. In the General Election of 1977, the political pendulum swung back once again. But this time, unlike during previous changes of government, the economic policy package of the new Government was designed and intended to make a complete and radical break with the past. The new policy

package relating to economic activity was accompanied by equally radical political and constitutional changes designed to ensure the unhindered implementation of the new economic policies.

The essence of the new economic policies was de-regulation and exposure of economic activity to market forces. This resulted in the almost total dismantling of import and export controls which had existed in varying degrees of severity since before Independence. These liberalization measures were strongly backed by practical support from international financial agencies such as the IMF and World Bank and also by the international financial and banking communities.

In the banking field, this resulted in the opening up in Colombo of a large number of foreign banks, the advent of a free market on foreign exchange and the virtual abolition of exchange control in transactions relating to trade and industry. Even in the area of capital transfers, exchange control became minimal.

The Foreign Branch (which had, in the meantime, been converted to an International Division) was not fully prepared to meet this situation. The same may be said in varying degrees, of the foreign branches of the other three indigenous banks. This is not surprising because the highly regulated economic regime of the preceding period gave neither the opportunity nor the scope for the local banks to prepare for the highly competitive liberalised regime that followed. Accordingly, most of 1977 was spent in adjustment to the new environment and familiarisation with it. However, by the beginning of 1978,

the International Division had geared itself to cope with the new situation. This is both remarkable and praiseworthy, and is a tribute to the Division's corporate and personnel resilience when considered in the context of the Bank's heavy orientation towards the countryside, and its staff recruitment being geared to such orientation.

During the early years of this period, the foreign banks which were newly established in Colombo engaged in highly aggressive and sophisticated marketing activity. Some of them, particularly the branches of the large international banks, backed up their marketing activity by flaunting the latest in banking technology in which some of them were world leaders. In this situation a certain amount of demoralisation was inevitable in the People's Bank and other indigenous banks for the reason that they could not match the operational and marketing technologies and skills of the new banks. But this, too, was only a passing phase and, within a couple of years, the Bank regained its self-confidence so that in the 80's they were able to make an aggressive come-back to retrieve the ground lost in the period of transition and also reclaim the loyalty of those customers who had left them. This process was helped by an increasing realisation by businessmen that their long-term interests lay in dealing with the indigenous banks which are firmly rooted in the country's soil.

The liberalisation policies of the government also released the state corporations from their earlier obligation to patronise the state banks. Exposed to high pressure marketing and the lure of the latest in technology which were offered by the new banks, quite a number of the Corpo-

rations, too began patronising them. But as the People's Bank and the other indigenous banks modernised and upgraded their operational technologies and delivery systems, like the private businessman, the Corporations too began to see advantages of dealing with their former bankers and proceeded to do so in an increasing measure.

Even eight years after the introduction of market forces and competition into the banking industry in Colombo, it cannot be said that the People's Bank has been able to match the streamlined operation and technology and the higher efficient delivery systems of the most dynamic of the international banks operating here. However, it can certainly be asserted that the Bank does provide its customers with a service that is highly competitive when taken as a whole. The remarkable thing is that it has been able to hold its own in this manner despite all the constraints imposed on it by reason of it being a state owned bank and, despite all developments to the contrary, its being still heavily oriented towards the Co-operative Movement and the Rural Sector.

As already noted, the Bank's involvement in international banking business was incidental to the pursuit of its statutory objectives. Consequently, while the International Division equipped itself to handle its business with competence, it never aspired to enter the international banking league. Indeed, any attempts on its part to do so would have been summarily rejected by those responsible for setting the Bank's policies and heavily denounced by those charged with the task of monitoring its activities.

Given this environment in which it operated the greatest achievement of

the Bank during this period can be said to be the survival with honour of its International Division in the competitive jungle in which it found itself after 1977.

Prospects for the future

There is no doubt that the application of the post - 1977 liberalisation policies to the banking and financial sectors, and the competition to which the indigenous banks were exposed as a consequence, had a very salutary effect on the Banks concerned. It was certainly so for the People's Bank's International Division.

The way forward in the future for the Bank lies in consolidating the operational and technological advances which have so far been made in order to survive in the competitive environment. It must also carry forward those advances and the modernisation that goes into it. The automated operational systems already installed, under way and in the pipe-line show that the Bank is fully committed to technological modernisation as the means of improving its customer services and in meeting the competition.

While these are steps in the right direction and highly laudable by themselves, they are quite inadequate for the Bank to successfully meet the challenges of the next few years. Indeed, unless other necessary steps are taken, technological modernisation may become counter-productive and result in a serious decline in the Bank's competitive position.

The most serious constraint that needs to be urgently overcome relates to staffing. It is a well known fact that the tremendous growth of the Bank over the past 25 years

has taken place with hardly any manpower planning. That type of unplanned growth of the Bank's operations and expansion of staff may have been tolerable and not caused serious damage to the Bank in the near-monopolistic environment in which it found itself in most parts of the country during the first decade of its existence. However, lack of planning, particularly in growth, and in manpower to support and sustain that growth, can be disastrous to the Bank's International Division in the context of the very sharp competition which it faces in the free market conditions which will continue to prevail over the next few years at least.

As is well known, manpower planning involves forecasting staffing requirements over a period of time in terms of numbers, skills and levels of responsibility. Thereafter, determined and timely efforts must be made to secure the best material available in relation to the skills required. Once recruited, staff career paths must be mapped out, and followed through, to ensure that the requisite skills at the requisite levels are available at the requisite times to fill emerging positions and vacancies.

This type of manpower planning has been practised by leading international banks for a long time, and it will not be difficult to secure the necessary expertise in this field and implement programmes suitably adjusted to the Bank's own requirements.

But, what will be more difficult to secure is the will needed to do so. This is an unfortunate consequence of state ownership and the Bank being under the tutelage of a government Ministry, despite its affairs being the responsibility of a high-

powered government-appointed Board of Directors functioning within the ambit of a special Act of Parliament. Two examples of this constraint would suffice to show its crippling impact on the effectiveness of the International Division. Firstly, the Division has been unable to get adequate numbers of staff with a working proficiency in English because staff recruitment is not on the basis of open competitive selection by the Bank, but by appointment of candidates nominated through political procedures. This system of recruitment has also severely handicapped the Bank in its efforts to get the most promising products of our schools and Universities to fill its staff cadres.

Secondly, the Bank's decision to set up its own accommodation for the International Division has not been implemented even four years after the building site has been acquired because the entire exercise has been enmeshed in bureaucratic procedures which involve many of the major decisions being outside the Bank's counter.

The early removal of these constraints is an essential pre-condition for the successful performance of the Bank, and particularly its International Division which faces the brunt of the competition from the new banks.

The Hon. Minister of Finance and Planning has, on many occasions spoken out on the need for competitive selection of staff. It is earnestly hoped that he, as the Minister responsible for the Bank, would be able to persuade the Government to relieve the Bank of these constraints at an early date. Indeed, that would be a most appropriate Silver Jubilee present to the Bank from its major shareholder.