ECONOMIC REVIEW
NOV/DEC 2003

BUDGET 2004

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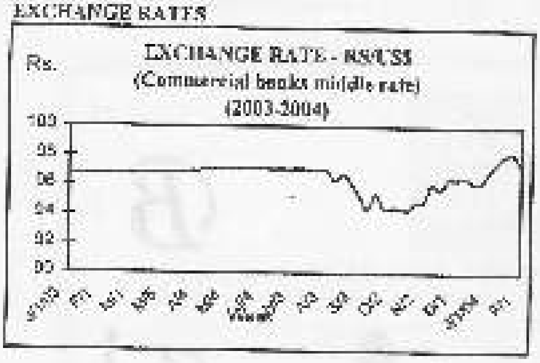
TRENDS IN ECONOMIC INDICATORS

EXCHANGE RATES



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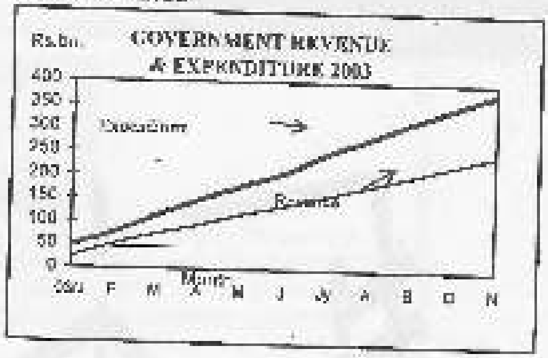

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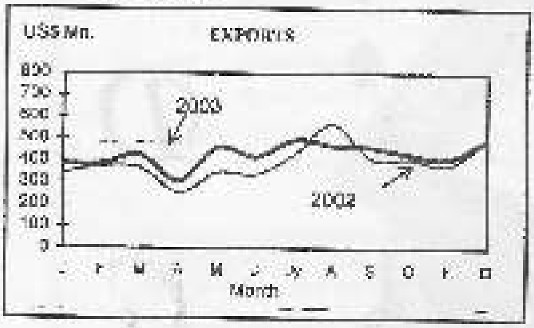

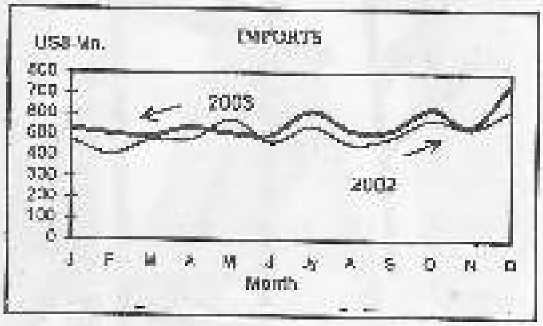

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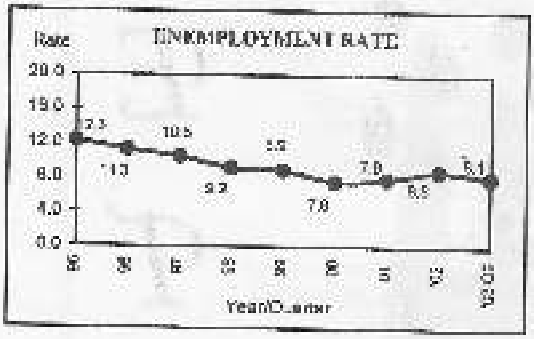

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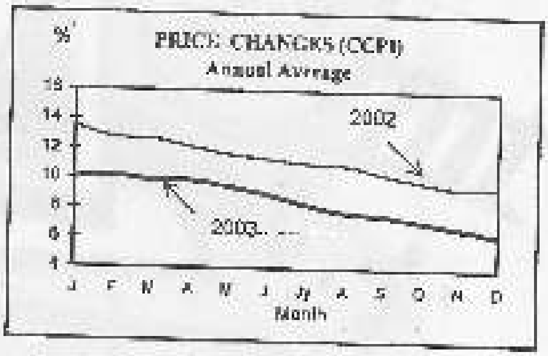

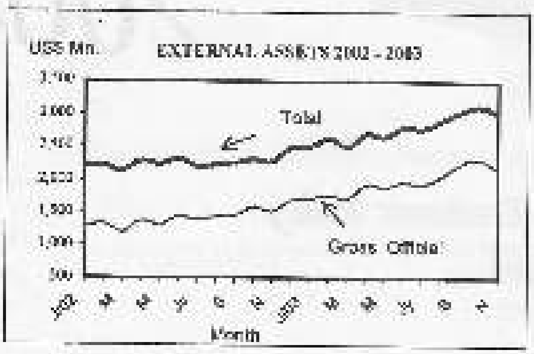

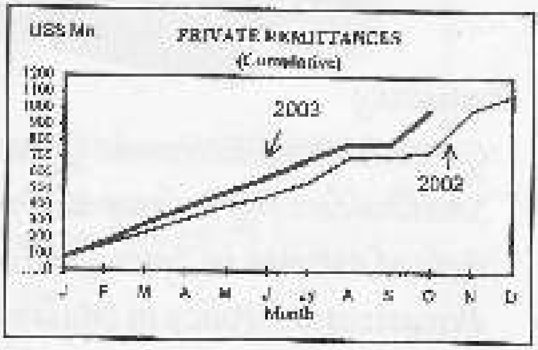

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BUDGET 2004
THE FISCAL PRICE OF POLITICS

R.M.B. Senanayake
Ex-Civil Servant & Economist

The Minister of Finance presented the budget for the financial year 2004 with much fanfare. It is obviously an election budget, what with the Provincial Council elections due early next year and the prospect of a Parliamentary election as well with the President's bid for power. So he has while increasing the taxation revenue through some tinkering with the tax structure to get about Rs. 18 billion more, has given it all away to various segments of the populace. The public servants are to receive a 10% increase in salaries which will cost Rs. 12.5 billion extra. The pensioners will get Rs. 500 increase which will cost another Rs. 2.5 billion. The farmers will get a larger subsidy for fertilisers which will cost Rs. 1.0 billion. The Voluntary Retirement Scheme will cost Rs. 8 billion but only Rs. 2 billion has been included in the budget. This VRS of course would help in fiscal consolidation in the medium term. But there are several other grants for technical training and for debt relief to farmers all of which will absorb the revenue increases expected for the next year. So there is nothing available to bring down the primary account deficit or the current account deficits which continue to be in deficit.

Are we on the road to fiscal consolidation?

The Minister seems to have overlooked the need for fiscal consolidation. The Minister of Finance has used the budget as a way of buying off various sections of society without bothering too much about the fiscal consequences. He has continued with run-of-the-mill revenue proposals that mainly tinker with the existing tax structure. None of this will remedy the rot that affects the fiscal system and keeps the debt to GDP ratio high. The Fiscal Management (Responsibility) Act of 2002 which will be effective from 2003 stipulates that budget deficit must be reduced to 5% of GDP by 2006 and thereafter maintained at that level. It also requires that total government liabilities (debt) should not exceed 85% of the GDP by 2006 and be brought down to 60% by the end of 2013. If these targets are to be met the government should not increase its expenditure but instead increase its revenue. Really it should provide for reductions in public expenditure or at least not take on commitments which will increase them beyond the minimum required to cope with the annual inflation. So the government is not justified in increasing public expenditure by raising the salaries of public servants. It should of course not curtail capital expenditure and must actually increase it to raise the rate of economic growth for that will help to bring down the debt/GDP ratio. Changes in the Debt/GDP ratio depend on the following formula which is reproduced from the Central Bank Annual Report of 2003.

$$\frac{\Delta B}{GDP} = \frac{(i_t - g_t)}{(1+g_t)} \times \frac{B_{t-1}}{GDP_{t-1}} \pm \frac{PD_t}{GDP_t}$$

Where GDP = Gross Domestic Product. B = Total Government Debt; PD = Primary Account deficit; I = nominal interest rate on government debt; g= the nominal rate of economic growth in the economy and t=time period.

Reducing the future Debt/GDP ratios

The first term of the formula shows that the nominal rate of interest on government debt must be less than the nominal growth rate of GDP if the debt/gdp ratio is to come down.

Lets consider what would happen in the budget for 2004. The Minister expects to bring down the overall budget deficit to 6.9% of GDP. The budgeted deficit for 2004 is Rs. 138 billion. He has projected a GDP in nominal terms of 1806 billion from the current year's Rs. 1588 billion. He has assumed the same GDP deflator of 9.4 as for 2003. But since inflation is less this year he may have over-estimated the GDP for the next year. If so he may not bring down the Debt/GDP ratio to the level projected. The Debt/GDP ratio was 103% when the UNF government assumed office. It is expected to come down to 100% this year, a marginal improvement due more to lower interest rates and better debt management - What of next year?

The Treasury generally over-estimates government Revenue and under-states public expenditure to present a budget where the budgeted deficit is within acceptable limits, limits agreed to with the IMF for the medium term fiscal consolidation programme. But the reality will be otherwise. The tax revenue is likely to grow by about 8% on the current taxation which will provide about Rs. 310 billion. The new taxation proposals are likely to bring in an extra Rs. 18 billion making a 328 billion, a shortfall of 12 billion from the budgeted Revenue. So if one considers the falling of the figures for Revenue and the extra-budgetary payments for items not included in the Budget, there is no possibility of keeping the budget deficit/GDP ratio to the limit agreed with the IMF on the medium term fiscal consolidation plan. It would however appear to show that the government has managed to give significant salary increases to public servants and still meet the goals agreed with the IMF. But the realised figures will not show such compliance unless the Treasury cuts capital expenditure during the year as it is wont to do by delaying the release of funds to the capital spending departments. This of course affects the economic growth rate of the future. This year the Minister has provided more for Public Investments but will he keep to it? If he doesn't keep up with the budgeted Public Investments the GDP growth rate will be affected not only for next year but for years to come. We must maintain the GDP growth rate of 5.5% and if possible raise it to 6% or even 7% if the country is to be rescued

	1990	1998	1999	2000	2001	2002	2003
Primary deficit	-3.5	-3.8	-1.9	-4.2	-4.1	-1.6	-2.6
Current A/c deficit	-1.2	-2.7	-1.0	-3.4	-4.8	-4.4	-7.8
Overall deficit	-9.9	-9.2	-7.5	-9.9	-10.8	-8.9	
Treasury bill interest	17.4	12.0	11.8	17.3	12.8	9.9	0.0
Current Expenditure	19.6	18.7	20.2	21.5	21.0	20.8	19.2
Revenue	17.2	17.7	18.8	16.7	17.5	16.5	18.3
Capital Expenditure	5.5	5.5	5.4	4.6	4.5	3.7	5.0

Source: Central Bank

from the fiscal impasse, since the interest costs are increasing each year at about 6.8%. This is particularly evident since the Medium Term Fiscal Consolidation Programme of the PA regime was not achieved. I give below the figures of the deficits on the budget in recent years.

The government has been saved by the decline in interest rates on Treasury Bills and Bonds. It is the decline in interest rates that has enabled the government to keep the budget deficits and the borrowing requirements down. Each year the government has to repay debt falling due for repayment and this amount in next year's budget is Rs. 196 billion. Receipts from Privatisation are no longer significant. In 2004 it will be Rs. 13 billion only. What happens when there are no state owned enterprises to privatise. It can sell all available government owned assets but what when there are no assets to sell. The government keeps on borrowing to fund its investments programme. This of course is alright only if they increase government revenue from such investments. Adding to infrastructure will quicken economic growth which in turn will increase government revenue. But what have we to show for all the capital expenditure incurred over the years. Very little since the assets created have not been maintained. The revenue has also not increased in keeping with the rate of inflation. This is why the Revenue/GDP ratio has been coming down. It should be increased at least to cover the ratio of Current Expenditure to the GDP, which is around 20%. It seems very unlikely that it can be brought down because over 70% of it goes to pay the salaries and other remuneration of public employees. There is very little discretionary expenditure in the budget. So the government cannot afford to let tax and other revenue come down. The prices of services provided by the government like the postal rates must be linked to the rate of inflation if these revenues are to keep to the GDP ratio. The problem is that many public services do not even recover costs. Education is free to all from primary school to university and health care is also free to every one. Its time to review these policies if the country is not to end up in financial bankruptcy. Then nobody abroad will lend to the government and domestic borrowers will demand very high rates of interest to lend to the government.

It must as a first step curtail the interest bill from exploding. It has been growing by over 6% each year. The UNF Government is lucky to keep interest rates low because the banks prefer to invest in low interest Treasury securities to risky lending to businessmen. But can the government hope to keep such interest rates low if it has to increase the volume of borrowings each year as it will have to if it continues to run deficits in the current account and in the overall budget. Borrowing for Public investments should not be reduced since they alone can quicken economic growth. Capital expenditure over the years has been coming down and the UNF government has this year managed to boost it to 6%. The Debt/GDP ratio can be reduced only if there is faster economic growth than the increase in debt. This year the UNF government has maintained it but it is because interest costs have come down and some high interest debt has been converted into low interest debt.

Fiscal Objective should be to Increase Public Savings and Reduce Net Public Sector Debt

A noteworthy feature of our economic scene is the low level of domestic savings. In 2002 it was only 14.6% of the GDP. Adding 'Net Factor Income from Abroad' the national savings is 19.7% of the GDP. This is low even by the standards of developing countries. The government has always been a dis-saver running increasing budget deficits on current account. This means that public finances-and associated levels of public indebtedness-must remain sound. Because the propensity of our people to accumulate private savings is relatively low, the Government must consider a more concerted effort to raise the level of public savings so that overall national savings are at an acceptable level of at least 25%.

Thus the Government's medium-term fiscal objective should be to achieve underlying Budget balance, on the Current Account and also provide for a surplus on the Primary Account. The government's actual performance can be seen from the figures above. Consistent with this medium-term objective, the fiscal strategy adopted by the Government in framing its Budgets should be centred on returning the underlying Budget to surplus in the current account at least over the life of the present Parliament. It is also necessary to maintain economic growth so that the Debt/GDP ratio does not increase as shown in the formula above relating to the growth of the debt/GDP ratio. The reductions in general government net debt should be an important public policy goal for a number of reasons:

- Reductions in net public debt levels are beneficial because they help reduce our vulnerability to economic shocks-such as those posed by external developments such as in East and South East Asia during the crisis of 1997. A strong and healthy fiscal outlook will be important in sustaining financial market confidence and shielding the country from external shocks.

- Reduced public net debt will be important in ensuring that the economy is better placed to cope with emerging pressures on the fiscal position such as ageing of the population. This will become an important consideration in the next ten years. According to the Minister of Finance the unfunded debt on pensions is a staggering Rs. 550 billion. This will become an increasing burden on the budget.

- Reducing public indebtedness should also help ensure that the burden of the cost of services enjoyed by the current generation is not transferred to future generations.

- By repaying the debts of the past, the reduced burden of interest payments on public debt will allow lower taxes and the provision of better public services and rising living standards. The easiest way to do so is through privatisation and the use of such proceeds to repay public debt rather than using such money to fund current expenditure or to increase public expenditure.

The Budget strategy should emphasize improving national saving and reducing net public debt. The savings from fiscal consolidation efforts-together with the proceeds from asset sales should be used to reduce net public debt. These should be the goals of budgetary policy.

The Importance of Foreign Borrowings

The UNF government has managed to change the composition of debt between local and foreign borrowing. Foreign borrowing most of which comes from Foreign Aid is of very low interest. So Foreign Aid is critical for our Public Finances. Foreign Debt in 2003 was about 49% of the total Public Debt. The foreign borrowings have been at very low rates of interest and the interest payable on foreign debt is only 9% of the total interest payments although it constitutes 46% of the total public debt. But with the depreciation of the Rupee the values of such foreign debt in terms of Rupees keeps on increasing. So the volume of outstanding foreign debt keeps on increasing even if foreign borrowing stops altogether. This will cast a burden on the Rupee budget since the government must find the extra rupees from its revenue in accordance with the canons of prudent public finances.

The country is lucky to be promised US$ 4.5 billion over the next three years. But this foreign aid will be forthcoming only if the Peace Process is continued. So the President must re-start the Peace Process if the public finances are not to end in a serious crisis next year and the years to follow. The country cannot afford to lose this opportunity for enhanced foreign aid. Sooner or later the International Donors are going to say that if we don't re-start the Peace Talks they would rather fund the LTTE directly. We are in danger of losing the foreign aid for the South if we do not resolve the constitutional crisis and re-commence the Peace Talks. It is worth asking the question what will happen to our public finances if Foreign Aid stops. Since nearly 60-75% of the capital Expenditure or Investments made by the government are funded by foreign aid, we will have to raise such moneys from the local market if foreign aid ceases. The other option is to forego such investments. But then how can there be economic growth? Economic growth is driven by investments.

In fact we have often found ourselves in the position of being unable to spend sufficient money to maintain our real capital assets like the roads, the Railways, the bridges, the schools, hospi-

Table							
Item	1980-89 Average	1990-97 Average	1998	1999	2000	2001	2002
GDP/capita	US$302	$618	$879	$863	$899	$841	872

Source: Central Bank of Sri Lanka

tals and even government buildings. So it is not possible to avoid investments without rising economic stagnation and even a drastic recession with accompanying decline of incomes. What has been our performance in Per Capita Economic Growth?

It is seen that our GDP per capita growth is insignificant. In the last five years the GDP per capita has also fluctuated. The per capita income in 2001, 2002 have been less than the per capita income for 1998. This sort of situation could also lead to a political crisis. There is immense political pressure to spend money on behalf of the constituencies of the Members of Parliament. These pressures, at times, have become exceptionally difficult to deal with. To close the gap between the financial demands of political constituencies and the limited real resources available to their governments, many countries too often have bridged the difference by borrowing from foreign investors. In effect, the path of least resistance has been external borrowing, even if it means higher interest rates on such borrowings.

The governments may also be tempted to create money to fund the budget deficits. This is the easy way out but it creates inflation and destroys economic growth and creates social unrest. It could end as hyper-inflationism in several Latin American countries. The only way out is if sufficient money can be borrowed in the domestic debt market from the local public to which we must turn our attention. But before that there is the possibility of market borrowings from the international capital markets. The PA regime tried to borrow during the 1994-99 period and found that it was called upon to pay high interest rates on such borrowings. The country lacks a good credit rating to obtain low interest foreign funds. It may not be able to get funds at all if the international capital markets have no confidence in the ability of the government to pay the debt. This was the experience of several Latin American countries including Argentina over the last twenty years. In the late 1980s there was the debt crisis in the Latin American countries when several of them defaulted on their foreign debts.

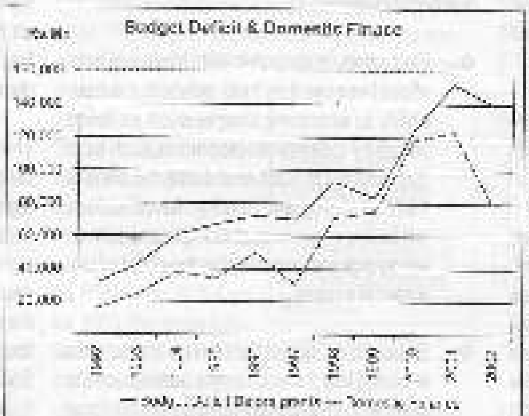
Although the range of outcomes has been wide, many emerging-market nations have had less success in insulating their international financial positions from domestic political pressures.

Periodically, as an economy borrows its way to the edge of insolvency with debt denominated in foreign currency, government debt-raising capacity appears to vanish virtually overnight. This vanishing capacity characterizes almost all financial crises. Will there be a financial crisis waiting to happen in our economy? It is just a matter of time.

Local Borrowings

I AM INDEBTED TO MR. JANAKA URUMULLA OF FIRST CAPITAL FOR THE DATA AND INFORMATION REGARDING THE GOVERNMENT SECURITIES MARKET. THIS MARKET HAS GROWN TREMENDOUSLY WITH THE CONTINUOUS BUDGET DEFICITS.

According to data obtained by me from First Capital the total domestic borrowing in 1992 was only Rs. 170 Billion as against 948 Billion as at end of November 2002 an increase of 550%. This domestic borrowing has taken the form of issuing Treasury Bills and Treasury Bonds. The PA regime of 1994-99 resorted to some highly inflationary borrowings from the commercial banks and the Central Bank as much as Rs. 60 billion. The present government has managed to pay all these debts to the banks. The amount outstanding on the market instruments of borrowing in the form of Treasury Bills and Treasury Bonds was 59% of the total domestic debt at the end of 2002. As at end of year 2002 the amount outstanding on market instruments was Rs. 566Bn. The volume of such Treasury Bills and Bonds is expected to grow each year and in 2003 it is expected to grow 16%. I give below a chart showing the movement in Budget deficits each year and the volume of domestic borrowings.



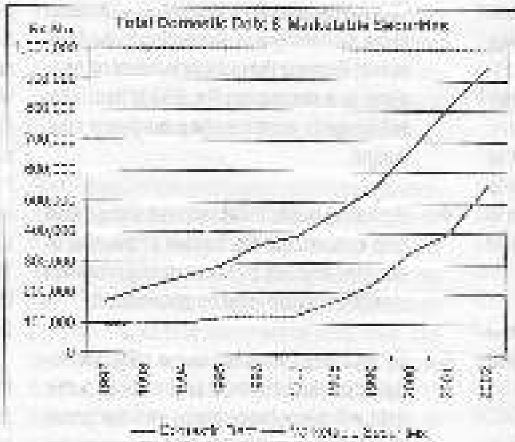
Source First Capital

The chart above shows how the governments of the day have widened the gap between borrowing in the form of marketable securities from the market and other non-market borrowing. This is of course a dangerous practice.

Prior to 1997, there were only Treasury Bills for maturities of 3 month, 6 months and 12 months. However the market outlook changed dramatically with the introduction of Treasury bonds in 1997.

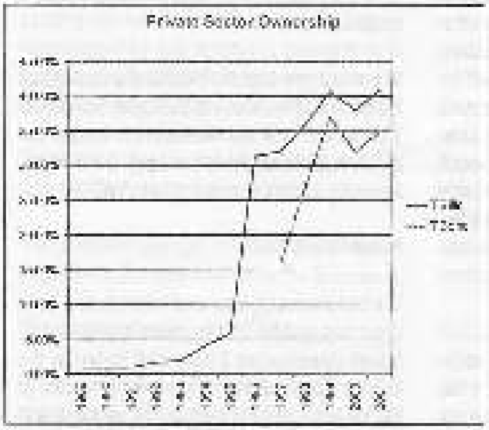
A PROPER GOVERNMENT DEBT SECURITIES MARKET IS STILL BEING DEVELOPED

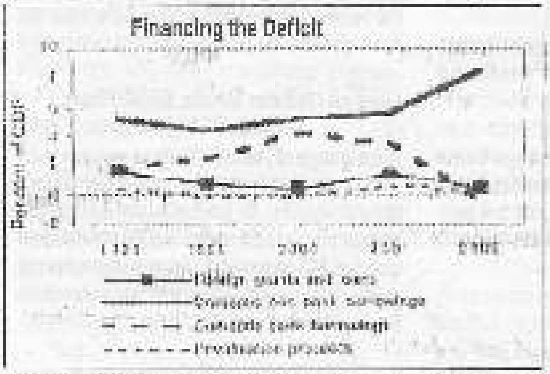
In the past the government securities market was dominated by the government sector funds and the captive funds. Like the Employees Provident Fund, The Employees Trust Fund and the state owned Sri Lanka Insurance Corporation. These institutions were persuaded by the Treasury to invest in government securities. And they did not pay enough attention to the rate of interest. So the government debt securities market was not a free market. However, with the establishment of a proper Primary Dealing System, the private sector contribution has grown tremendously. By end 2001, 37% of the government securities were held by the private sector as compared with 1.5% in 1992. The chart below show how the private sector share of ownership of government debt securities has grown over the recent years.



Source First Capital

The question arises whether future governments can continue to borrow more and more money from the domestic debt market to fund its budget deficits. That would indeed be a nice situation. But can this be a possible scenario? Lending institutions and even the public will provide funds beyond the immediately visible short-term cash flow of a borrower, even of the Treasury, only if they perceive that maturing debt will be rolled over. It is this capacity to roll-over debt that is critical. Can such debt be rolled over without limit? Contrary to what the public expects this can pose a serious problem particularly to a government that lacks the confidence of the business community. For years during the PA regime from 1994 to 1999 the Stock Market was in the doldrums. Why? Because investors both local and foreign lacked confidence in the capacity of the government to manage the economy properly. As soon as the UNF government assumed office or shortly thereafter the market took off and had a long bull run which terminated with the take-over of the three ministries by the President. Business confidence is essential for investors to take a long term view and invest their money. It's a moot point whether an SLFP or PA coalition government will be able to build sufficient business confidence to keep the debt rolling over for the government. The first whiff of inadequacy in debt-raising capacity which falls short of rolling over all debt falling due for repayment, will induce a run to the exits—not unlike a bank run. Thus, an economy's necessary condition for solvency—indeed a necessary condition for economic growth—is the maintenance of significant unused financing or borrowing capacity in the debt securities market. The UNF government has managed to raise additional debt in addition to the requirements for rolling over debt falling due for repayment. It seems to assume that this situation will go on forever. It is not so. Political uncertainty can cast doubt about the repayment capacity of the government and then the game will be over. It is then that the government is tempted to resort to printing money to contain the impending debt crisis with inflationary policies that inhibit growth.


Private Sector Ownership


Financing the Deficit

So the government will still need to keep domestic borrowings down since any excess borrowing can undermine confidence in the bond markets and can lead to an increase in interest rates. The debt servicing burden of foreign debt is very much lower than of domestic debt although any depreciation of the Rupee will increase the Rupee burden on the budget. It's time that those who denounce the donor community and find fault with them realised that but for their support the country would not have any investment and much lower economic growth. If our growth rate declines below the rate of interest on the debt we will enter permanently into a debt trap. We would then have no economic growth, our Rupee will be weak and our interest rates will rise. The temptation will be for any government then to inflate away the debt. So a future government which doesn't obtain foreign aid will print money to fund the budget deficits and the country will end up like Argentina. The economy will stagnate and there will be no foreign exchange to buy our essential needs which include food. The SLFP governments with their socialism and welfare policies coupled with the politicisation of the public service have followed the footsteps of the Perons of Argentina. How long will it be before the country ends up like Argentina?

Controlling Inflation

Controlling inflation is essential to creating an environment of sustained growth. I wish to quote from Alan Greenspan the doyen of Central Bankers and the famous Governor of the Federal Reserve system in USA. " Once inflation gets above a certain point, it has a large negative effect on growth, according to most research. Stanley Fischer, for example, concluded that if a country with inflation of 10 percent becomes a country with inflation of 110 percent, its annual growth rate would fall 4 percentage points. The consequences of this for standards of living can hardly be overemphasized. This effect may help to explain why East Asia, where inflation has been relatively low on average, has been more successful than Latin America, where many countries have suffered bouts of hyperinflation.

More generally, Latin America provides a good example of both the adverse effects of macroeconomic instability and the benefits of putting sound policies in place. Between 1975 and 1990, when many Latin American countries struggled with large budget deficits and high inflation, average per capita income in these countries expanded at a pace of just ½ percent per year. Economic performance in the region improved markedly in the early 1990s, as these countries reduced inflation, liberalized their foreign exchange regime, increased their openness to trade, and developed their financial markets. More recently, while Argentina, Brazil, and several other countries in the region have experienced economic disruptions, Mexico and Chile have remained relatively insulated, apparently reflecting market confidence that these countries are committed to sound policies." So we cannot underestimate the importance of market confidence in the process of economic growth.

Mexico is a particularly interesting case. In the two decades before 1995, the Mexican economy suffered several severe crises. Yet in recent years, with the implementation of NAFTA, a floating exchange rate regime, relatively stable fiscal policies, and much lower inflation, Mexico's vulnerability appears to have declined markedly. This country now seems to be viewed by international investors as a relative "safe haven" within the region. So the policies contained in Regaining Sri Lanka are in line with orthodox economic policy and should strengthen business confidence and promote foreign as well as domestic investment.

As Easterly and Levine indicate, much of Africa's plight can also be linked to macroeconomic instability says Alan Greenspan. " Empirical evidence suggests that Africa's large government budget deficits, underdeveloped financial markets, and black-market foreign-exchange premiums apparently explain roughly half the growth divergence between East Asia and Africa over the past several decades. In other words, these results suggest to Easterly and Levine that growth of per capita annual income in Africa would have been about 2-1/2 percentage points a year higher had countries in Africa followed policies adopted by the East Asian economies.

Our own per capita income figures are given above and show that our growth rates are too low to permit any significant increase in the standard of living. People usually quote the average per capita income to explain economic improvements. But this figure hides extreme values and gives a wrong picture. A better statistic is the Median income which in 1997 was Rs. 3,878. The population below US$1.00 per day which measures absolute poverty consists of 6.6%. Although comparatively low it is far from acceptable. The population with income less than $2.00 is as high as 45.4% in 1995-6. These statistics show that we need a much faster economic growth rate and a growth targeted towards the poor to achieve the minimum acceptable level of income.

2004 BUDGETARY PROPOSALS

Tax Reforms

Any Government is dependent on the collection of tax revenues to pay for the infrastructure and other services provided to the public. A significant shortcoming in our tax revenue collection system is that the tax net is small. A large numbers of persons and businesses that should be paying taxes do not do so. The Government has taken a systematic approach to address this problem. The comprehensive tax amnesty was a major success with over 50,000 declarations received, which is more than 10 times the number received under any previous amnesty. The Revenue Authority, being established to take over the Inland Revenue, Customs and Excise Departments will strengthen the process of tax administration in a systematic and fair manner, broaden the tax base and increase revenue collection.

Economic Service Charge

There are around 32,000 registered companies in the country. Less than 9,000 of them filed income tax returns for the year 2001/02 and just 2,850 of them paid income tax. In other words, less than 10% of the companies in the country pay income tax while the rest, who also use the same infrastructure and other services provided by the Government, make no contribution whatsoever towards meeting the cost of these services. This also applies to other forms of businesses such as partnerships and sole proprietorships.

Every business must make some payment towards Government revenue collection, even if the amount is small. We cannot place greater burdens on businesses that already pay tax.

Therefore as a transitional measure to achieving a ratio of income tax to GDP that is comparable to that of other countries, I propose, with effect from April 1, 2004, to impose on all entities carrying on any trade, business, profession or vocation that have a turnover in excess of Rs. 20 million or total assets in excess of Rs. 10 million and which have been in commercial operation for more than two years, an Economic Service Charge (or ESC) of 1%, payable on turnover or total assets. Each business will be permitted a one time choice of whether the 1% ESC should be applied to turnover or total assets. The ESC can be set off against income tax payable for the year, limited to the full amount of tax payable without any carry forward provision. The minimum ESC payable by an entity which is liable to this charge will be Rs. 100,000 and the maximum amount payable will be Rs. 20 million.

A request will be made to BOI companies to submit to the ESC from 2005/06 as a measure of fairness in view of their enjoying the same infrastructure and other Government services in conducting their business.

We expect to collect Rs. 3,000 million in revenues during 2004 with the introduction of this Economic Service Charge.

Deductions for Losses

Many businesses that make substantial profits do not pay taxes because they set off these profits against losses incurred during the year and brought forward from previous years. Commencing April 1, 2004, businesses can set off losses against the current year's total statutory income only up to a maximum of 35% of such income. This measure is projected to result in Rs. 800 million in revenue.

Partnership Income

Some partnerships currently distribute profits to fictitious partners and neither the partnership nor the partners pay tax on the profits earned. Commencing April 1, 2004, an up front tax of 10% will be imposed on the divisible profits and other income of all partnerships. This tax can be set off against the proportionate individual tax liability of each partner, up to a maximum of the tax payable, with no carry over provision. We estimate that Rs. 500 million will be collected through this measure.

Personal Income Tax

The tax free allowance for individuals will be increased to Rs. 300,000 from the present Rs. 240,000 and the subsequent tax slabs broadened.

The tax slabs for terminal benefits from all such benefits will be expanded so that the first Rs. 3.5 million will be free of tax.

Details of these two measures, which will substantially reduce the tax burden on individual tax payers and retirees. These measures are estimated to reduce revenue by Rs. 300 million.

Value Added Tax

At present, VAT is charged at two rats of 20% and 10%. Seventy percent of the revenue collected by the Government from VAT comes from the 20% band, which includes a large number of items that are consumed by the average consumer. The high rate of 20% is, in some cases, a cause for tax evasion. Furthermore, the dual rate distorts prices in the economy and creates problems relating to VAT collection and refunds. The drop in revenue collection in 2003 is largely attributable to complications caused by the two band system. The upper rate of 20% and the dual band system acts as a deterrent to growth in the business and industrial sectors. Therefore, from January 1, 2004, we will move to a single unified VAT rate of 15%.

The turnover threshold of Rs. 500,000 per quarter for payment of VAT will be raised to Rs. 750,000 per quarter and the annual threshold will be increased to Rs. 3 million. Certain changes will be introduced in the present refund system to simplify administration.

The new unified VAT rate will result in price changes, with the majority to items reducing in price. A publicity campaign will be launched to inform consumers, traders and retailers of the need to bring down prices in line with the reductions in the upper VAT rate from 20% to 15%.

With increased compliance resulting from the lowering of the upper band and the elimination of problems relating to VAT refunds, the Government expects to collect Rs. 2,000 million in additional revenue.

I have been particularly mindful of ensuring that the resulting increase of the lower band from 10% to 15% will not increase the cost of living. A detailed analysis has been done. Many essential items are exempt from VAT.

Hotel Room Tax

We had previously intended to introduce a hotel room tax of 10% of the room charge for all hotels classified as 3 stars and higher by the Ceylon Tourist Board. However, because of the large negative impact on the sector due to the recent political actions we have now decided to defer the imposition of this tax.

Levy on Cellular Mobile Subscribers

We are currently faced with large revenue leakages from the non payment of VAT on mobile cellular phones. An annual levy of Rs. 300 per mobile phone subscriber will be imposed instead of VAT on the purchase of mobile phones, starting January 1, 2004. VAT will continue to be payable on the cost of calls.

It is estimated that the revenue yield in the first year will be Rs. 600 million with increasing yields expected from the anticipated rapid growth of mobile telephones.

Elimination of Tax Exemptions

A number of tax exemptions have come into the Inland Revenue Act over a long period of time and the original rationale for them no longer exists. Their removal will result in more equal treatment of income from different sources. I therefore propose to eliminate the tax exemptions starting April 1, 2004. This measure is estimated to result in increases in Government revenue by Rs. 500 million.

Withholding Tax

Commencing January 1, 2004 the present exemption limit of Rs. 8,000 per month or Rs. 100,000 per year for withholding tax on interest income per deposit will apply to the total interest income from all deposits in any individual bank or financial institution made by a person or a corporate entity.

However, the withholding tax free limit will be raised to Rs. 25,000 per month or Rs. 300,000 per year in aggregate from all deposits of individuals whose sole or main source of income is interest from deposits. Such individuals must obtain a direction from the relevant Government authority for this purpose. This measure will assist pensioners from January 1, 2004.

Commencing on April 1, 2004, a 10% withholding tax will be levied on any annuity or royalty paid by any person or partnership in excess of Rs. 50,000 in any month or Rs. 500,000 in any year, and a 5% withholding tax on any management fee or similar payment. This withholding tax can be set off against the final liability to tax of the recipient.

The proposed changes in withholding taxes are estimated to increase revenue by Rs. 500 million.

Tax Administration and Compliance

In order to widen the tax net and improve tax compliance I propose to introduce the tax administration and compliance measures which includes measures relating to VAT. This will result in Rs. 400 million in additional revenue.

Tax Expenses and Allowances

The changes in tax laws and procedures will be introduced from April 1, 2004 which will result in the simplification of procedures and the rationalisation of expenses and allowances for the determination of taxable income. This measure will yield Rs. 500 million.

Duty Changes

Customs Duty/Excise Duty (Special Provisions)

As part of the continuing process of rationalising and simplifying customs duties, the duty bands will be reduced from 6 to 5. At the same time the present 20% surcharge on duty will be reduced to 10%. These changes will take place with effect from January 1, 2004. Excise Duty (Special Provision) on some items will also be adjusted at that time.

These measures are estimated to yield Rs. 4 billion in revenue without adverse impact on the cost of living.

Excise Duty

The excise duty on beer has remained unchanged since 1998 while the excise duty on hard liquor has been increased several times. Therefore, I propose to raise the excise duty, with immediate effect, by Rs. 5 per litre on beer with an alcohol strength of less than 5%, and Rs. 10 per litre where alcohol strength is 5% or higher.

Large quantities of rectified spirits issued for industrial purposes are being grossly misused for the production of illicit liquor. Besides the health hazards to the public of consuming such illicit liquor, it has been estimated that on illicit liquor produced using one litre of rectified spirits the Government non-losses almost Rs. 800 on taxes. I therefore propose to increase the excise duty on rectified spirits from Rs. 36 per litre to Rs. 200 per litre with immediate effect.

These changes will result in additional revenue of Rs. 950 million.

Other changes in excise duty required to maintain revenue neutrality will be made at the time of introduction of the single VAT rate.

Depreciation for Calculation of Fiscal Levies

The maximum age of used motor cars that can be imported, without a licence, is at present three years. With a view to allowing Sri Lankans access to motor cars at a lower price I propose to increase this age to three and a half years.

Further, at present there are two separate depreciation Tables, which are used to calculate depreciated values for determining VAT and duty on used motor cars and commercial vehicles. These depreciation Tables will be changed in the manner to encourage the import of newer vehicles which are better from an environmental point of view and to reduce the practices where motor cars have been classified as commercial vehicles to take advantage of the higher depreciation rates applicable to the latter category.

Construction Machinery Imports

The maximum age of used construction machinery that can be imported will be reduced from 10 years to 7 years.

Fee Changes

Licence Fee on Kitul Palms

In the 2003 budget the Government introduced an excise tax of Rs. 250 per tree on the tapping of kitul palms to provide a legal framework for granting of licences for such tapping. There has been significant development in this industry since that time. To further encourage the sector the excise tax will be reduced to Rs. 50 per tree with immediate effect.

Administrative Fees, Rents & Other Charges

Rationalisation and changes to administrative fees, rents on Government houses and buildings and other charges of loss making entities will be introduced to reflect realistic costs. Rs. 1,250 million in additional revenue and budgetary cost savings will result.

Turnover Levy on Tourist Board Registered Organisations

A 1% turnover levy was imposed on all organisations registered with the Sri Lanka Tourist Board in 2003. The General Sales Agents of airlines whose income is derived from the small percentage commissions they receive from the sale of air tickets will be exempt from this levy with effect from January 1, 2004.

Developing Sri Lanka as a Regional Shopping Centre

We plan to introduce a scheme to make Sri Lanka a regional shopping centre for consumer electronic goods and high quality locally produced goods, such as ceramics. Under this scheme, foreign visitors to the country who buy such goods from VAT registered retailers, will be entitled to a refund of the VAT paid on such goods, at the time of departure at the airport, and the duties on imported consumer electronic goods will be reduced to a nominal 3%. The scheme will be introduced early in 2004 and will have a beneficial revenue impact on the tourism sector.

The revenue foregone as a result of the duty reduction and VAT concessions is estimated to be Rs. 200m.

Funds in Dormant Accounts with the Employee Provident Fund

Detailed analyses of EPF data reveal that there are large numbers of EPF accounts with low balances which have been dormant for long periods and which are very unlikely to ever being reclaimed. Rs. 4,500 million of such funds will be transferred to the Government as tax revenue with the provision to the EPF of a contingency guarantee, as necessary. A part of this amount will be used for the proposed unemployment benefit insurance scheme.

Increase in Salaries of Public Officers

The Tissa Devendra Commission report published in mid 2002 carried out a detailed review of the public service salary structure and related issues. The trade unions and the opposition have been calling for the implementation of the recommendations in the report. Budgetary constraints, however, did not permit this. With the improvement of the economy we are now in a position to do so on a phased basis during the coming three years.

As part of this process, I will be appointing a Salary Review Committee to review the recommendations in the Devendra report to rationalize and amalgamate salary scales and to enhance selected scales because of anomalies or changes in circumstances. The Committee will also study options for rationalisation and closure of government entities. Its recommendations will be proposed for implementation with the next budget.

Meanwhile, commencing January 1, 2004 the Government will grant every public officer a monthly increase of 10% of his present salary or Rs. 1,250 whichever is higher. This will also apply to employees of the Police Department, the armed forces and corporations.

Further benefits will follow in 2005 & 2006

The Rs. 1,200 interim allowance granted in 2000, and the Rs. 1,000 or 10% of salary interim allowance granted in 2001, will be incorporated into the base salary of each scale by 2006. With this incorporation, lower level public sector employees will be on salary scales substantially higher than those recommended in the Devendra report. Consequently their pensions will also be higher. The higher increments recommended in the Devendra report will also be introduced by 2006, in stages.

The rate of movement to the full Devendra scales will be subject to the condition on voluntary retirement that I will speak of shortly.

Where public sector or corporation employees in any individual sub-sector have been granted increases in salaries or allowances during the past three years, beyond the allowances granted all public officers in 2000 and 2001, these increases will be set off to calculate the additional monthly amounts to be paid to such employees during 2004, 2005 and 2006. This process will eliminate the differences that have arisen between the salaries of such employees and public sector employees as a whole. The cost of the 2004 salary increase is estimated to be Rs. 12.5 billion.

Voluntary Retirement Scheme

We do not intend to implement the 30% reduction in the lower and middle grades of the public sector recommended in the Devendra report without a suitable safety net, since there will be hardships due to the resultant high unemployment. To overcome this problem we will introduce a Voluntary Retirement Scheme, or VRS, on January 1, 2004 with a suitably designed staggered compensation package which ensures that employees who accept the VRS will continue to receive monthly ex-gratia payments equivalent to their salaries and allowances.

As employee accepting the VRS will receive an up front payment equal to one year's remuneration, consisting of the retiring salary and the 2000 and 2001 allowances. The employee will also receive monthly payments equal to his salary at retirement plus the 2000 and 2001 allowances until he reaches the retirement age of 55 years. Thereafter, he will receive the applicable pension.

Employees will also be relieved of Rs. 24,000 of outstanding distress loans at the time of retirement. Any balance outstanding on loans will be recovered from future monthly payments, with a one year grace period without deductions. Employees with no distress loans or loans less than Rs. 24,000 will be paid equal monthly payments over two years so that they enjoy the same total benefit as those whose loans have been written off.

Our target is to reduce 100,000 public sector employees by 2004 and a further 200,000 by 2006 from the lower and middle income grades. Numerous indirect savings will accrue to the Government as a result.

The cost of the up front payment for the staggered compensation package is estimated to be Rs. 8 billion, of which Rs. 2 billion is already included in the voted budgetary estimates.

Increase in Pensions

It is only fair and just that pensioners be included in any revision in public sector salaries. Therefore, pensioners will be granted a 10% increase in pensions from January 1, 2004. This is the largest increase granted to pensioners during the past 10 years. This increase will cost the Government Rs. 2.5 billion.

Further, the recently set up Pensions Reform Office is presently studying various options to address anomalous situations where persons who have been retired for many years receive substantially smaller pensions than lower grade employees who retired later, because of salary scale changes that have occurred since the retirement of the first group.

Enhancement of Interest Rates on Deposits by Senior Citizens

In view of the difficulties faced by retirees and senior citizens because of the reduction in deposit interest rates, special deposit schemes have been introduced through the National Savings Bank and the two state commercial banks for senior citizens, where such persons receive a higher rate of interest on deposits.

Unemployment Benefit Insurance Scheme

The Government will provide Rs. 1,000 million as initial funding for an unemployment benefit insurance scheme to be set up during the coming year. When fully operational the Scheme will be funded by contributions from employers and employees.

Housing Loan Scheme for Public Sector Employees

A loan scheme for public servants, in addition to the existing scheme, will be facilitated by the Government through the National Savings Bank for the purpose of construction, purchase, extension or repair of a house, purchase of land to build a house, or to repay a loan obtained from a recognised financial institution for housing purposes. The maximum loan available will be Rs. 1 million, the interest rate 9.5% per annum, and the repayment period a maximum of 20 years. Instalments for repayment will be recovered from the salaries and remitted to the Bank.

Increase in Fertilizer Subsidy

We propose to increase the subsidy given to fertilizer from Rs. 2,000 million to Rs. 3,000 million from January 1, 2004. This will mean that the total subsidy on bag of Urea will increase from Rs. 300 to Rs. 450. Rs. 3,000 million is the largest fertilizer subsidy granted in the last decade.

Agricultural Loan Relief for Farmers

The two state banks have, at the request of the Government, already instituted a scheme whereby farmers who have obtained loans from these banks for agricultural purposes and found it difficult to repay these loans due to crop failures and other valid reasons will be granted relief by the banks. Under the scheme farmers will be able to reschedule their loans for repayment over six growing seasons and the interest rate on the rescheduled loans will be a very attractive 4% per annum.

Garment Sector Productivity Improvement

A garment sector productivity improvement project will be implemented in 2004 through the Joint Apparel Association Forum. This will include a grant towards an international campaign to promote the industry and an interest free loan for the training and development of production staff. The cost of this project is Rs. 150 million.

Agri-Business Development Fund

Continuous funding will be provided to the Agri-business Development Fund from which grants will be given to private sector entities that qualify, for the development of new technologies and practices in agriculture. The cost of this programme is estimated to be Rs. 100 million.

Development of the Milk Industry

Commencing January 1, 2004, incentive payments of Rs. 2 per liter and higher will be provided to companies processing milk who collect a minimum 5 million liters of milk per year. The tariff adjustment will provide an additional incentive. These incentives will increase milk collection and develop dairy farming. This programme is estimated to cost Rs. 60 million.

The Government also intends to introduce a milk feeding programme for needy pre-school age children. A Committee will be appointed to study issues relating to the distribution of milk and lactose intolerance among children and make recommendations on how to implement a suitable milk feeding programme.

Rs. 5 million has been allocated for the work of the Committee and for setting up a pilot programme based on the Committee's initial findings.

Technology Improvement for Small and Medium Industry

A project to bring about technology improvements in small and medium enterprises will be implemented.

A total of Rs. 1,000 million in funding has been budgeted for this project, of which a sum of Rs. 900 million will be obtained from previous small and medium industry guarantee scheme funds collected by the Central Bank, which are no longer required for guarantee purposes.

Development of Rural Telecommunications

In keeping with the decision taken by the Economic Policy Committee of the Cabinet and the directive issued previously, starting April 1, 2003 telephone operators were required to pay a prescribed charge to the Vishwa Grama Fund. This fund will be used for the development of rural telecommunication.

Streamlining of Departmental & Statutory Funds

There are more than fifty statutory and departmental funds within various Government entities without adequate performance reporting or auditing and outside budgetary control. Income of these funds are from fees, charges, fines and donations and are estimated to be in excess of Rs. 10 billion per year. These funds will be rationalised, merged and closed as appropriate. The funds will be brought under budgetary control and performance reporting and auditing systems will be introduced.

Visas for Foreign Nationals

At present the Government grants citizenships to foreign nationals who meet specified criteria for investment in the country. This process is complicated by issues such as dual citizenship, which arise in this context. To avoid such complications, forty nine year long stay visas will be granted to non-residents who meet specified criteria for investment and deposit in the country.

Five year resident visas will be granted to professionally qualified persons in identified categories where a shortage of such professional skills exists in the country.

Budget Forecasts

In Table 1 provide details relating to the expected budgetary performance for the year 2003.

Table 2 provides a summary of the budgetary estimates for 2004. These estimates have been prepared on a conservative basis assuming that we will be able to realise only Rs. 332 billion in revenue for the year. We have done so because of the uncertainties associated with the revenue impacts of some of the new tax proposals and the performance in revenue collection. If we are able to collect higher revenues, the additional amount will be spent on capital expenditure not identified or included in Table 2.

The fiscal deficit for 2004 is estimated to be Rs. 136 billion, or 6.8 per cent of the projected GDP. The net domestic borrowing requirement for the year is projected to be Rs. 66 billion.

Table 3 provides summary details relating to the gross borrowing requirements for 2004.

BUDGET FORECASTS

Table 1 - EXPECTED BUDGET OUTTURN 2003 (Economic Classification)

	Rs. Billion	As a % of GDP
Total Revenue	292	16.2
Tax Revenue	251	14.1
Non-tax Revenue	41	2.3
Total Expenditure and Net Lending	-432	-24.2
Recurrent Expenditure	-343	-19.2
Public Investments	-90	-5.0
Restructuring	-6	-0.3
Other	5	0.3
Current Account Deficit	-51	-2.8
Overall Budget Deficit	-140	-7.8
Financing	140	7.8
Foreign Grants	9	0.5
Net Foreign Borrowings	37	2.1
Net Domestic Financing	80	4.5
Divestiture Proceeds	14	0.8
Debt/GDP Ratio		100.1

Table 2 - BUDGET OUTTURN 2004 (Economic Classification)

	Rs. Billion	As a % of GDP
Total Revenue	332	16.4
Tax Revenue	293	14.4
Non-tax Revenue	39	1.9
Total Expenditure & Net Lending	-469	-23.2
Recurrent Expenditure	-350	-17.3
Public Investments	-100	-5.0
Restructuring	-10	-0.5
Other	6	0.3
Current Account Deficit	-25	-1.3
Overall Budget Deficit	-136	-6.8
Financing	136	6.8
Foreign Grants	10	0.5
Net Foreign Borrowings	50	2.5
Net Domestic Financing	66	3.2
Divestiture Proceeds	10	0.5
Debt/GDP Ratio		94.9

Table 3 - GROSS BORROWING REQUIREMENT - 2004

		Rs. Billion
Total Receipts (excluding Borrowings)		366
Revenue	343	
Divestiture Proceeds	13	
Foreign Grants	10	
Total Payments		-651
Recurrent Expenditure	-353	
Capital Expenditure	-140	
Debt Repayments	-136	
Advance Accounts	-22	
Gross Borrowing Requirement in terms of Book Value		285
Add: Adjustment for on lending to Private Sector and Debt Restructuring		23
Total Gross Borrowing Requirement in Terms of Book Value		308

PROPOSED CHANGES IN TAX LAWS

1.1 Tax Slabs of Individuals

With effect from the Year of Assessment 2004/2005

(a) The tax free allowance to be increased from Rs. 240,000 to Rs. 300,000

(b) The tax slabs for income tax to be widened as follows:

First Rs. 300,000	Nil
Next Rs. 240,000	at 10%
Next Rs. 240,000	at 20% and
Balance	at 30%

(c) Tax slabs for terminal benefits from employment (provident fund contributions, retirement gratuity and compensation for loss of office) to be revised as follows:

First Rs. 3.5 million	Nil
Next Rs. 500,000	at 5%
Next Rs. 500,000	at 10% and
Balance	at 15%

The methodology for calculating 'Retirement Gratuity' for tax purposes will also be reviewed.

1.2 Losses incurred in any trade, business, profession or vocation

With effect from April 1, 2004, losses incurred in any year or losses brought forward from previous years, by any person, will be available for set off against income earned in any year to a maximum limit of 35% of the total statutory income in that year.

All current limitations on the carry forward of losses will be removed. The existing provisions with regard to the carry back losses, and to special conditions for certain sectors including losses on horse racing, leasing, FCBU onshore transactions will also be removed. Capital losses will be abolished with effect from April 1, 2004.

Further, losses generated by way of intra group transactions, which have no economic substance will be disallowed.

FISCAL POLICY DEVELOPMENTS & BUDGET 2004

P. Guruge

Advisor, Fiscal Policy, Ministry of Finance

The third Budget of the UNF Government was presented to Parliament on 19.11.2003, despite the political uncertainties prevailing in the country since the first week of November, 2003.

This article will briefly examine the fiscal policy background in relation to the Budget – 2004 and the proposed strategy to consolidate the fiscal position of the government.

The Budget – 2004 proposals were an extension of the fiscal policies and economic policies adopted by the government since the presentation of its first budget for 2002.

At the time of presentation of the Budget – 2002 the fiscal situation of the country was beyond any imagination. There were several unsatisfactory features, among which the following may be so important to determine the prudence or otherwise of the fiscal policy of the country prior to 2002.

- Accelerating budget deficits – By the time the first budget of the Government was presented the budget deficit was Rs. 152,222 M. (10.8% of GDP) in 2001 and this was a result of continuously increasing budget deficits(overall deficit before grants) except for one year, as follows:

	Rs. m	% of GDP
2001	152,222	10.8%
2000	124,541	9.9%
1999	83,254	7.5%
1998	43,147	9.2%

Having such a high budget deficit continuously had resulted in unmanageable fiscal problems in the country.

- Galloping inflation – This is a by product of very high budget deficits and had an impact on the level of real income and cost of living basically. The rate of inflation in 2001 was around 14.2% which was the highest in so many years.

- High interest rates – This again is connected to very high budget deficits and resulted in heavy borrowings made by the government. Major portion of the available funds were borrowed by the government at very high interest rates. General interest rates were remained at very high levels between 17% to 18% except in 2000 which was exceptionally high.

Since the revenue generation was not commensurate with expenditure the major source of deficit financing was through borrowings. In 2001 the total debt burden exceeded the GDP of the country pointing to a disastrous situation. The debt burden was built up over the years as follows:

	Rs. m	% of GDP
2001	1,452,756	103.2%
2000	1,218,700	96.9%
1999	1,051,331	95.1%
1998	924,699	90.8%

The drop in Government Revenue

In 1995 the quantum of government revenue was as high as 20.4% of GDP which is a fairly satisfactory achievement. But by 2001 this has dropped to 16.7% of GDP. Nearly 4% reduction over a period of 6 years. When the revenue performance is analyzed it can be seen that this drop commenced in 1998 with the introduction of Goods and Services Tax (GST) in place of Turnover Tax (TT). At the time of the abolition of TT, the highest TT rate was as much as 20%. Major portion of tax revenue came from this TT.

This contribution was dropped with the introduction of the GST not because the GST is a bad tax but due to wrong decisions. The revenue neutral GST rate was estimated between 17 – 18% but the rate adopted was only 12.5%. As a result of such a low rate and the elimination of cascading effect etc. which prevailed under TT the unavoidable result was a very low tax revenue from GST. Even after realizing the short fall, no action was taken to remedy this situation and the country witnessed a continuous period of revenue drop from 1998 onwards.

Tax Revenue as .....% of GDP

1997	-	16.0%
1998	-	14.5%
1999	-	15.0%
2000	-	14.5%

Sri Lanka is a country with a very weak revenue base. The non-tax revenue in Sri Lanka was very low. When the charge on Central Bank profits is removed the other non-tax revenue was negligible. In a situation like this one has to be very vigilant in regard to tax revenue. Maintenance of an adequate tax base is of paramount importance if necessary revenue is to be generated. For the last so many years the major revenue source was the collection of indirect taxes. Although the importance of customs duties was diminished since 1960s the importance of internal consumption taxes such as TT and Excise duties was enhanced. Very often the combined income from such indirect taxes was more than 80% of total tax revenue. Due to this excessive reliance on indirect taxes a lot of inferior features crept in to the fiscal system. The policy makers were neglecting direct taxes and concentrating heavily on indirect taxes. Even the tax administration was not interested in improving the direct tax system but was concentrating on easier to collect indirect taxes. In addition to that society suffered by way of high inflation and associated ill effects such as high interest rates and unbearable cost of living with the erosion of the real income.

Not only was direct taxation neglected as mentioned above, the use of tax policy for economic purposes in big way also contributed to the accelerated drop of income tax revenue. In Sri Lanka the major portion of income tax revenue was generated from the corporate sector. Excessive tax relief and concessions including the much favoured "Investment Tax Allowance" granted in 1996 destroyed the corporate tax base. Soon after the introduction of the investment tax allowance corporate income tax revenue dropped by about 20 per centum. This trend continued even after the abolition of this allowance in 2000 as a result of the continuous impact due to the carry over of the unabsorbed allowance to future years. The unutilized allowance as at 31.03.2002 has been estimated to be around Rs. 50 billion which may be higher than one full years taxable income declared by all companies in Sri Lanka. This drop in corporate tax revenue may be illustrated as follows:

2002 Rs. 14,499 m.
2000 Rs. 15,757 m.

The performance of the non corporate sector, basically personal income tax was very poor during last so many decades. A dependable amount (even in small quantity) came only from PAYE tax paid by non-public sector employees. Others engaged in trade, business, professions or vocation did not contribute adequately to the income tax revenue due to poor tax administration. Although since 1973 Sri Lanka has adopted the system of self assessment for income tax payments, many tax payers did not follow this system. It was estimated that only about 35,000 (average) self assessment payments were received both from corporate and non-corporate sectors. Many tax payers wait for an assessment from the

Inland Revenue Department due to lack of knowledge and other administrative faults. This has obviously resulted in low income tax revenue collection. Although there were withholding tax systems covering employment income (PAYE), interest and some other sources a satisfactory amount of revenue came only from the PAYE system as mentioned earlier.

This policy compounded the situation of direct tax revenue and as a result the revenue growth from direct taxes even with improved performance from withholding taxes was very much low when compared with indirect taxes.

	Income Tax Rs. m	Indirect Taxes Rs. m
1996	20,429	97,706
2000	27,457	122,502
2002	37,619	148,540

To arrest this deterioration in the fiscal management certain measures were introduced in the nature of self discipline.

Fiscal Management (Responsibility) Act (FMRA)

The introduction of FMRA in 2002 can be considered a landmark in the fiscal history in Sri Lanka. Sri Lanka has been experiencing unplanned fiscal outcomes as explained above due to various reasons since the last two decades. While the government revenue was declining below expectations year by year government expenditure was rising unabatedly due to the "war situation" prevailed in the North and East, till recently. Due to this unexpected increases in expenditure not only were the budget estimates not realized but the government also borrowed money from all possible sources. Further, extra budgetary expenditure such as credit purchases of defence related goods was not a rare happening. On top of all these undisciplined fiscal behaviors, there were various benefits given on the eve of general elections. Salary increases, additional subsidies, various grants, new employment etc. were among some of these pre election benefits granted and all these additional expenses took the fiscal imbalance from bad to worse.

As a result of all these bad fiscal behaviors the budget deficit became unmanageable and the debt burden surpassed the aggregated GDP.

In order to instill some sort of discipline in the area of fiscal policy the new government decided to introduce a Fiscal Management (Responsibility) Act (FMRA) which became law on 09.01.2003 as Act No. 3 of 2003.

The purpose or objective of this Act has been given as follows:

"An Act to ensure that the financial strategy of the Government is based on principles of Responsible Fiscal Management; to facilitate public scrutiny of fiscal policy and performance; and to provide for matters connected there with or incidental there to."

Accordingly this law –

(i) cast a responsibility on the Government in power to adopt the principles of Responsible Fiscal Management in planning and executing the financial strategy of the Government, and

(ii) pave the way for public scrutiny of such fiscal policy and performance.

According to the provisions of this Act the above objectives are to be achieved as follows.

- ❖ reduction of government debt to prudent levels, by ensuring that the budget deficit at the end of the year 2006, shall not exceed 5% of estimated GDP and to maintain such level thereafter.
- ❖ prudent management of the financial risks faced by the government.
- ❖ adoption of policies relating to spending which do not increase government debt to excessive levels.
- ❖ adoption of tax and spending policies which are consistent with a reasonable degree of stability in future level of tax rates.
- ❖ Government guarantees not to exceed specific limits.
- ❖ Limitations on Govt. debt not to exceed 85% of GDP in 2005 and 60% of GDP in 2013.
- ❖ Taking policy decisions of the Govt. having regard to their impact on future generations.

In order to achieve these objectives certain procedures have been stipulated.

- ❖ Preparation and publication of Fiscal Strategy Statement of the Government.
- ❖ This statement to be released to the public at the time of each budget debate.
- ❖ Any revision to the statement to be submitted to the Parliament.
- ❖ Each year a Budget Economic and Fiscal Position Report should also be submitted at the time of the budget debate.
- ❖ A Mid-year Fiscal Position Report, Final Budget Position Report Pre-election Budgetary Position Report etc. also should be submitted to the Parliament and published.

The objective of these steps is to increase public awareness of the Govt.'s Fiscal Policy and to establish standards for evaluating Govt.'s conduct of its Fiscal Strategy.

The basis of the government's Fiscal Policy strategy based on the above guidelines may be concentrated in the following areas:

1. Reduce public debt to a sustainable level.
2. Create opportunities for new employment and enhance the earning capacities of the people.

Now let us examine the main budget proposals which will have an impact on the above strategy.

The main proposals

The main Budget Proposals for 2004 should be analyzed in the framework of the above mentioned fiscal strategy of the government.

Medium term fiscal strategy of the government aimed at the reduction of budget deficit to the following levels as a percentage of GDP.

2003	-	7.8%
2004	-	6.8%
2005	-	6.5%
2006	-	5.0%

In order to achieve the relevant target for 2004 i.e. a deficit level of 6.8% of GDP it is necessary to keep the expenditure at 23.2% of GDP and to aim at total revenue in the range of 16.4% of GDP. When compared with the revenue performance in previous years it will be a difficult task to achieve this high level of revenue even if the expenditure target may be achieved.

However the post budget critical developments on the expenditure side as well as revenue side may develop in to a situation of excessive expenditure and shortfall in revenue which may push the fiscal position back to square one.

The strategy proposed was basically concentrated in the following areas:

- **Consolidation of indirect taxes**

  Still more than 80% of tax revenue come from indirect taxes such as VAT, Import duty and Excise duties. Out of these three taxes excise duties were almost at a saturated level and any considerable increase would have had negative effects of encouraging tax evasion in various forms. Except for minor adjustment in the area of excise duty no major changes have been proposed.

  Total excise duty collection realized in the last two years and proposed for 2004 were as follows:

2002	Rs. 52,099 m.
2003	Rs. 50,973 m.
2004 (estimated)	Rs. 57,246 m.

The increase in revenue for 2004 from excise duty is mainly based on the normal growth in consumption.

Import duties are facing a process of rationalization. Within the next 2 to 3 years the aim is to fix a 3 band tariff structure in place of the current 6 band system. When such rationalization is in place it is very difficult to expect additional revenue. As a step towards this rationalization the number of rate bands were reduced from 6 to 5 in a way that there will be no major drop in revenue, taking into consideration the proposed reduction of the surcharge from 20% to 10%.

Total customs duty collection realized in the last two years and proposed for 2004 were as follows:

Customs Duty Collection –

2002	Rs. 28,600 M.
2003	Rs. 34,479 M.
2004 (Estimated)	Rs. 40,065 M.

The increase in revenue from Customs duty is mainly based on the duty revision on motor vehicles and the upward revision of the lowest rate.

VAT is the only indirect tax that may be further expanded willingly or unwillingly. On that basis certain major changes have been proposed in the area of VAT. The revenue performance of VAT was below expectations in 2002 and 2003. Therefore, any revision in the VAT structure should be aimed at revenue consolidation.

One of the major proposals was the introduction of a single rate of 15% in place of two positive rates which prevailed at 10% and 20%. The tax administration faced a lot of problems due to these two rates and considerable revenue leakages have taken place through VAT refunds in 2003. This unification of rates should be viewed from macro perspectives without looking at price changes in individual consumer items. When the tax revenue is expected from indirect taxes, it is not wise to expect low consumer prices always. More indirect taxes usually mean higher prices for consumer items in general.

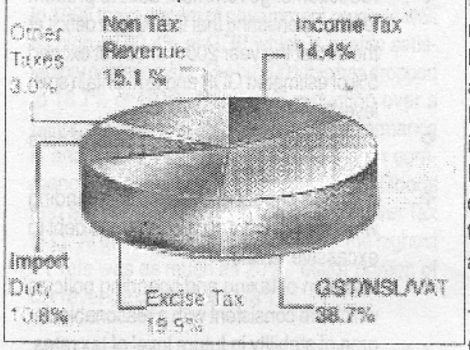
Along with this rate rationalization a few changes have been proposed to the list of tax exempt supplies. Exemption on unprocessed agriculture, horticulture, farming, fishing, forestry etc. have been removed. However, this will not have any impact on small scale farmers and producers since the VAT registration threshold has been increased to Rs. 3.0 mn. per year w.e.f. 1st January 2004 from the previous level of Rs. 1.8 mn.

VAT revenue collection (Net of refunds) realized in the last two years and proposed for 2004 were as follows:

2002	-	Rs. 95,836 m. (including GST and NSL up to 31.07.2002)
2003	-	Rs. 97,195 m.
2004 (estimated)	-	Rs.121,540 m.

The VAT revenue estimate for 2004 is almost same as the2003 estimate which was not realized. Therefore to achieve this, better supervision of refunds and revenue collection is important.

How a Rupee was Earned - 2002



With other miscellaneous indirect taxes the total revenue estimate on indirect taxes is Rs. 225,388 m. for 2004 which is approximately 24% higher than the 2003 actual realized amount. When the poor tax administration levels are considered achieving expected increase may be a herculean task!

- **Expansion of direct taxes**

While consolidating the indirect tax base, more emphasis is placed on direct taxation. The poor performance of direct taxes was the major problem not only from the revenue point of view but also from the point view of social implications as well. In a society like Sri Lanka where the majority are supposed to be poor people, having excessive reliance on indirect taxes while neglecting direct taxes may create a situation of social unrest as well.

For all these revenue and social reasons it is very important to increase the incidence of direct taxation, basically income taxation.

The efforts taken during the last few years to expand the income tax base by lowering marginal tax rate and making the tax system more convenient and tolerable has not produced adequate results, mainly due to the problems in tax administration. Therefore, in order to strengthen the direct tax base the major overhaul is necessary in the tax administration and the government has proposed to establish a Revenue Authority to streamline the tax administration in general.

In the mean time the Budget – 2004 has proposed certain novel concepts to increase direct tax revenue.

Economic Service Charge - (ESC)

This will be payable by any person (including a partnership) engaged in any trade, business, profession or vocation which was in existence for 2 years or more and having assets with a total value exceeding Rs. 10 mn. or total annual turn over exceeding Rs. 30 mn. The liability will be on the lower value of either the assets or turn over on the year of assessment basis w.e.f. 01.04.2004. The rate of the charge is 1% and subject to the minimum charge of Rs.100,000 and maximum of R. 20 mn. This charge paid can be set off only against income tax payable for the same year on the profits and income from such trade, business etc.

The intention was to collect a minimum amount towards the provision of various infrastructure facilities by the government to the respective businesses whether they are liable to pay income tax or not.

This will have no impact on small businesses but will cover a substantial number of organized businesses which are not contributing to income tax revenue now.

Taxation of Partnerships

In Sri Lanka due to the high exemption limit available to individuals, there is a tendency to create partnerships to do any trade, business etc. which will help them to split income and avoid income taxation. In order to mitigate this situation it has been proposed to charge a 10% tax on the divisible profits and other income of the partnership for each year of assessment. This amount will be available to the respective partners to set off against their income tax liability on such share of income, if such individual partners are liable to pay income tax.

These two measures, if properly administered will increase the direct tax revenue to a considerable level.

In addition to these new steps, it was proposed to strengthen the existing direct tax systems also in several ways –

• Restriction on loss deduction

Existing rules relating to the deduction of losses incurred in any trade, business, profession or vocation are very complicated and many persons specially corporate bodies use these complicated rules for tax avoidance. In order to minimize this misuse, it has been proposed to allow any loss only up to 35% of total statutory income with the facility of carry over of the balance loss to the next year and so on. This will greatly reduce the misuse of tax loss provisions and may improve the direct tax base to a considerable extent.

• Introduction of economic depreciation

The system of accelerated depreciation introduced as far back as in 1990s continued for so many decades without any evaluation of the success or failure of such a system. Any economic development achieved through such hidden incentives would not be sustainable in the long run and the adverse impact on the income tax base due to such accelerated depreciation was also considerable. In consideration of the necessity to expand income tax base an appropriate economic depreciation rate system will be implemented from 01.04.2004.

• Withholding taxes

Since the introduction of withholding tax on Govt. securities and deposits in banks and financial institutions on the basis of final withholding tax for non-company entities, in 2002 the revenue from this area has increased tremendously. Out of all WHT systems interest income generates more than 90% of total WHT revenue.

The following statistics prove the success of this measure:

2001 – WHT on interest - Rs. 6,828 m.
2002 - WHT on interest - Rs. 9,755 m.
2003 - WHT on interest - Rs. 11,500 m.

In the last two budgets new withholding taxes were introduced in the areas of commercial rent, lottery prizes, betting and gambling winnings, Govt. rewards and shares of listed subsidiaries by the Government. In this budget further areas such as annuities, royalties and management fees etc. were brought under the withholding system.

All these measures will increase the direct tax base and in 2004 estimated withholding tax revenue is Rs.13,708 Mn. The estimates have been revised downwards due to the prevailing low interest rates and this figure is without dividend tax which is considered as part of Corporate tax revenue.

• Removal / consolidation of tax exemptions

This has become a very difficult area to reform due to the unwarranted sacrifice of fiscal policy for the needs of economic policy. Whenever any investment is promoted they always insist on tax concessions whether such concessions really matter or not.

A large number of exemptions included in the Inland Revenue Act on ad-hoc basis will be removed as a result of the proposals made in the Budget. The main thrust is to consolidate BOI and Inland Revenue exemption regimes.

Further, some other exemptions which may have to be allowed due to the under developed nature of our economy in certain areas such as infrastructure will be rationalized and consolidated.

It may be a long wait to see a tax regime without any exemptions but steps have to be taken to prune them gradually. This is necessary because of the low tax regime introduced in the last few budgets. The marginal income tax rate has now been brought down to 30%. There may be further reductions in future, if the tax base is expanded to a satisfactory level. If we are to have a lower reasonable income tax régime, then it is equally important to have a wider tax base in order to generate required revenue for the Govt.

• Simplification of tax rules

This is another important area in which various steps have been taken as a result of the last two budget proposals. Arbitrary powers enjoyed by tax officials have been reduced considerably and instances of "harassment" and "hazzle" due to uncertainties in tax rules have been rectified.

Now any tax payer can have a determination of his tax liability within a reasonable period of time. Tax collection has to be done within a period of five years. This will increase the efficiency of the tax administration as well. All inquiries, assessments etc. have to be finalized within a period of five years. All these legislative changes will increase the principle of certainty in the determination of tax liabilities.

• Revamping tax administration

All steps already discussed will be of no use to consolidate the fiscal situation of the country unless the tax administration is strengthened and brought up to date. The lethargic attitude and other associated problems in tax administration has negated the good results that would have achieved as a result of tax reforms mentioned earlier.

Therefore, the intention of the Govt. to revamp tax administration involving Inland Revenue, Customs and Excise should not be neglected due to pressure brought against such steps, if the country is to benefit from these continued tax reforms which have already taken place.

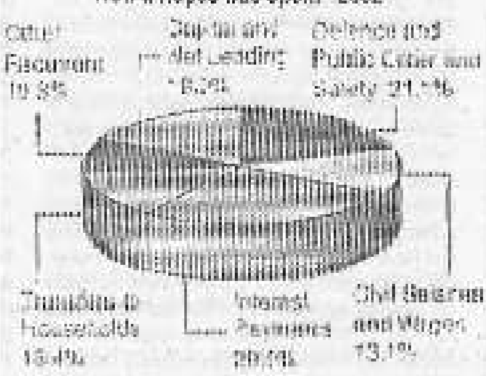
Conclusion

Fiscal Policy consolidation is important not only for the government but it will be important to each and every citizen of this country whether poor or rich. Therefore, everyone should understand the critical areas behind this strategy, which may adversely affect some of them in the short and medium term. Policy makers should also have a clear vision in this strategy so as to facilitate the progress of the implementation of the strategy. There should be no lapses whatsoever and the Fiscal Policy should be used to the maximum benefit of the fiscal system itself. Otherwise, the country will face the same fiscal problems in many more years to come which may lead to economic stagnation and deterioration.

Further, a word of caution may be appropriate to those who clamour for tax concessions in order to improve economic development. Special tax breaks or concessions will not generally create a healthy and sustainable economic development.

Therefore, what is important is a suitable macro-economic situation with low interest rates, low inflation, low tax regimes and other stable socio-economic behaviors including good governance. When such a conducive background is available the economic activities will flourish even without any specific tax concessions. Tax concessions alone will not move the engine of growth.

How a Rupee was Spent - 2002



(Note: All statistics are based on the Central Bank and other Government Publications)

Governance & Economic Growth in Sri Lanka

Some Lessons from Newly Industrialising Economies

O.G. Dayaratne Banda *
Senior Lecturer, Department of Economics
University of Peradeniya

Need for a Consensual Approach of Governance Aimed at Rapid Economic Growth

It is puzzling as to what may be the barriers to economic progress in Sri Lanka given the fact that the resource base, level of human capital, level of social development, and development strategies and policies appear to be relatively conducive and pro-growth at least for the last two and a half decades. Writing on Singapore's growth experience Lee Kwan Yew (2000), states on the development trajectories of Sri Lanka that during his visits over the years he witnessed once a promising country go to waste due mainly to political barriers, despite Sri Lanka was relatively prosperous in terms of more resources, better infrastructure, and better social development than Singapore. This article is aimed at reviewing the political environment in Sri Lanka, which has become a major impediment for faster economic growth, with the aid of development experiences of most successful growth performers of the 20th century in East Asia. This effort is important both with regard to development history of Sri Lanka and given the current political anarchy reinforced by the political antagonism over gaining and retaining power in the country. This write-up emphasizes the governance of national reconciliation aimed at attracting foreign direct investment and stimulating economic growth. Economic growth is the foremost importance for developing countries such as Sri Lanka. The quest for economic growth has beleaguered economists as long as there have been economists (Easterly 2001). In 1776, Adam Smith, attempted to explain what determines the wealth of nations. In 1890, Alfred Marshall noted that the quest for growth "gives to economic studies their chief and their highest interest". Nobel Lauriat Robert Lucas (1988) asserts that "it is hard to think about anything else" when one starts thinking about economic growth. However, economic growth has not received due attention throughout post-independent development efforts in Sri Lanka. In the post-1977 era, even if growth was prioritized it did not work out due to diverse political and social barriers that are intrinsic in the socio-political system. Development economists and practitioners in Sri Lanka have guided the economy into an absolute mess due to their perpetual change of the ideologies by over-emphasizing the need for classical democracy and socio-political freedom that do not warrant in a poor economy retarding economic growth which resulted in damaging not only the very democracy that they advocated but also the economic prospects.

In formulating and implementing successful growth strategies, it is hard to ignore the fact that human societies are characterized by a diversity of interests, preferences, ideals and knowledge. Each of these directly or indirectly involves the use of scarce resources, or means of using resources, which individuals or groups seek to encourage or protect. Although, people prefer to get their way in general, the cooperation is essential if they are to progress due to externalities associated with their activities which lead to conflicts. For trying to resolve disparities, human species have evolved a set of conscious processes. These processes are the institutional arrangements and policies within which individuals accrue skills and firms accumulate capital and produce output. It may imply that all the institutional arrangements, cooperation and negotiation involved in the use, production and distribution of resources, whether material or ideal. The development experience of most successful economies in the 20th century in East Asia suggests that market-oriented growth strategy generates better outcomes. It appears, however, that the market-oriented growth strategy needs to be accompanied by appropriate institutional arrangements and domestic policies with stable political system for the economies to perform well in terms of rapid growth.

The market-oriented growth strategy needs to be accompanied by appropriate institutional arrangements and domestic policies with stable political system for the economies to perform well in terms of rapid growth.

The political system, institutional arrangements and economic policies are integral ingredients of any economic activity, albeit mainstream economists ignored the importance of these factors in their economic analyses for a long time. The idea that politics, institutions and policies that affect investment and technological progress, thereby economic growth dates back to at least Adam Smith. But it has recently received greater attention (Baumol 1990, Murphy, Shleifer, and Vishny 1991, Oslon 1993, 1996, Sachs and Warner 1995, Hall and Jones 1999, Temple and Johnson 1998, Parente and Prescott 2000). In the recent literature there is increasing emphasize on the importance of political factors in economic growth in developing countries. The political and social systems of an economy are no longer exogenous components of modern day economic analysis. Economists have increasingly realized that achieving economic progress is impossible if the political and social systems are not conducive. Parente and Prescott (2000) in their analysis of technological progress and economic growth show that there are apparent evidence for the fact that Europe was not even at the eve of industrial revolution when modern technological progress originally emerged in China even if China failed to capitalize and foster these technology initiatives due to political and social barriers in the 14th and the 15th centuries. This clearly shows that social and political systems can become impediments to long-run growth by permanently damaging the process of technological progress. In this context, this paper examines the growth experience of most successful economies of East Asia in the 20th century focusing on the political factors that contributed to the rapid growth of those economies with the purpose of drawing lessons for Sri Lankan growth process.

Growth Performance

The East Asian First-Tier Newly Industrializing Economies (NIEFT-4) such as Singapore, South Korea, Hong Kong, Taiwan, and Second-Tier Newly Industrializing Economies (NIEST-4) such as Malaysia, Indonesia, Thailand, and the Philippines provide haunting lessons for Sri Lanka. These economies have maintained amazingly high growth rates for the past three decades while South Asian countries maintained moderate growth rates. During 1980-90 period, some of the leading growth performers of East Asia such as Indonesia, Malaysia, South Korea, Thailand, and Singapore recorded annual average growth rates of 6.1, 5.3, 9.4, 7.6, 6.7, and 6.9 respectively. On the other hand, such South Asian countries as India, Sri Lanka, Pakistan, and Bangladesh recorded average annual growth rates of 5.8, 4.0, 6.3, and 4.3 respectively (World Development Indicators 2002).

Due to the remarkable growth performance of East Asian economies, their per capita incomes have reached to higher levels. Despite the fact that some of the South Asian countries such as Sri Lanka were thought to perform well in 1980s, and 1990s, East Asian countries have outperformed them during 1980s and 1990s (World Development Indicators 2002). For instance, although the per capita income of South Korea and Sri Lanka were the same in the early 1960s, the per capita income of South Korea was 10 times higher than that of Sri Lanka in 1999.

Some of the key factors that might have contributed to sluggish growth performance of Sri Lankan economy are: political instability, late liberalization of foreign investment regimes, and unable to create and sustain effective institutional and policy environment. One of the striking features of Sri Lanka's growth performance is that even if it has experienced severe institutional constraints arising from ever changing governments, ethnic tensions, low quality bureaucracy, high level of corruption, late liberalization, and political instability, Sri Lanka has managed to maintain moderate growth rates in 1980s and 1990s.

Democracy, Governance and Growth

There is a remarkable literature that addresses the issue that whether there is a correlation between democratic or authoritarian regimes with private investment, technological progress, and economic growth (Parente and Prescott 2000, Leftwich, 1998, Evans 1995, Barro 1991, 1996, Oslon 1993, 1996, Przeworki 1988). Nevertheless, it appears that there do not have a

* PhD Research Scholar, National University of Singapore

consensus among economists as to whether the democratic or the authoritarian regime is appropriate for sustaining faster economic growth. The existing studies fail to exhibit any robust results revealing that the regime type has a systematic relationship with economic growth (Barro 1996). While some studies show a positive relation between democracy and growth, others find that the developing economies perform well under authoritarian regimes since their greater ability to mobilize domestic savings for investment, and most successful growth performers in NIEFT-4 have experienced developmental authoritarian regimes.

It is a fact that sustaining democracy is unachievable if economic progress is impeded by various practices in the name of democracy. Historical experience of successful economies seems to suggest that democracy is not a prerequisite for maintaining rapid growth and achieving prosperity. Over-emphasize on democracy by retarding economic growth will kill not only democracy and social cohesion but also economic progress.

From a growth point of view, however, it is the preeminence of the nature of the state that has to be the focus of our attention, not the type of regime. Successful developmental outcomes, both contemporary and historically, seem to have relied less upon

Political instability arising from political disagreements is found to be a major impediment to economic growth (Easterly 1995, 2001; Parente and Prescott 2000). Political consensus is required on every major issue to create a stable environment for attracting FDI and for sustaining rapid economic growth.

Even if most researchers focus on the fact that whether democracy or authoritarianism matter, it appears that it is not the form of the government or the regime type to be the focus of our attention when considering the appropriate political agreements, institutional arrangements and domestic policies required for attracting FDI and maintaining faster growth, but whether the state has itself committed to and continue to perform appropriate institutions and policies, while the opposite political agreement has been reached to maintain political stability. It not only is its technical and administrative arrangements which determine the character and competence of the state that matter, but also the politics which generate and sustain that state (Leftwich 1995) irrespective of whether the state is democratic or not. Political instability arising from political disagreements is found to be a major impediment to economic growth (Easterly 1995, 2001, Parente and Prescott 2000). Political consensus is required on every major issue to create a stable environment for attracting FDI and for sustaining rapid economic growth.

Regardless of the fact that most liberalists and multilateral development agencies advocate democratic governance presuming that it helps create and maintain appropriate institutional arrangements and policies for rapid growth, it is not apparent as to what form democracy should take, or the institutional arrangements which should be established. According to Schumpeter (1965), in the minimalist sense, democracy means a system that characterizes 'political parties and groups that are free to pursue their interests according to peaceful, rule-based competition, negotiation, and cooperation within an institutional arrangement for arriving at political decisions in which individual acquire the power to decide by means of a competitive struggle for the people's vote' (Schumpeter 1965). The general perception appears to be that democratic institutions and policies are more appropriate for private investment and stimulating economic growth. However, experience seems to suggest that Sri Lankan type of democracy is harmful for the long-run growth of the economy. It provides a splendid example for the other developing countries for them not to pursue this kind of democracy in their rapid growth process if they are to prosper.

whether regimes have been democratic or not, and more on such characters of the economic system as: internal stability of its democratic or undemocratic kind; acceptability of international economic and political realities; sound physical and human infrastructures; freer domestic markets, more openness; a competent and disciplined administration, and a critical minimum level of consensus between groups and regions about the objectives of growth and rules for achieving it.

Governance and Growth in Newly Industrializing Economies

It is their characters of the institutional arrangements, policies, and political systems which explain higher attraction of foreign direct investment (FDI) and sustained and successful growth performances of over the last 35 years of societies as different as NIEFT-4 and NIEST-4 not their regime type since some of these are democratic and others are not. It is their bad domestic and international economic policies, weak institutional arrangements, and political disagreements created by the institutional environment that were in place which explain the poor attraction of FDI, high aid-dependency, and the negative or weak growth records of societies as Zaire, Pakistan, India, and Sri Lanka not their regime types since some of these are democratic while others are not. In this backdrop, the successful economies of East Asia that marched from Third World towards first provide astonishing lessons for Sri Lanka given the fact that Sri Lankan type of fragile democracy is an impediment to maintaining political stability and to provide leadership to rapid growth process. Political stability created either through consensus or through authoritarian practices has provided a strong basis for the growth process of most successful economies of East Asia in the 20[th] century.

Japan: One Party Rule (1955-1993) cum Market-Oriented Growth Strategy

It is worth noting at the very outset that the paradigm case here is obviously Japan where the Liberal Democratic Party (LDP) ruled the country without break from 1955 to 1993 which guaranteed policy continuity and consistency reinforced by the strength and influence of the bureaucracy, and by political stability. Japan not only has experienced outward-oriented growth strategy but also has established and executed institutional arrangements and domestic policies for supporting outward-oriented growth strategy with political stability assured by one party rule. Even if the foundation for Japan's thriving growth process was laid in the 19[th] century, Japan evolved into an economic giant during 1955-1993. But these central characteristics have also been found in other countries such as Singapore and Malaysia, where Singapore marched from Third-World to first while Malaysia has been performing very well for the last three decades, albeit their resource endowments could be different while associated economic strategies and trajectories could not be more dissimilar.

Singapore: One Party Rule (1965-To Date) cum Market-Oriented Growth Strategy

Being a multi-ethnic society, Singapore provided a fertile ground for conflicts at the time of becoming a separate nation in 1965 when Malaysia expelled Singapore from Malaysian confederation. Communal riots erupted from time to time between Chinese and Malay communities at the initial period. In order to avoid ethnically motivated conflicts, English was made the official language while all the other four languages were made state languages. A series of policies and strategies were adopted to create political stability while adopting market-oriented growth strategy. The economy was clearly weak. Singapore has been boosting close relations with major players of capitalist block such as USA, and communist block such as China.

In Singapore Peoples Action Party (PAP) which has been occupying the office of government since 1960s to date has dominated politics, economy and society from before independence in 1959. In the case of Singapore, leftist groups were effectively eliminated and much of the local political talent was integrated into the party with its power base built on labour unions and worker constituencies (Sours 1997) enabling it to create a dominant multi-class and multi-ethnic party from the start. Moreover, during the initial consolidation period, Singapore inherited no established parties representing powerful interests, ideological schools as was the case in India or in Sri Lanka, and nor was there a propagation of new parties. In short, socio-economic structure in Singapore generated little serious or lasting competition over the use and distribution of power for effectively executing the open market-led growth strategy. While the civil society was clearly weak, or weakened from the start, where the new and independent organizations came into existence in the post independence years, they were quickly ab-

Experience seems to suggest that Sri Lankan type of democracy is harmful for the long-run growth of the economy. It provides a splendid example for the other developing countries for them not to pursue this kind of democracy in their rapid growth process if they are to prosper.

sorbed by the PAP or financed by the state. These circumstances enabled power to be concentrated at the political centre and enhanced the relative but 'embedded' autonomy of the state (Evans 1995) thereby facilitating the state to create and sustain a disciplined market-oriented growth strategy.

Creation, implementation, and execution of bureaucratic institutions effectively are other salient features of NIEFT-4. In Singapore, the state created and promoted key economic bureaucracies dominated by the people who perceived openness and freer markets. One such institution has been the powerful Economic Development Board (EDB) that is responsible for making and reviewing growth policies. Using effective institutions, PAP has been able to pursue consistent, coherent, and continuous growth policies without fearing seriously that the allegedly uncertain outcomes would disrupt their strategies and efforts. The type of governance structure that Singapore maintained over the last four decades by assuring political stability and institutional quality has created a paradise for foreign investment and economic growth.

Malaysia: Multi-Party Coalition Rule (1970-To Date) cum Market-Oriented Growth Strategy

Malaysian case is another kind of one party political power created in the form of a long lasting multi-party coalition which provides important lessons for Sri Lanka. Although Malaysia has certain features of the dominant party type it is better explained as an example of the kind of plural society which has successfully generated a 'coalitional capitalistic developmental state'. The ethnic composition of the country is characterized in such a way that some 58 percent of population is Malay, 32 percent is Chinese (urban), 9 percent originated in the Indian sub-continent. It is apparently the case that, albeit the offices of head of state and prime minister are entitle only to Malays and even if United Malays National Organization (UMNO) has been the dominant political party, its power and authority have been reconciled through a complex ruling coalition formed by 14 political parties, called National Front (Barisan National-BN).

The explosion of ethnic tensions between Malay and Chinese communities in 1969 led to a new consensus, embodied in the dominant coalition, BN, which persuaded a broadly agreed market-friendly growth strategy accompanied by appropriate institutional arrangements and domestic policies, named New Economic Policy. By consensus, Malaysia was able to create a 'capitalistic developmental state' through a constitution and political agreement which has concentrated considerable power and developmental direction at the centre. This in turn has empowered politico-bureaucratic elite with relative developmental autonomy to develop or amend strategy and role of the state (Ravenhill 1995). Given these institutional arrangements and domestic and international policies under the 14-party coalition which occupied the office of government since 1970 to date, Malaysia has attracted remarkable amount of FDI and has generated an extraordinary record of growth which has yielded an average annual rate of growth of GNP per capita of 5 to 6 percent since 1980.

South Korea: Military Dictatorial Regimes cum Market-Oriented Growth Strategy

South Korea provides yet another illustrious example of a somewhat distinct type of capitalistic developmental regime compared to other partners of NIEFT-4. South Korea has transformed itself from one of the world's poorest economies into a prototype of newly industrializing economies within a period of less than four decades. While some have presented Korea's growth performance as an ideal case of a successful export-led growth strategy (Balassa, 1981, Krueger 1983), others have cited it as a role model of economic growth with equity. Initial two and a half decades of Korea's growth efforts since 1963 has been the period of consolidating and taking off of a powerful growth process with almost no attention to democracy occurred. Despite the fact that Korea's remarkable growth performance over the last three decades is attributed to outward-oriented development strategy, market-friendly state interventions, human capital investment, macro-historical forces and their dynamics as prerequisites for capitalistic development, and its Confusian culture and authority structure as some have ascribed Korean miracle (Leftwich 1998), the most convincing view about Korea's development performance has been not merely that it is a product of aforesaid factors, but also an outcome of conscious efforts by the state in creating and sustaining appropriate institutional arrangements and domestic policies assuring political stability embedded in the outward-oriented growth strategy.

Through a military coup Park Chung Hee (1961-79) captured political power in 1961 and undertook a sequential pursuit of macroeconomic stabilization, liberalization, and the transition to export-led growth strategy. Park regime created an efficient, consistent and coherence policy choices adopted by the regime, as well as their effective implementation, all of which guaranteed policy credibility. The predominance of the bureaucratic unity and insulation of economic policy making from social and political pressure has served as the institutional basis for effective economic management. Leadership commitment to capitalistic development played an important role in South Korea (Bardhan 1993). Nevertheless, when Chung Doo-Hwan seized political power through a military coup, Park Chung Hee's adventurous economic and political journey ended in 1979. At the time of seizing the power, the Korean economy experienced a macroeconomic crisis, albeit the economy has already reached to higher levels of average income. Chung's response took the form of not only short term adjustment but also restructuring industry, liberalizing the financial sector, opening up of the economy further to free trade and investment, and redefining the role of the state to make it more compatible with outward-oriented growth strategy. Given the fact that many dictatorships are ineffective, the fact that the authoritarian regime in South Korea has been effective means that it has been able to foster an open market-led growth strategy accompanied by disciplined and effective institutions, high quality leadership, and competent bureaucracy and effective domestic policies with less place for political uncertainty.

China: One Party Communist Regime cum Market-Oriented Growth Strategy

China's thriving economic growth, which recorded 6 to 9 percent growth rate for the last one and a half decades, that has been outperforming the rest of developing countries (White 1996) can only be attributed to market-oriented growth strategy reinforced by political stability generated by communist type of one party governance structure. The post-Maoist developmental drive towards a freer economy could only have been undertaken by an authoritarian state providing a stable political context for the transition to a relatively open economy. China's relative success, however, may not be mainly due to the authoritarian communist regime that has been in operation, but due to the fact that China has introduced and implemented an open market development strategy accompanied by appropriate institutional arrangements and domestic policies that are compatible with the interests of profit-motivated inbound foreign investors. Since China's political system provided a little scope for destabilizing the growth process arising from political disturbances, it guided and facilitated faster economic growth generated by higher inflow of long term foreign capital. This argument proves true if one takes into consideration the fact that most of the other authoritarian communist-type regimes that had been successfully maintaining political stability have been unsuccessful in embarking on long lasting growth process because stable political systems have not been accompanied by market-oriented growth strategy.

Sri Lanka: Westminster Democracy cum Anti-Market-Oriented Growth Strategy (1956-1965, 1970-1977), Market-Oriented Growth Strategy (1948-1956, 1965-1970, 1977- To date)

In the little over fifty-year old post-independence growth experience of Sri Lanka, the salient features of processes of political evolution and economic growth are characterized by utter contradictions and puzzles. Prominent researchers and World Bank chief economist (in 1968) forecasted that Sri Lanka (Burma and the Philippines among others) has a very bright future noting that Sri Lankan economy would move towards the First-World in the 20th century (Easterly 1995). It is worthy of quoting some of the extracts from Lee Kwan Yew's book *From Third World to First: the Singapore Story* that illustrates well the political and economic trajectories of Sri Lanka since its independence that evolved from relative prosperity and stability to economic, social and political disaster. Lee Kwan Yew (2000) notes that "my first visit to Sri Lanka was in April 1956 . . . I . . . was impressed by the public buildings . . . undamaged by the war . . . more resources and better infrastructure than Singapore . . . Ceylon was Britain's model Commonwealth country. After the war . . . when Ceylon gained independence in 1948, it was the classic model of gradual evolution to independence . . . Alas, it did not work out. During my visits over the years, I watched a promising country go to waste. One-man-one-vote did not solve a basic problem . . It is sad that the country whose ancient name Serendip has given the English language the word 'serendipity' is now the epitome of conflicts . . . and hopelessness".

Despite that Sri Lanka was well-placed among developing economies with a promising future and with adequate resources to nurture long lasting growth process at the time of gaining independence, it gradually evolved into a society with contradictions and development puzzles in the world. It is particularly puzzling as to why Sri Lanka has been unsuccessful in embarking on a rapid growth even though it has experienced market-oriented growth strategy for the past two and a half decades. The answer to this seems to depend on whether Sri Lanka has liberalized the foreign investment regime, has been able to create and maintained effective institutional arrangements and domestic policies accompanied by open market economy, and to sustain political stability either through authoritarianism or through consensus. The major barrier, in fact, is in the political system. Two political parties armed with two conflicting development ideologies dominated the political arena. From 1948 to 1977, SLFP-led leftist coalitions and more liberalistic UNP have alternatively held the power in every five years term. While the SLFP-led coalitions, whenever they were elected into the office, have practiced inward-oriented or anti-market growth strategy before 1977, the UNP has practiced relatively market-oriented growth strategy. Consequently, the economic system with such characteristics as lack of credibility, discontinuity and inconsistency of the policies together with inappropriate institutional arrangements, political conflicts and political disagreement has resulted in retarding economic growth. In spite of the fact that UNP and SLFP-led coalitions have ruled the country alternatively, both the regimes practiced the outward-oriented growth strategy since 1977. Throughout its history, whenever it came to power, UNP has persuaded market-oriented growth strategy with a vision amidst serious political barriers. During 1977-1995, Sri Lanka managed to maintain considerable growth amidst these political disturbances.

It appears reasonable to argue that institutional arrangements, policies and the nature of the political system that have been in practice which have resulted current state of affairs and conflicts in violent and disruptive form. The major factors that contributed to the failures of the institutional structure itself were the flaws and the limitations of the institutions, policies and political system themselves in relation to the type of the institutional arrangements, policies and political stability that were required for achieving rapid growth. The major political parties failed to come to a broader agreement aimed at faster economic growth due to ideological differences. On the other hand, the welfare-oriented democratic state promoted attitudes which focused on present consumption and short term benefits by damaging long term growth process. It failed to promote the value system, responsibilities and disciplines that were needed for rapid economic growth. Both the government and the people failed to nurture a healthy institutional arrangements and domestic policies on consensus accompanied by open market economy that drove the societies that experienced a more rapid growth path such as the NIEFT-4 and NIEST-4. Political instability reinforced by the lack of consensus on all major issues has killed and will continue to kill growth prospects of this tiny island economy.

Some Lessons from East Asian Successful Economies for Sri Lanka

There are a few notable features which can be taken as lessons for formulating national development strategies in Sri Lanka, regarding development experiences of NIEFT-4 and NIEST-4. First, one of the striking features of successful growth stories of the 20th century is that a one dominant political party or a coalition of parties has held the power for a long time creating and implementing effective institutions, and policies within which economic activities have been coordinated under stable political systems. These experience show that democracy is not a prerequisite for maintaining rapid growth. Whether the regime is democratic or not political stability is a prerequisite for sustaining rapid growth. Second, governments of these economies have had representations from all ethnic groups, labour unions, and other pressure groups making it a collective effort to faster economic growth providing a little scope for allegedly uncertain outcomes to devastate growth prospects. It is in most cases consensual governance. Third, these countries have followed market-oriented growth strategy for a long time. A strong industrial and service base have been created by following export-oriented growth strategy while modernizing domestic industries. Fourth, economic openness has been facilitated by appropriate institutional arrangements, domestic economic policies, and political stability providing appropriate economic environment for faster economic growth. Efforts of gaining or retaining political power have not created damaging effects on growth process in these economies. Finally political stability has been maintained by forming the government either in the form of one party government or coalitional governments. These key features of East Asian industrialization can be taken as fundamentals for Sri Lanka to reform its political set up and institutional arrangements.

Prospects of Consensual Governance for Rapid Economic Growth

A close scrutiny of Sri Lankan growth process seems to suggest that while Sri Lanka has been able to create market-oriented growth strategy, at least for the last two and a half decades, it has badly failed in creating a favorable institutional structure and political stability either through authoritarianism or through consensus. Politico-economic structure in Sri Lanka has generated serious or lasting competition over the attainment, use and distribution of power for effectively executing market oriented growth strategy. The main focus, therefore, should be on reaching a broad consensus on national development and on reforming the institutional structure to suit rapid growth. Sri Lanka's political problems are not exogenous to growth process for the economists to treat them as being disturbances as has been the case for a long time. Any effort for faster growth should need to take into account the fact that these political problems are integral ingredients of the system, so that an appropriate political deal needs to be accomplished to maintain long term political stability.

In reality however, there is no opportunity in Sri Lanka for creating a developmental authoritarian regime given the current political set up, and the way it has evolved. The authoritarian structure expected by creating executive presidency for providing political stability and leadership for rapid growth has become a curse rather than a blessing for national development goals. Nevertheless, the contemporary political landscape in Sri Lanka warrants the greatest possibility for creating a 'capitalistic democratic developmental state'. The experience of newly industrializing economies in East Asia, especially Malaysian experience, proposes us a strong case for both preserving relative democracy with maintaining political stability while not sacrificing long-term growth. In Sri Lanka, the only effective way forward is to form a long lasting broad coalition aimed at rapid economic growth due to a number of reasons. First, such a broad coalitional rule enables us to preserve relative democracy at least in Schumpeterian minimalist sense thereby securing political stability while not sacrificing much needed rapid economic growth. Second, such a coalitional rule is necessary for bringing the alienated ethnic minorities into the mainstream development efforts. Third, a broader coalition will also disable the current mechanism of government formation that has made dissidents and ethnic-based minority parties become king-makers. Fourth, it will create an appropriate political structure to create, amend, and maintain effective institutions required for rapid growth. Finally, such a coalitional rule provides a strong basis for formulating, amending and implementing growth policies and strategies on a consensual basis for a longer period.

In this set up, the Sri Lankan political arena provides opportunity only for two broader coalitions. One such coalition may comprise the parties that pursue market oriented growth strategy and federalism. The parties which are against market-oriented development strategy and federalism fall within the second category. Majority of political parties in Sri Lanka fit into the parameters of the first category. The two major parties (UNP and SLFP), most of the Tamil parties, Muslim parties and some traditional elitist parties could join forming the first coalition. If two major political parties could form this coalition with the help of other like minded parties and work together, Sri Lanka could proudly regain its lost dignity and achieve prosperity by unified efforts. This kind of a coalition will retain the power for a long time while elections are held in every six years for maintaining relative democracy, assuring policy credibility, continuity, and consistency. However, the leadership of such a coalition needs to be assigned to a party which has pursued and continue to pursue market-oriented growth strategy with a vision, experience, expertise, skills, and global networks since it could effectively provide the leadership to such a broader coalition. This has been the case in Malaysia where United Malays National Organization has been leading the ruling coalition for nearly last thirty-five years even if there are other major political parties in the coalition. Nonetheless, a coalition formed, without a clear basis and strategy to national development, by a bunch of parties to make up the parliamentary majority will only bring economic and political destruction rather than prosperity. As noted before, achieving rapid growth through market oriented growth strategy should be the basis for the broader coalition. However, formation of such a broad pro-growth coalition is far from our sight as the way current politics of the country is evolving.

Chrys Gunaratne

A Tribute to an eminent journalist and sportsman

The unique contribution made by Chrys Gunaratne (1935-1989,) a towering figure in the field of contemporary Sri Lanka journalism will be remembered for many years to come. The continued publication of Economic Review journal by the Research Department of the People's Bank, which Dr. Susantha Goonathilaka, pioneered with Chrys Gunaratne remains a fitting tribute to his everlasting contribution made to economic journalism of the country. Apart from journalism Chrys had an abiding interest in Table Tennis in Sri Lanka.

This appreciation a fitting tribute to Chrys on his 70th birthday briefly records the professional achievements and sterling personal qualities of our departed colleague. Asoka de Silva in keeping with his interest in journalism and academic research had a brief stint at the Research Department of the People's Bank (1976-1978) before moving into other areas of banking. During this period he along with Chrys Gunaratne and Susantha Goonatilaka played a vital role in nurturing and popularising of Economic Review in its formative years.

Asoka de Silva
General Manager, People's Bank

Almost 14 years ago a sudden death snatched the life of Chrys Gunaratne the eminent economic journalist, business writer and sportsman. At the time of his untimely death he was 54 and at the pinnacle of his career at the People's Bank as Deputy Director Research/Publications. Had he been alive today he would have turned 70 on 27th January 2004.

The considerable time gap between his demise and this appreciation provides me an opportunity to set things in proper perspective and have an objective look at the life and times of our departed colleague and friend.

John Chrysostom Thomas Moore Gunaratne was born on 27th January 1935 to a middle class family. His father was an officer attached to the Ceylon Government Railway. He grew up in a large family which consisted of seven boys and one girl. He would always recall with a brimming face the nostalgic memories of his early childhood and his adventures in the environs of Dehiwela, which was a village with extensive gardens and mangroves in the 1940s and early 1950s.

He completed his primary and secondary education at St. Peter's College, Bambalapitiya excelling both in studies and extra curricular activities. On the completion of his school education he entered University of Ceylon at its golden era. Chrys Gunaratne's undergraduate life at the Peradeniya University (1957-1961) during Sir Nicholus Atigala era provided him ample opportunities to exhibit his academic excellence and sporting talents. During the decade of 1950's he along with D K K Schoorman dominated the Sri Lankan Table Tennis field. His contemporaries at the University, most of them rose to top positions in their chosen fields and continued their friendship till the abrupt end of his life in 1989 still recall with nostalgic memories the sterling qualities of their departed colleague. Apart from sports he had a lifelong interest in the English language and followed a special degree course in English. He was fortunate enough to have studied under Prof. Doric de Soyza and A J Gunawardena, the legendary figures in Sri Lankan English literature. In his later life Chrys continued to cherish his memories of campus life and often amuse us with anecdotes of that bygone era.

Soon after his graduation, with keeping with his abiding interest in letters, he chose a career in journalism and joined Lake House as a News Reporter at Daily News. By dint of hard work and commitment to his profession he quickly rose in the ladder as Assistant News Editor, Pictures Editor, Features Editor and Deputy News Editor.

From Lake House he moved away to the Market Research Company Ltd., established by the late Mr. Esmond Wickramasinghe, the doyen of Sri Lankan journalism. His work here laid the foundation for his abiding interest in research and analytical writing. In later life he became the most sought after research writer of the country, often commissioned by reputed institutions including the World Bank. During the late 1960s when Mr. Esmond Wickremasinghe pioneered the publication of the Sri Lanka's first economic publication *The Economic Journal* he entrusted the task of editing of that path-breaking publication to Chrys Gunaratne. He used his professional skills to enrich the contents of this journal and through this exposure obtained during this period he was able to become a veteran in economic writing in Sri Lanka.

During the early 1970s he joined the Industrial Development Board as its Publication Officer and edited the journal *Karmantha*. During his brief stint at IDB he also edited the first comprehensive Exports Directory of Sri Lanka.

A remarkable turning point occurred in his professional life in 1976 when he was recruited to the Research Department of the People's Bank in recognition of his proven track record in economic journalism and his wide exposure to the contemporary socio-economic issues of Sri Lanka and third world by Dr Susantha Goonathilaka, as the co-editor of the *Economic Review* journal, the widely acclaimed socio-economic publication launched by the bank in April 1975. I myself met Chrys in [illegible] of TDP and build a strong image of a [illegible] of the "Economic Review".

The Sri Lanka *Economic Review* (along with its Sinhala and Tamil editions) marked an important turning point in the economic journalism of this country. Chrys Gunasekera, having produced the first ever economic publication *The Economic Journal* in the late 1960s was destined to take part in the launching of the second venture of this nature, the *Economic Review* along with an eminent researcher and ex-director of [illegible] Dr. Susantha Goonatilake, an internationally famed sociologist. At the initial stages of *Economic Review*, this duo received the encouragement and support of two prominent personalities who were holding authority at the People's Bank at that time. One of them was Mr. Hector Abeywardena, a leading left theoretician of the country in the seventies. He functioned as the Chairman of People's Bank during 1970-1975 period. In keeping with his intellectual pursuits he saw an opportunity for the discerning Sri Lankan readers, who were hungry for serious reading material, to access to serious discussions taking place in the regional and international gatherings. The circumstances in global scenario at that time, where most of the third world countries have begun to assert their rightful place at various international forums, necessitated a publication to be able to document the new voices being raised in Sri Lanka and other third world countries. Mr. Hector Abeywardena seized this opportunity and decided to launch *Economic Review* as a publication of the People's Bank. [illegible] then holding a senior executive position at the People's Bank also took a keen interest in this publication and contributed valuably to its success.

At *Economic Review*, Chrys found an ideal platform to pursue his lifelong interest in economic journalism in a much broader context. This path breaking journal [illegible] in its first five years to publish cover stories on [illegible] such as Black Gold [illegible] [illegible] and Artificial Intelligence [illegible] Dr. Susantha Goonatilake [illegible] Development Studies [illegible] as the chief editor of this journal [illegible] to Chrys to [illegible] much more independently. [illegible] economists, sociologists, development [illegible] well known [illegible] in their chosen fields [illegible] use of the [illegible] of *Economic Review* to [illegible] views to the discerning readers [illegible] thought provoking [illegible].

By dint of hard work, creative thinking and objective reporting they succeeded in making *Economic Review* the most sought after publication in the [illegible] in that era. Its thought provoking [illegible] were often quoted in the Parliament and the media. The unique contribution made by Chrys Gunasekera towards the growth of economic journalism of Sri Lanka during the period 1975-1996 by [illegible] trends in the Sri Lankan economy [illegible] compiled [illegible] *Economic Review*. The [illegible] graduates, students and researchers [illegible]. The real tribute to Chrys Gunasekera [illegible]

[illegible] economic writing comes from the local and foreign research [illegible] the Research Department of People's Bank [illegible] today. Even the back issues of this journal [illegible] sources.

Chrys's dedication [illegible] recognition of his analytical and presentation skills was soon drawn from People's Bank Service for the position of [illegible] Director [illegible] Programme in early 1989. He also played an active role in the formation of Sri Lanka Market Research Bureau and undertook [illegible] assignments for several reputed firms.

He always went out of his way to help his young colleagues to hone their professional skills and encouraged them to [illegible] their pursuits confidently. He generously provided his professional advice and guidance to a large number of researchers/writers attached to various research organisations and universities.

Amidst the heavy demands of his professional life he always found time to improve the game of Table Tennis in Sri Lanka as an active office bearer of the Sri Lanka Table Tennis Association. He was also involved in the [illegible] Asian Table Tennis Federation.

Apart from his remarkable achievements in his chosen fields of journalism and sports Chrys Gunasekera will be remembered by his wide circle of friends, associates and colleagues as a man of sterling qualities who was always prepared to give a patient hearing to anybody who would approach him with his problems. He generously spent his time and energy in helping his friends. During his tenure at *Economic Review*, wherever he spotted new promising talent in a new writer, he always encouraged him/her to realise his/her true potential. By his valuable professional insights and advanced knowledge he made it a point to add value to the work of other writers.

During my brief stint at the Research Department of the People's Bank (1976-1978) [illegible] moved into the other areas of banking and took up higher management positions, I had the privilege of closely associating with Mr. Chrys Gunasekera [illegible] thinking [illegible] enhanced the reputation of the People's Bank both nationally and internationally. Thanks to his concerted efforts made towards enriching the contents of *Economic Review* with [illegible] analysis of the emerging trends in the economy and society of the post independent Sri Lanka, the People's Bank came to be known in the other countries as the Publisher of *Economic Review*. The [illegible] subscription list of this journal includes New York Public Library, [illegible] University, World Bank, [illegible] and other reputed International Universities and Research Institutions. This was made possible due to his deep commitment towards [illegible] analytical thinking.

Therefore, we at People's Bank [illegible] the needs of the discerning readers [illegible] the valuable services rendered by Chrys Gunasekera in projecting a strong image of our Bank [illegible] tribute to his everlasting memory.

Smallholder Agriculture Sector in Sri Lanka Under Open Economic Policy

of the land operators cultivated less than 0.8 hectares of land. Though a great majority of them is operating land as owner farmers, there is a significant incidence of tenant farming and various forms of share cropping arrangements. This Paper attempts to state the impact of open economic policies and their contribution to the smallholder agriculture sector in Sri Lanka.

M.S. Senanayake*

Agriculture continues to be the backbone of Sri Lanka's economy. It constitutes 21% of GDP, 35% of total export earnings and 36% of national employment (year 2001). In addition, the agro-processing industry also makes a significant impact on the national economy and its development via its contribution to GDP, government revenue, net foreign exchange earnings, employment generation as well as its forward and backward linkages. Sri Lanka's agriculture sector grew at a sluggish 2.5% per annum in the 1990s. The government is planning to at least double, the rate of agricultural growth for this decade. Since very little scope for growth in the paddy sector is evident, almost the entire growth should derive from the higher value commercial agricultural commodities. Agro industries need to expand capacities to create a demand- pull and thereby stimulate agricultural commercialization.

The international environment for the agricultural sector is changing. It will both open up new opportunities and pose new threats to Sri Lanka's agricultural sector. Sri Lanka appears poised to enjoy wider market access in markets hitherto subject to significant trade protection. At the same time, greater reliance on global markets will expose Sri Lanka's agricultural sector to increased competition. The agro-industrial sector has significant scope for capacity expansion and domestic employment creation. However, the private investment required to finance such growth is also very high indeed. The government should therefore create an enabling environment for private sector to earn a reasonable return on its investment in the agricultural sector. Investment promotion is an important strategy in achieving the objectives of increasing agricultural production of both primary and value added products while creating maximum employment opportunities.

Foreign Direct Investment (FDI) expected to supplement the domestic private investment in enhancing production capacities, which would also result in transfer of technology, improvements in managerial skills and gaining access to international markets. There are also opportunities for investments in technology, infrastructure such as packaging, storage, transportation and certification

However, the existing experience suggests that the profitability in the smallholder- farming sector is low and poverty, unemployment and underemployment have become the critical problems in the rural cum agrarian sector. This poses problems for sustainability of this farming system, especially under free trade policies that encourage the importation of cheap food products. On the other hand, smallholder –farming sector has not been able to reap the opportunities provided in the globalization process. It appears that existing agrarian structure and land tenure regimes explains to a significant extent the existing impasses in the smallholding sector to a reasonable extent. Yet, the agricultural policies in the country seem to focus mainly on import protection and provision of subsidies to the sector.

Pervasive impact of on-going commercialization process on smallholder agriculture production and marketing necessitate having a closer look of the existing agrarian structure and look for opportunities for improvements. For instance, the 1982 Census of Agriculture being the most recent census of agriculture, it has estimated that over 64%

"Agricultural policy has been aided by a healthy environmental policy being adopted by the Ministry of Environment and Natural Resources. Among other activities, the ministry pursues a sound policy on managing the country's biodiversity and natural resources. The Ministry of Irrigation and Water Management has been managing and developing major irrigation systems, and implementing the government policy of participatory irrigation management of major and medium scheme under its "Wap Haula" program. This program aims at facilitating and efficient, effective and sustainable joint management of water resources for improved water and land productivity with beneficiary participation. Marketing infrastructure was improved with the action taken to establish Dedicated Economic Centers(DECs) in the main fruits and vegetable growing areas. These centers provide a convenient trading floor for farmers to sell there product to the retail and wholesale dealers directly and obtain a better price for their produce." (Central Bank report 2002)

Open Economic Policies and Smallholder Agricultural Sector

Since 1970, there have been two distinct regimes of economic policy in Sri Lanka. The first policy regime, during 1970-1977, was characterized by a heavy emphasis on import-substitution industrialization (ISI) under a protectionist framework and profound government

* Senior Scholar, School of Economics, Huazhong University of Science and Technology, Wuhan, P R China and Research Associate in Hector Kobbekaduwa Agrarian Research and Training Institute, Sri Lanka

intervention in both domestic and external economic affairs. The second policy regime from 1978 to date has seen the implementation of a far-reaching program of economic reforms under an open economy framework. The reform 'package' included the reduction of protection provided to import competing sectors, exchange rate adjustments, fiscal and monetary reforms, liberalization of domestic factor and product markets, and privatization of some government business enterprises. There has been a growing body of literature, that focuses on the impact of different economic policy regimes in Sri Lanka since 1970.

During the **protectionist regime** (1970-77) experienced, the Sri Lankan economy faced with external shocks of world oil crisis, and world food and fertilizer shortages during the period 1970-77. These shocks and foreign exchange limitations forced the coalition government to impose restrictions on imports of food and agricultural inputs such as fertilizer, tractors and agrochemicals. The government adopts a policy of food self-sufficiency under increased government intervention in domestic factor and product markets. Many private business enterprises were taken into government control and management, while private lands under plantations and paddy were nationalized under an ambitious land reform program. Several new state owned industrial co-operations (ex. Steel, Textile,) and marketing boards (ex Paddy Marketing Board (PMB), Salusala (Government owned Textile outlet) etc.) were established under the government increased its share in export-import trade. Further a dual exchange rate regime, which was introduced in 1968, was also continued.

During the **first wave of economic policy reforms** (1978-88), the UNP government implemented a wide range of economic policy reforms in order to achieve a number of declared objectives. The objectives were to accelerate economic growth; create employment opportunities; increase capacity utilization; stimulate savings and investment; improve the balance of payments; and achieve international competitiveness (Athukorala and Jayasooriya, 1994). To accomplish these objectives trade liberalization measures were introduced. Tariffication was one of the measures implemented in place of a number of quantitative restrictions (QRs) and regulatory mechanisms (i.e. licensing and quota). Most QRs on imports were replaced with a six-band duty system ranging from zero (0) percent for 'essential' consumer good imports to 500 percent imports of 'luxury' items. The exchange rate was also unified and a flexible exchange rate regime was introduced. Exchange controls were removed. The rupee was devalued substantially. Massive public sector investment programs (i.e. Mahaweli development Program, Export Processing Zone, Housing Development and Integrated Rural Development Programs) were initiated.

The introduction of the 'Open Economic Policy' in 1977 has also led to the elimination of most of the controls, which operated in domestic factor and product markets under the previous government. Major fiscal policy reforms included the replacement of generic (non-targeted) food subsidies with a targeted Food Stamp Scheme in 1978, and the reduction of fertilizer subsidies.

Reforms including financial regulation, which allowed the operation of the private sector in banking and finance and deregulation of agricultural markets, resulted in increased private sector participation. The role of the PMB has been resulted to 'the buyer of last resort', supporting the floor prices when market prices fall below the floor prices, particularly during harvests (Gunawardhana and Quilkey, 1993).

The second wave of policy reforms (1989-94) was commenced under a changed leadership of the UNP government in 1989. This is needed for several reasons. Macroeconomic instability, compounded by government mismanagement of the domestic economy, mounting ethnic violence and insurgency, put a halt to the initial wave of liberisation (Dunham and Kelegama, 1994). The massive donor-funded public investment projects during the early 1980s and escalating civil wars produced mounting budget deficits, inflationary pressures, and erosion of export incentives, current account deficits and external debts. The first wave of reforms and liberalization measures caused hardship to certain sections of the community.

The second wave of liberalization in 1989, involved two types of policy reforms and initiatives. The first were 'technically important, but un-dramatic, low profile adjustments' (Dunham and Kelegama, 1994). These included the maximum nominal tariff on imports being reduced to 45 percent by 1993. The tariff system was altered from a six-band structure in 1988 to a three-band structure in 1992 to further relax the rigidity and distortions in the non-plantation agriculture and manufacturing sectors (Presidential Tariff Commission on Tariff and Trade, 1994). The rupee was devalued in order to exports. The second type of initiatives consisted of three high profile projects (Dunham and Kelegama, 1994): (i) privatization of a further number of public enterprises; (ii) a new emphasis placed on export oriented industrialization under a more liberalized trade regime and further incentives to foreign investors in Export Processing Zones; and (iii) a major program for the alleviation of poverty (i.e. Janasaviya programme.)

The current policy regime (2001 to date) was initiated by the UNP government in 2001 and continued with the liberalized economic policies implemented by the previous regimes during 1978-1993 and 1994-2000. However, the government has emphasized a balanced approach to economic growth and poverty alleviation, through the drive of **liberalization with a human face**". The major changes in agricultural policy reforms include: tariff reduction on the imports rice, subsidiary food and agricultural inputs; and reducing turnover tax on agricultural inputs. Further consumer subsidies on wheat flour and bread have also been partially removed to avoid the heavy burden on government expenditure.

Economic policy liberalization under structural adjustment policies, along with GATT/Uruguay Round Agreement on Agriculture (GURAA), have opened new horizons and policy directions even for Sri Lanka. Agricultural input and output markets and policies are to be liberalized further, allowing the private sector to play a greater role as an 'engine' of an economic growth. In compliance with GURAA, Sri Lanka has bound all tariffs on imports of agricultural products at a uniform rate of 50 percent (World Trade Organization, 1995). In fact, Sri Lanka's gazette tariff rates on all agricultural products are below the bound rate (Presidential Commission on Tariffs and Trade, 1994). Under the South Asian Preferential Trading Agreement (SAPTA), there is a possibility for Sri Lanka to take advantage of non-plantation crops imports from these two countries (Samaratunga, 1998-1999).

Since 1977, trade policy measures particularly import tariff protection provided to Sri Lankan agricultural sector has been gradually reduced in line with the liberalized trade and other agricultural reform policies. The main objective of tariff reforms was improving the international competitiveness for the Sri Lankan agricultural products to maintain efficiency in the process. Once the trade barriers relating to agriculture became an internationally prominent issue, Sri Lanka's tariff and related protectional policies were the subject of critical analysis. In this context, Quantitative Restrictions (QRs), import tariffs, export tax, export subsidies and exchange controls were reduced or dismantled and other institutional reforms were undertaken which were conducive to economic growth in Sri Lanka. In 1977, most QRs in international trade of manufacturing and agricultural product sectors were replaced by a six-banded tariff regime, ranging from 0-500 percent. These rates were imposed even on non-plantation agriculture, considering various commodity specific tariff rates. The Sri Lankan tariff structure has been periodically reviewed since 1990, and successive changes toward a lowered tariff structure have been implement (Ratnayake, 1993; Report of Presidential Commission on Tariff and Trade, 1994) . It is expected to liberalized tariff regime further and imposes a two-band tariff regime for all products including products in the smallholder agriculture in Sri Lanka by the year 2005 in line with the agreement of World Trade Organization (WTO).

During the period 1994-2001, the tariff rates imposed on food crops (i.e. paddy/rice, chillies, onions, potatoes, green gram, black gram) and other varieties of food imports, which are not grown in Sri Lanka, were ranged from10 to 35 percent. The 35 percent import tariff rate on the CIF price was imposed on rice, sugar, potatoes, red onions, B'onions, green gram, black gram, maize and split lentils. The 20 percent tariff rate was applied for wheat and the 10 percent tariff rate was claimed for condiments like coriander, cumin seed, and fennel seed. However, the United National Front (UNF) government came to power in end of 2001, have proposed to increase existing tariff rates in non-plantation agriculture on imports of rice, B'onions, chillies and potatoes. In 2002, tariff on agricultural products remained low except for a few commodities such as potatoes, chillies onions, green gram and rice. During the year, however several changes were made to tariffs on agricultural imports. The surcharge of 40% imposed on the import duty on rice, paddy, milk powder, potatoes, red onions, big onions and chillies was removed to bring down the cost of living. Tariff structures on some of the food items were also changed to protect the local farming community. The import duty of 35% on paddy and rice was change to a specific duty of Rs. 7 pre kg. with effect from 21 Jan. 2002 and further reduce to Rs.5per kg. with effects from 06 Nov. 2002. A specific import duty of Rs. 30 per kg. on chillies, Rs,6 per kg. on big onions and Rs. 5 per kg. on red onions was imposed with effects from 23 March 2002. This conversion from ad valorem duty to specific duty is to provide adequate protection to domestic small farmers, minimizing price risk due to seasonal fluctuation of commodity prices.(Central Bank 2002). This sort of tariff protection may safeguard the farmers' interest in the short run but other macroeconomic distortions and issues in inflation and externalities may hamper the agricultural development process and lead to macroeconomic instability in the economy.

Impact of Open Economic Policies

The combined impact of policy changes during the 'first and second waves of liberalization' and the boost in aid-financed construction activities generated an acceleration of the economic growth during the period 1978-1998. In 1994, the government continued the liberalization process in trade and exchange rate regimes further and introduced more conducive and competitive incentive packages for foreign direct investment. In line with these incentive packages, even agricultural sectors were also encouraged for diffusion of improved technology and horizontal and vertical diversification. These measures helped to encourage more FDI in the export- oriented product sectors. The private sector investment in manufacturing, services and agriculture sectors has been increased. As illustrated in **Table 3.1** below, after economic liberalization, most macroeconomic indicators in Sri Lanka were healthy and positive and shown the right economic fundamentals. It has further shown that a high rate of economic growth was achieved.

Political Economy of Agricultural Policy

Sri Lanka, from the independence in 1948, and even before, successive governments are operated in the various agricultural policies, strategies and programs for the self sufficiency of food. All the governments were given high priority for the production of food in their economic and political objectives. Creating of large-scale land settlement schemes in 1940s and 1950s, and even in colonials administration, were the prime objective and operational programs for the production of food. In addition to that, in 1956, tenancy reform act, 1972 land reforms act, is one of the major institutional development packages for the encouragement of food production. Green Revolution is the other major technology innovations for the increase of food production in 1960s. Most of these programs from 1948-1977 periods made immense result to the increase of food production. At the same time, the government followed the inward-looking, closed and controlled economic policies as in micro and macro level. Within these frameworks, self-sufficiency of food was the major policy goal of the government as a nation. It is obvious to note that, the inward looking, closed and control economic set of policies were providing the better environment for the goal of self-sufficiency of food in country. In other words, the agricultural policies followed by the government at the time, are mutually reinforced to the production of food.

The government of Sri Lanka introduces a new set of open economic policies to the economy in 1977. Based on economic liberalization, a number of policy changes and reforms have been commencing. The most significant changes was a shift from inward looking, closed and control economy, to an outward looking economy with heavy market orientation. Removal of price controls removal of import restrictions, exchange rate reform and are few characteristic open economic policies. However, these policies originally came from the "economic liberalization" and "structural adjustment policies" which were introduced by the International Monitory Fund (IMF) and World Bank, as external economic forces in Sri Lanka. Under this policy regime, "self sufficiency of food" is no more prime objective or policy goals in development agenda. New regime, encourage the foreign investment, export trade and policies given high priority for the strategies and programs of industrial development, rather than agricultural development in the context of food production.

Table 3.1 : Macro-Economic Indicators in Sri Lanka (1978-1998)

Main component	1978	1983	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Rate of GDP growth (%) #	8.2a	5.0	2.7	2.3	6.2	4.6	4.3	6.9	5.6	5.5	3.8	6.3	4.7
Budget deficit *	16.8	17.8	15.6	11.2	9.9	11.2	7.3	8.4	10.0	9.6	9.4	7.9	9.2
Inflation (%)	12.1	21.4	17.0	11.6	21.5	12.2	11.4	11.7	8.4	7.7	15.9	9.6	9.4
Current account deficit *	2.4	9.1	5.6	4.4	3.2	5.4	4.5	3.8	6.5	4.9	4.9	2.6	1.8
Investment *	20.0	29.6	22.5	21.5	21.9	22.9	24.3	25.6	27.0	25.7	24.2	24.4	25.4
Domestic savings *	14.7	14.5	12.0	12.2	14.3	12.8	15.0	16.0	15.2	15.3	15.3	17.3	18.9
Exports *	34.8	22.4	21.1	22.3	24.7	22.6	25.4	27.6	27.4	29.5	29.5	30.1	33.6
Per capita GNP(US$)	183	300	375	369	417	518	556	588	652	710	748	804	823
Per capita GNP (PPP) ## (US$)	n.a.	n.a.	2050p	n.a.	n.a.	n.a.	n.a.	n.a.	3160	3545	n.a.	n.a.	n.a.
Unemployment Rate (%)	14.8	11.7	20.0	n.a.	16.3	13.8	13.3	13.8	12.1	12.7	11.1	10.3	9.1

* As a percentage share of GDP   # Constant prices-1982   a Constant prices
PPP=Purchasing power parity   p 1987 per capita   n.a. Not available

Source : Annual Report, Central Bank of Sri Lanka (various issues)

Production of New policy regime makes massive crises in local agricultural sector, rather than progress of food. The self-sufficiency of food as a goal of the policies no more valid, and imports of food becoming big and vast policy crises in Sri Lanka. Imports of food badly affect to the local farmers. Peasant agriculture faced severe problem of food production and marketing. One hand the government encourages the local food production in peasant agricultural sector providing subsidies, infrastructure facilities, land, water, marketing and others. At the same time government imposed free economic policies, and encourages the import and export trade. In March 1994, Sri Lanka accepted Article viii status of the IMF accordingly; Sri Lanka agreed not to impose any restrictions on import and export of goods and services. Therefore, self-sufficiency of food production in Sri Lanka is prime goal of the policy. There is ample scope of the low price of food imports in Sri Lanka, from other countries. However, the major problem is no enough foreign exchange to import of sufficient food. On the other hand, imports of food create many problems on the production and marketing of local foods. Owing to the imports of foods, reduce the price of local production and it is leading to the "decrease of farmer's income" as a central problem of domestic agriculture in Sri Lanka. While it reduces the quantity of production of many crops, land extent and specially, food security of the household level as well as national level. Further this dilemma of food inconsistency leads to the increasing of malnutrition and there were growing incidence of poverty in small farming sector in Sri Lanka, and the process of agricultural food production in peasant farming sector is not in right direction. Meanwhile, the government of Sri Lanka attempts to fulfill two objectives simultaneously. *At the one time government struggles to encourage the increase of local food production, through the increase of farmers' income, and at the same time government seek to reduce the price of food commodities through the completion of the liberalization of food imports by means of reducing political pressure with economic and social unrest of the country.* Thus, the proper political commitment of the government to reach food surplus economy rather than food deficit economy in Sri Lanka, with free from hunger and malnutrition is questionable. Under these circumstances, the major question is "Sri Lanka as a small country, can survive without a self-sufficiency in food as a policy goal of agriculture, within the framework of economic liberalization, and how small countries like Sri Lanka, solve the problem of food, in protecting and improving rural farmers, at the time of globalization. In this sense, there are prominent features of "food crisis" in Sri Lanka.

Globalization, Trade and Growth

Globalization means many things to many people. Globalization is a multi-faceted concept as far as it describes both economic phenomena and their social, political and distributional consequences. The term globalization defines as "boundryless trade and information" or "integration of the world economy through trade, investment and the global movement of capital" (WTO, 1996). The term globalization refers to an ongoing process of increasing integration into the world economy. Globalization further defines as economic hegemony of Multinational Companies" (Govinnage, 2001). The economic aspect of globalization can be measured through the flow of goods, services and capital and migration around the world. Statistics show that expanding trade http://www.yahoo.com/and long-term capital flows have also grown. The average daily turnover in foreign exchange markets has increased from about US$ 200 billion in the mid 1980s to well over US$ 1.2 trillion in end of 1990s (WTO,1996).

The improved international transport systems (ships, container carriers, oil tankers, cargo planes, refrigerated trucks etc.) with information technology directly influence the growth trends in most countries. The countries heavily rely on trade today than at any time in history. The openness measured by the ratio of trade to GDP has been increased in many developing countries. Faster growth in developing countries indicates their share in world trade, which has increased from less than one quarter to almost 30 percent between 1985-1998 periods (de Melo and Grether, 1996). The global figures make some regional differences in trade shares of the world trade. Asia's shares of world trade increased from 15 percent in 1948 to 27 percent in 1997. Further, the composition of world trade shifted from agriculture to manufacturing and trade in services. In Asia, most developing countries managed to achieve the average growth rates between 5 percent to 7 percent per year since the beginning of 1960s. As a result, poverty in Asia has been reduced dramatically (WTO, 1998). The recent financial crisis in part of the region may reverse the gains to a certain extent. The countries with low trade orientation show relatively poor growth rates.

The Driving Forces of Commercialization Technological Change

Technological innovations have led to increase productivity in all spheres of production processes and slashed transportation costs greatly. The technological inventions such as electricity, telephone, automobile, container ships and planes resulted in increasing production, communication and transportation. Further the recent developments in information and communication technology, and computers have led the way for reducing time for communication and expanding geographical coverage for communication to interact and transact individuals and enterprises around the world. New waves of technological innovations in biotechnology will continue to increase incomes and improve social welfare of people. Technological improvements have cut transportation and communication costs dramatically. (Bachelle et al, 1996).

Commercialization of Trade & Investment

The commercialization of trade and investment has expanded the boundaries of factor and product mobility. Commercialization has allowed any country in the globe to get whatever the amount of capital and improved technologies. Many countries have moved greatly to gain benefits through international trade between nations. Further, liberalization has mainly focused on trade and investment regimes and a range of regulatory issues. In this process, GATT/WTO system has played a vital role in the reduction or elimination of border barriers to trade through eight rounds of multilateral trade negotiations. In industrialized countries, tariff rates have been reduced from high double digits level to less than 10 percent in the late 1980s less than 4 percent once the Uruguay Round is fully implemented. In addition, most non-tariff measures (NTMs) on trade except those imposed for health, safety or other public policy reasons have been removed. Following the GATT/Uruguay round negotiations, textiles, clothing, and agriculture are being brought within the multilateral framework and subject to progressive liberalization. Further, GATT/Uruguay round introduced new disciplines on Trade Related Investment Measures (TRIMs).

Internationalization of business activity

With the Commercialization scenario, it is encouraged to remove trade barriers in economies. The lower trade barriers and liberalization generally invite more and more companies and investors to globalize production structures through foreign direct investment (FDI) abroad. It would stimulate and expand international trade between nations. The increased information flows and the greater tradability of goods and trade in services have influenced the decision on location of the business. Modern businesses are increasingly able to locate different components of their production process in various regions and countries and still maintain a single corporate identity. In general, firms sub-contract part of their production processes to their sub-contractors or other enterprises abroad. In this context, jobs, technologies, capital and skills necessary for the entire processes of production, marketing and distribution are transferred around the globe.

Emerging Issues in Global Agricultural Development

Agricultural development in the 21st century is vital to assure the food security for the global population in the coming decades. However, recent years have witnessed important changes in the financing, management, and institutional structures in the process of agricultural development in many parts of the world. After the green revolution, growth in agriculture has slowed down in most countries and in some countries, annual spending on mechanisms of agricultural development has declined. Particularly, expenditure on research and development (R&D) is reduced in developing countries. The private sector is now contributing more on agricultural R&D while governments are reducing their expenditure on agricultural R&D (Alston et al., 2001).

Food Security and Food Safety

The world's population is expected to exceed 8 billion people by 2025 and India will have the world largest population. Urbanization in the world aggravates the problems of food shortages. The income growth and food needs in developing countries are expected to more than double and global food demand could nearly double (Serageldin, 2001). The challenge to world agriculture to feed the world population is enormous. In future, land and water resources (irrigation) are becoming increasingly scarce. Future food needs will be fulfilled by production of biological food or genetically modified (GM) food rather than naturally produced food by area expansion, and more irrigated facilities. The lands used for cultivation of food are fragile in most countries. Urbanization and land degradation caused problems in area expansion for cultivation of food crops. Further expansion of water for irrigation purposes cannot be expanded effectively. The future demand for food can be met by biological food or GM food. In this context, in future food safety will be a major issue rather than the food security.

Poverty Alleviation and Hunger

The Green Revolution-induced technological change has proved the Malthusian arguments on food supply and population growth are wrong. Concurrent increases in agricultural productivity also resulted in a sustained decline in the real prices of food. Despite these achievements, rising population and unequal participation in growth have left 1.3 billion people in the world struggling to survive on less than a dollar per day. About 800 million of them are hungry, undernourished or malnourished. More than 500 million children under the age of five are not receiving the nutrition they need to develop mentally and physically (Sergeldin, 2001). However, recent report, completed by Stern et. *al (2001)*, based on experiences in 24 developing countries, has shown that early globalizes managed to reduce poverty levels by increasing the GDP per capita growth rates and real wage rates. Addressing above problems of world hunger and its related issues requires integrated policies, mechanisms and efforts in agricultural and rural development and poverty alleviation throughout the world, paying special consideration for food deficit and slow growing countries.

Challenges and Opportunities

The major structural change in the economy in recent decades has been a reduction in the share of agriculture and an expansion of the share of manufacturing and trade in services. However, agriculture, together with agro-processing activities and allied services, remains a major sector of the economy. From a dominant position at the time of Independence, the direct contribution of agriculture to GDP had fallen to 19.7 percent of GDP by 2000. While the share of agriculture is now only about a fifth of GDP, its contribution to employment is much larger, accounting for over 36.3 percent of total employment in 1999.

Challenges

Commercialization opens the door free movements of factor and products between the nations through the liberalized economic development process. While moving along with the globalize growth path, Sri Lanka has to face some emerging challenges in the world economy. The WTO has designed the rules of the game for liberalization of world trade. Considering the future likely challenges in the globalization process, the following some emerging challenges in relation to the Sri Lankan agriculture are identified.

• Integration to the World Economy

Integration into the world economy will be a major challenge for the agricultural sector in Sri Lanka with the existing structural and institutional mechanisms, product coverage, R&D investment, role of the sate and integration mechanisms followed within agriculture in Sri Lanka. The main thrust area of agricultural development process has been identified as to maintain food security. However, the commercialization encouraged to produce mainly tradable to earn more foreign exchange within the agriculture and agro-based products environment. Particularly formulating and implementing strategies to integrate into niche, larger and global markets. Commercialization may create domestic demand for niche products, which can be channeled through the existing supermarket chains, hotel industry and airline catering services in the country. In addition, commercialization encourages regional trading blocks to integrate within the specified region through harmonizing trade with the trade creation strategy. In future, Sri Lanka should make initiatives to join with Asia Pacific Economic Cooperation (APEC) and ASEAN, rather than confining to SARRC and South Asian countries only. However, it will be a challenge with existing barriers in structures and the facilitating process of export promotion in agriculture. Integration to the world economy should be based on competitive advantage. The competitive advantage of the product is based on low cost combination of product in agriculture and value-added products based on world consumerism, catering to the changing consumer preferences in the world economy.

• Improving the Climate for Agro Enterprises through Market Integration

Commercialization creates opportunities to integrate distance markets to open up investment opportunities for domestic investors. The conventional supply driven R&D and extension should be reformed and identified the role of the state as a facilitator to assist to create demand driven R&D mechanisms in agriculture. Demand driven R&D should based on the needs of the target group. Initiating demand driven product development, getting and development of new technologies, and improving post-harvest technologies are the major areas to be concerned. Commercialization opens the door for new technologies to develop agro-based products. Existing R&D system is biased towards farmers and no serious initiatives have been taken to popularized agro based products. The state should take the lead as a facilitator to invest in human resource development on agro based product development, marketing, business management etc. identifying products, which can gain competitive advantage. Further, it is necessary to disseminate information on product development and demand to world economy to create world demand, transferring agricultural technology to the client, get the services to private sector through state- private partnership to integrate domestic agro based products to the world economy. This would be a major challenge for the Sri Lankan agriculture to integrate into the world economy. For this purpose, we may need to reform the institutional mechanism to encourage to build partnership with world food giants through joint ventures, partnerships and management partnerships. It will be a paradigm shift in a right direction to attract foreign capital and technology to gain globalization benefits for Sri Lanka.

• Investment in People and Technology

Consumerism will be the major thrust area in demand driven R&D to cater to the target needs. However existing investment scenario in people and technology is diminishing over the years. (Samaratne, 2002). This should be carefully reviewed by the state sector to formulate policies for future human resource development in agriculture. It is necessary to focus identifying the clear target. Otherwise, generic type of human resource development (HRD) will be a challenge for economic development. Unemployment is severe in the country and hence HRD can play a role directing to train people to cater not only to local needs but also to the international needs. The technology generated and used in agriculture is supply driven, which is a clear challenge for the Sri Lankan economy to shift to demand driven system. For this purpose institutional reform process should be initiated to cater to the need of demand orientation of HRD in the Sri Lankan agriculture.

• Maintaining Macroeconomic Stability and Competitive Advantage

Sri Lanka has initiated the liberalization process in 1977 to maintain the macroeconomic stability in the economy. It was a paradigm shift to take advantages from the regional and global economies. However, the some rigidity and some structural problems created as stumbling blocks in the development process particularly the risk factor due to unsettled condition in the country. In the Sri Lankan agriculture faces the same fate in attracting FDI and technologies to integrate the sector into the global economy. If the economic fundamentals (real rate of economic growth, budget deficit, current account deficit, investment, domestic savings, inflation, and unemployment rate) are right, we can expect improvement in growth in investment from various domestic and foreign sources by infusing new technologies. Even to improve the growth rates in agriculture it is necessary to maintain macroeconomic stability. If Sri Lankan agriculture is going to gain advantage in trade in agriculture, it is necessary to maintain the lowest cost compared to trading partners. The policy environment should be sound and efficient to face the dynamism in the domestic and international (i.e. global) policy environments, which will reflect in increased growth rates in the sector concerned.

Opportunities

Within the commercialization scenario, various opportunities are opened for the Sri Lankan agriculture. These opportunities are used to achieve the objectives of sustainable level of sectoral growth, efficiency in natural resource use, generation of employment opportunities and improvement in the status of social welfare of the all stakeholders involved in the process. Some of the opportunities in the Sri Lankan agriculture within the commercialization scenario are as follows:

❖ Technological Advancement

The initiatives should be taken to introduce green house and poly-tunnel technology among youths and agriculture graduates to grow some products for identified niche markets eg. Vegetable for super market chain and the airline catering service and cut flowers for the export market. The demand for these products is showing an upward trend in the world market. Further, the technological advancement should be encouraged to tea, rubber and coconut sectors to increase the level of integration to generate new range of products through private sector. For the domestic market, demand driven distribution of technologies in the horticultural sector should be organized for product integration. The necessary technologies have been already developed in other tropical countries.

❖ Regional Specialization

The regional specialization mechanisms should be organized by pooling regional resources to gain higher productivity, increased farmer income and generating employment opportunities directly and indirectly. The planning and executing market oriented regional integration strategies can be formulated to contract farming mechanisms in collaboration with the private sector. The earlier experience on regional specialization mechanisms namely Export Promotion Villages (EPV) Agricultural Productivity Villages (APV) and yaya program in the paddy sector programs can be revitalized in order to the today's demand through participation of both state and private sector.

❖ Market Integration

It is possible to attract FDI and new technologies into the sector through market integration. It may be either horizontal integration (e.g. Market oriented crop diversification) or vertical integration (e.g. Seed and seedlings production, agro-based products – vegetables, fruit, tea, rubber, spices etc.). The world demand is moving to nature-based products, herbal products and natural products. In the agriculture, it is possible to introduce new green products or organic products (eg. Organic spices, pesticide free rice).

❖ Supply driven Vs demand driven R&D and Extension in Agriculture

The opportunities are open to change the ineffective supply driven research and development and extension in agriculture within the globalize environment. The demand driven R&D will generate higher rate of return for the investment of research. The R&D can be conducted for adaptive or applied research rather than basic research for tradable products and development of new products considering the consumer preferences. It will be easier to manage scarce resources efficiently. In the Sri Lankan agriculture, the priority should be given to the green house products, horticultural products, forestry based products and fish based products. The private sector should be encouraged through incentive packages for targeted extension in the exportable product sectors, while the government should look after the extension in the subsistence-farming sector.

❖ Trade Creation Through Regional Trading Blocks

Sri Lanka has signed a Free Trade Agreement (FTA) with India to harmonize trade between India and Sri Lanka on the basis of preferential trading agreements. It is possible to gain benefits through trade creation and mobilizing other factors and products through the regionalized environment. Further, Sri Lanka can import Indian product at the concessionary terms, re-export them to other destinations, and generate additional income for investors. It also encourages investors to invest in either country through building joint ventures and partnerships.

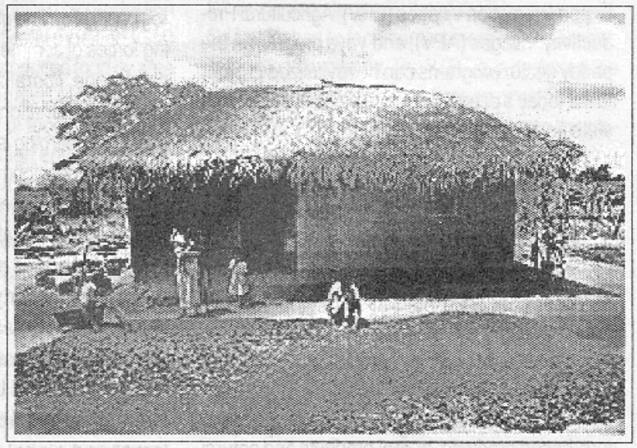
Conclusion

Commercialization is a process which comprises three stages namely liberalization, regionalization and globalization. The major driving forces of commercialization are technological change, liberalization of trade and investment and internationalization of business activities. The emerging issues in commercializing agriculture development are: agro-environmental damages and sustainable development, food security and food safety, genetic diversity, trade and market power, mechanism for transferring technology, poverty alleviation and hunger, sanitary and phyto-sanitary measures. **Within the commercialization scenario, the challenges for the Sri Lankan agriculture have been identified as integration into niche, larger and global markets; improving the climate for agro-enterprises through market integration; investment in people and technology; maintenance of macroeconomic stability and gaining competitive advantage.** If the Sri Lankan economy follows the strategies of commercializing the Sri Lankan agriculture, there are pre requisites to fulfill to facilitate the entire process namely, development of national agricultural policy, formulating of an institutional mechanism including identification of a dynamic role of the state and complimentary micro-sectoral policy mechanism

ROLE OF WOMEN IN SPICE CULTIVATION

Dr. Anoma Ariyawardana
&
Dr. Jeevika Weerahewa
Department of Agricultural Economics
Faculty of Agriculture, University of Peradeniya.

In Sri Lanka, women play an important role in agriculture and in rural development. Their productive involvement has created beneficial impacts in uplifting the status of the household. But, unlike in other sectors, the involvement of women in agriculture is mostly unaccounted and unpaid. Similarly, research is less focused in addressing the role of women in agriculture. Therefore, this study was undertaken primarily to examine the role of women in spice cultivation. Relevant data were gathered from a sample of spice growers from Kandy district. Results reveal that there is a significant gender division of work related to spice cultivation in Sri Lanka. More female participation was seen among the activities that could be done along with the household work. Female involvement in marketing is minimal and hence their contribution to the total income is at a lower level than the husband's contribution. In general, female work in spice cultivation is part time and is especially not accounted and is unpaid. Hence, any impact on the spice industry of Sri Lanka will have very marginal effects on the women in spice cultivation.



In most of the developing countries, women play an important role in agriculture and in rural development. However, the women's contribution to agriculture and other sectors in the economy remain concealed and unaccounted. A report prepared by the Asian Productivity Organisation (1995) has shown that generally women were in fact discriminated against by stereotypes, which restrict them to a reproductive role, and denied access to resources which could eventually enhance their social and economic contribution to society. Women's productive involvement in farming has created beneficial impacts in improving the nutritional status of the household and in alleviating poverty. Women's work is mostly unpaid, hence, the work done by women are generally not included in the official statistics (International Labour Organisation defines "work" as that which remunerates at the market). Therefore, the official statistics may underestimate the involvement of women in agriculture.

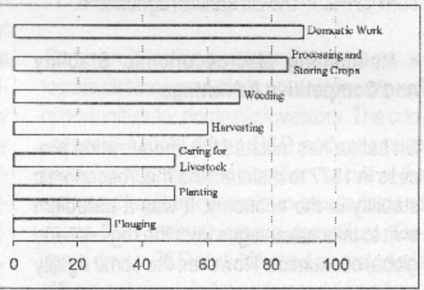
Women's participation in the labour force in Sri Lanka was historically confined to traditional sectors of the economy such as agriculture. Farming in a smallholder context was the mainstream of livelihood during ancient times. However, this trend changed along with the introduction of plantations where women had specific jobs to perform. Women started to perform work for wages. Even at present a majority of women are involved in tea plucking, rubber tapping and processing of coir fiber. Generally, women involved in the plantation sector of Sri Lanka are paid and are included in official statistics. Though unaccounted, a great majority of rural, non-plantation women are involved in other agricultural activities like paddy, other field crops and spice cultivation as well.

Women in Agriculture

In developing countries, a major portion of women in the labour force is engaged in agricultural activities while in industrialised countries a smaller portion of women is engaged in agricultural activities and their share is declining over time in both country categories (Dulayapach, 2002). According to the FAOSTAT data given in Dulayapach (2002), more than 50 per cent of the female labour in Asian and African developing countries are in agriculture related work **(Table 1)**. However, it is apparent that along with development, the role of women in agriculture declines.

In addition to the household work of a woman as a wife and a mother, she also is involved in a number different farming activities. As shown by the International Fund for Agriculture, women are generally involved in ploughing, planting, caring of livestock, harvesting, weeding, processing and storing crops. **Figure 1** shows the level of involvement of women in different agricultural activities. However, many argue that in the developing Asian countries, women are now involved in various agriculture related work because men have moved away from agriculture to industry or to the services sector leaving women to be on the farms (Stephens, 2002; Sharma, 2002). This feminisation of farming has created a greater burden on women and has resulted in lower productivity. It is also considered to have gone hand in hand with feminisation of rural poverty.

Figure 1 - Percentage of Agricultural Activities Performed by Women



Source: Dulayapach, 2002

Researches that have incorporated gender disaggregated data are scant. However, many researchers have re-examined the existing data and have raised the following gender concerns in agriculture (Stephens, 2002).

1. Most farmers in the world are women,
2. Small scale and subsistence farmers feed

Table 1 - Percentage Distribution of Labour Force of Women in Agriculture

World/Region	1990	1997
World	52	49
Developed countries	9	7
Developing countries	68	63
African developing countries	76	74
Asian developing countries	72	67
Latin American countries	13	11
Oceanic developing countries	44	45
Low income countries	76	77

Source: FAOSTAT

Table 2	Gender Division of Labour in Agricultural Activities			
Activity	Paddy Cultivation (%)		Dry Land Cultivation (%)	
	Female	Male	Female	Male
Field preparation	0	100	50	50
Sowing	0	100	60	40
Weeding	90	10	90	10
Harvesting	60	40	80	20
Threshing	0	100	30	70
Winnowing/Cleaning	80	20	80	20

Source: Wickramasinghe, 1995

the majority of the population in most developing countries.

3. Rural women's workday is significantly longer than men's, and is lengthening in most developing countries.
4. The market value of women's home garden production is often equal to or more than the market value of cereal and tuber crops which form the staple foods.
5. Multiple roles of women farmers cause extreme fragmentation of their time, lowering productivity and constraining household food security.
6. Women own a tiny portion of the world's land and other productive assets, yet they shoulder significantly more responsibility for food production than men.
7. Women are routinely paid less than men for work of equal value, even where equal pay legislation has been passed.

The role of women in Sri Lankan agriculture does not differ from that of women in the other developing countries in Asia. In the Sri Lankan context, female labour force participation rate is less than that of males but it shows an increasing trend. Female labour force participation rate has increased from 31.7 per cent to 34.1 per cent during the period 1995 to 1999. This rate is almost half the rate of the male labour force participation rate. According to the Census of 2002, 31.4 per cent of males and 39.5 per cent of females are engaged in agriculture, forestry and fishing related activities (Department of Census & Statistics, 2002). However, the total amount of labour involved in agriculture shows a declining trend, where 45.8 per cent of the labour that was engaged in agriculture in 1990 has declined to 36.3 per cent in 1999.

A study done by Jayakody (1983) pointed out that in Sri Lanka, women who are engaged in the agricultural sector are mostly from the rural areas and have a low education level. These rural women are generally involved in variety of tasks both on and off the farm and in the household. According to Wickramasinghe (1995), nearly 65 per cent of the production activities in dryland farming are done by women while in paddy farming they carry out only 30 per cent of the tasks. **Table 2** shows the gender division of labour in agricultural activities in Sri Lanka. However, the urban women are mostly employed in traditional feminine occupations like teaching, nursing and the like. A labour allocation study of rural women in agriculture revealed that women's contribution to agriculture is in the low skilled secondary occupations which have no promotions, lowest in pay and status (Jayakody, 1983). She showed that low education level of the female, low wage rate of women labour and the sex specific nature of some agricultural activities are the key reasons that differentiate male and female contributions to agriculture.

Statistics on the number of people involved in the spice industry is lacking. However, it is recognised that a greater number of people are involved in the cultivation of spices than in marketing. According to Herath (2002), there are over 200,000 small-scale growers involved in cultivating spices. Growing and processing of spices provide cash incomes to a wide range of rural Sri Lankans, particularly, smallholders. These farmers grow spices primarily on small farms and home gardens as a mixed crop with fruits and vegetables or as an intercrop with tea, rubber or coconut. However, there are no estimates on extent in bearing and average productivity. The available production estimates of spices are computed mainly on the basis of export figures, volume of domestic consumption and industrial uses (DEA, 2001). Similarly, there are no studies done on women's involvement in spice industry in Sri Lanka. Hence, a study was conducted primarily to examine the role of women in the spice cultivation. Specifically, this study aims to understand the types of work performed by females, pattern of time allocation during the off and peak season and the level of contribution of spices to income.

Methodology

The need for a cross-sectional study to collect primary data was identified due to the unavailability of secondary data at the individual grower level. A questionnaire was constructed mainly to obtain details of the growers' general information, level of production, rights of disposal, gender division of work and income. Even though, the target population was considered to have included all the spice growers in Kandy - the largest contributor to spice cultivation in Sri Lanka - lack of complete and up-to-date lists of spice growers created problems in obtaining the total population. Therefore, this study was conducted based on the receivers of the third and/or the final instalment of the Department of Export Agriculture subsidy in Kandy district during the period 1995-2002. Of the total 216 receivers, 120 were selected randomly from 12 Extension Officer divisions and these divisions are Gampola, Pambukotiya, Kundasale, Giragama, Thalatuoya, Pujapitiya, Hulugange, Hataraliyadde, Galagedera, Manikhinna, Taldeniya and Alawathugoda.

Table 3	Age Distribution	
Age Group	Husband (%)	Wife (%)
< 30	1.7	0.8
30-40	10.0	20.8
41-50	54.2	40.0
51-60	25.8	26.7
> 60	20.8	7.5

Results and Discussion

Eighty one per cent of the households that participated in the survey revealed that the head of the household is the husband, while only 19% of the households had female heads of households. Of these households, a majority (76.7%) revealed that the husband is the main applicant for the subsidy and that they have primarily obtained assistance for the cultivation of pepper. **Table 3** shows the distribution of age of the husband and wife in the households. A majority of the respondents represented the 41-50 year age group.

Males have a higher level education compared to the education level of the females. Seventy seven point five per cent of the females and 69.2 per cent of the males had education up to the GCE Ordinary level (**Table 4**). Further, in terms of the access to resources, husband's revealed a higher resource ownership than the wives, where the mean land ownership was 2.17 Ac and 0.88 Ac for husband and wife respectively. Mean production level of the main spice crop - pepper - was estimated to be 258.25 Kg per year.

Types of work performed

Results revealed that in majority of the households, both husband and wife are involved in the activities related to spices at varying levels. **Table 5** shows the percentage of the total males and females that were involved in various activities. The most common activity among females was drying, where 62.5 per cent of the total wives indicated that they are involved in drying spices. Similarly more female participation was seen in activities like weeding, processing and picking. However, male participation was more in activities like

Table 4	Level of Education	
	Husband (%)	Wife (%)
No school education	0.0	1.7
Up to year 5	14.2	27.5
Up to GCE O/L	56.0	46.5
Up to GCE A/L	20.8	15.0
Secondary education	1.7	1.7
Tertiary education	0.8	1.7

Table 5 Gender Division of Activities Involvement as a Percentage of the Total

Activity	Husband	Wife
Nursery management	14.2	5.8
Land preparation	40.8	8.3
Pruning/training	55.8	34.2
Weeding	51.7	65.0
Mulching	9.2	30.0
Fertilisation	53.3	30.8
Shade control	50.8	12.5
Picking	62.5	42.5
Drying	23.5	82.5
Processing	4.2	39.2
Wholesaling	78.3	21.7
Retailing	18.3	34.2

wholesaling, picking, pruning/training and weeding. Females have a minimal role in nursery management, land preparation and shade control and males have a minimal role in the activities like processing, mulching and nursery management. Many households use the planting material received from the Department of Export Agriculture and hence they indicated that they have a minimal involvement in nursery management. Further, many indicated that hard work like land preparation is done with the assistance of paid daily workers and their involvement is minimal. However, in terms of disposing the final product it is evident that husbands dominate bulk selling activities and wives are allowed to sell spices in small volumes.

Figure 2 Time Allocation during the Off Season

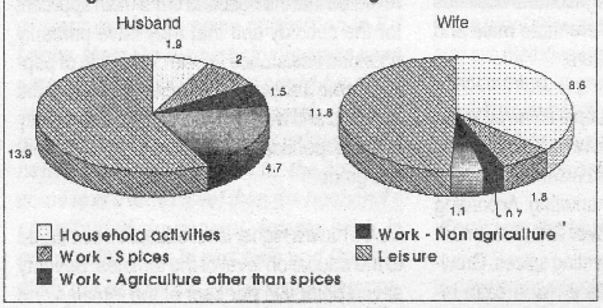
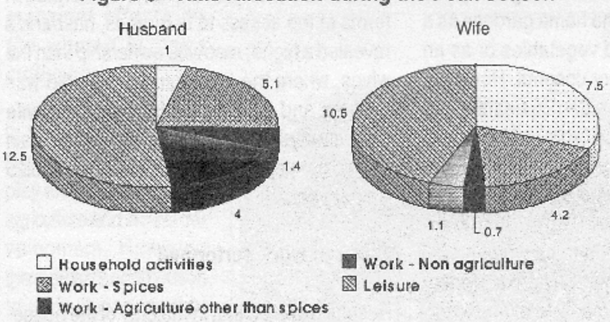


Figure 3 Time Allocation during the Peak Season



Pattern of time allocation

Analysis of the daily division of tasks and responsibilities by husband and wife revealed that time allocation for the activities related to spice industry is very low, where husband spend 2 hrs and wife spend 1.8 hrs per day on average on activities related to the spice industry. Even though females were more occupied in drying, they have done it while they were doing the household work and hence they were not fully aware of the time allocated in drying. The daily time allocation clearly shows that females are undertaking a bulk of the household work and in addition they are also involved in activities related to the spice industry **(Figure 2)**.

During the peak season, both parties are more involved in the activities related to the spice industry. On average, husband and wife spend 5 hrs and 4 hrs per day respectively on activities related to the spice industry. The additional contribution of time by both groups on spice cultivation during the peak season has been mainly obtained by cutting down their leisure and the amount of household work **(Figure 3)**. Further, only 7 per cent of the females and 21 per cent of the males revealed that they do outside work related to the spice industry during the peak season for payment.

Contribution to Income

The study revealed that on average, spices contribute 27 per cent to the total family income per year where pepper and cloves were the main contributors to the income. This finding is consistent with the findings of the Department of Export Agriculture where they found out that pepper and clove contribute 29 per cent and 21 per cent per year respectively to the total family income (Herath, 2001). The average annual contribution of spices to the total annual income amounted to be Rs.19,432, of which the husband's contribution amounted to be Rs. 16,735 or 86 per cent. This is significantly greater than the wife's contribution of Rs. 2,697.50.

Forty-six per cent of the households have revealed that their income has increased during the peak season. On average, total family income has changed by Rs. 10, 127 and wife's contribution to this total change was only 19 per cent. This could be due primarily to the female's lower level of involvement in selling activities. As pointed out in **Table 5**, 78.3 per cent of the husbands were involved in selling the output at the wholesale level, whereas the wives role was only 21.7 per cent. Almost all the respondents indicated that they are not fully involved in the spice industry even though they have obtained subsidies. Therefore, it is clearly evident that spices are grown as a subsistence crop and the emphasis given is very low.

Conclusion

This study shows that there is a significant gender division of work related to spice cultivation in Sri Lanka. Even though there is greater involvement of women in spice cultivation, more female participation was seen among the activities that could be done along with the household work. Females are doing a lesser amount of work for payment. Similarly, their involvement in marketing is minimal and hence contribution to the total income is at a lower level than the husband's contribution. In general, it could be stated that female work in spice cultivation is part time and is especially not accounted and is unpaid. Hence, any impact on the spice industry of Sri Lanka will have very marginal effects on the women in the spice cultivation. But any expansion in export markets will have a direct positive impact on the income of spice growers as they derive 27 per cent of the total family income from spices.

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Privatization Policies and Strategies in Malaysia

P. Sumanapala

Director, Department of National Planning

Malaysia belongs to the category of "Second tier newly industrializing countries". Total land area of the country is 330,242 sq. km. and population was estimated as 24.5 million in 2002. The political structure of the country is based on a federal system headed by a Prime Minister. Per capita income is US $. 3610. According to recent estimates the rate of unemployment has dropped to 3.5% and Malaysia has been able to manage the rate of inflation at a relatively low level. The rate of inflation was 1.8% in 2002. The real GDP growth rate was 4.2% and the incidence of poverty in terms of those who are below the poverty line was 5.5%. The rate of literacy and life expectancy are good and they have been recorded as 94% and 73 years respectively.

Where the sectoral composition of GDP is concerned the country exhibits the characteristics of a developed country recording a relatively lower contribution by the primary sector. The composition of the GDP in 2002 was as follows:

Agriculture	8.4%
Mining	7.6%
Manufacturing	30.1%
Construction	3.3%
Services	50.6%
Total	**100.0**

The present economic policy is based on a "guided market" in which free market operation takes place under the direction and guidance of the government.

Different aspects of privatization

The Privatization Master Plan in Malaysia published in February 1991, spells out the rationale, definition, objectives, scope and methods of privatization clearly. The Master Plan gives necessary guidance and directions on privatization procedures, implementation mechanisms and a monitoring system.

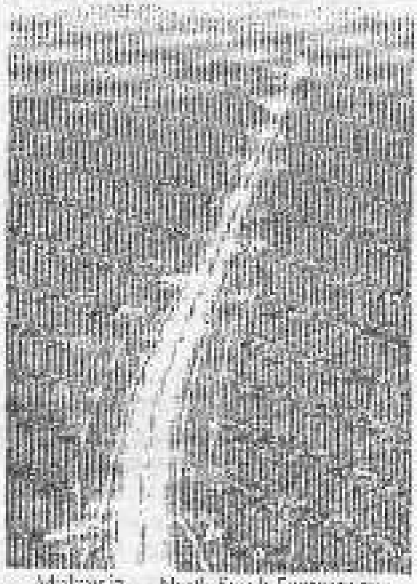
Rationale for Privatization

From independence (1957) to the 1980s, Malaysia maintained a big public sector which dealt with major economic activities relating to production, distribution and consumption. Therefore, it had a large number of public departments and agencies with approximately 800,000 employees. The following factors provided the rationale for privatization of state-run departments and agencies:

(i) By 1980s, the workforce of the public sector expanded up to 15% of the total working population. This created a heavy burden on the Treasury by way of annual salaries and other related payments.

(ii) The number of public enterprises rose to more than 900 and many of them relied upon government subsidies for their operation.

(iii) Due to the recession in the first part of the 1980s, the country experienced a negative growth rate. The growth rate of 6.5% in 1983 was reduced to - 1.1% by 1985.



Malaysia North-South Expressway

(iv) An ever increasing debt burden had an adverse impact on the Balance of Payments and Annual Budget due to high debt repayments characterized by amortization and interest. By 1986, external debt rose up to RM 50 billion which was equivalent to 76% GDP.

(v) Public sector enterprises were marked by the characteristics of ineffectiveness, low productivity, inefficiency and poor performance.

Objectives of Privatization

The Master Plan has identified five objectives of privatization which are relevant to the factors that provide a solid background for the process of privatization. In a nutshell, they are-

(i) Reduce the financial and administrative burden of Government.

(ii) Reduce the size of the public sector and promote participation in the market place.

(iii) Promote competition, efficiency and productivity.

(iv) Accelerate economic growth.

(v) Meet targets of the New Economic Policy (NEP) and National Development Plan (NDP).

Definition and Methods of Privatization

The Master Plan defines privatization as the transfer to the private sector of activities and functions which have traditionally rested with the public sector. This definition applies to enterprises already owned by the Government and to new projects which normally would have been implemented by the public sector. In effecting such transfers, three essential organization-related components are involved, viz, management responsibility, assets (with or without liabilities) or the rights to use assets, and personnel.

Where the methods of privatization are concerned, two types of projects are involved in the process-

(i) *Existing projects or activities.* These include government departments, agencies and enterprises which are in operation. When privatizing existing government entities, the following three methods are applied. They are:

- Outright sale or full divestiture. This is done through direct sale to the qualified bidder or issuing shares in the stock market.
- Lease of assets or transfer of rights to use assets for a specified period in return for specified payments.
- Management-Buy outs whereby the top managerial personnel of a entity is allowed to buy it out based on financing that is arranged by them.
- Management contract which involves the contracting of private sector management expertise to manage a government entity for a fee.

(ii) *New Projects*

In privatizing new projects, two methods are applied. The first involves Build-Operate-Transfer (BOT) and second deals with Build-Operate (BO). The BOT method involves private sector participation in the construction of a facility using its own funds, operating it for a specified period and transferring it to the Government at the end of that period. BO method is also very similar to the BOT, but there is no transferring. During the specified period (concession period) the investor is allowed to collect revenue directly from the users or indirectly through an intermediary.

In most cases, the privatization process follows sequential steps, especially in the privatization of flagships which are of national importance. The first step is the commercialization which transforms a government department into a self-accounting entity. At this stage, user charges are introduced and commercial accounting and performance practices are adopted. The second stage of corporatization, where the self-accounting entity will become a state-owned corporation. At this stage, the process of change in the legal status of an entity from a statutory body to a company governed by the Companies Act has occurred. Assets are owned by a company owned by the Government, but operating on commercial lines. The third stage or divestiture involves the transfer of ownership of the corporation from the public to the private sector. This transfer can be done either by way of public flotation or private sale.

Method of Prioritization

The Malaysian Government is keen about prioritization of projects in the process of privatization. The Master Plan stresses that at least one flagship should be privatized each year. The plan includes a Privatization Grid which explains the criteria to be adopted in selecting priority projects. Desirability and feasibility are the major determinants that rank priority. When considering desirability, the New Economic Policy and sector analysis are taken as the basis. In the case of feasibility attractiveness to the private sector and ease of privatization are taken into account. Based on these criteria, the Privatization Grid accords priorities in the following manner.

Desirability	Feasibility	Priority Action
High	High	Immediate Privatization
High	Low	Restructuring
Low	High	Back-burner
Low	Low	Future Consideration

In an overall sense, the Master Plan has identified the following areas for possible privatization:

(i) Telecommunication.
(ii) Airports.
(iii) Transportation.
(iv) Roads.
(v) Seaports.
(vi) Water Supply
(vii) Sewerage.
(viii) Postal Services.
(ix) Other Services. (e.g. Education)

Salient Features of the Privatization Strategy

It has been accepted by many that the privatization process in Malaysia has been unique, effective and successful in terms of its planning, implementation and monitoring. This is mainly because, the privatization process is based on the principle of centralized planning and decentralized implementation. The political leadership, planning mechanism and administrative set-up work towards a common objective of successful privatization programmes as a means of achieving the set growth objective.

The unique and salient features of the Malaysian privatization programme could be set out as follows:

(i) Better planning of privatization programmes in line with the objectives of the New Economic Policy and National Development Plan. In this regard the Economic Planning Unit (EPC) of the Prime Minister's Department plays a crucial role. All project proposals submitted by the government entities and private sector, are carefully evaluated by the EPC to see their viability. In this process value addition, employment and technology are given much attention.

(ii) Action Plan dovetailed with the Master Plan. The Action Plan has categorized potential candidate projects in terms of priority based on the criteria of desirability and feasibility. This provides a time-bound and systematic implementation framework in consonance with the macro economic policies and development strategy. This is a two-year rolling plan which is reviewed at the end of the year, detailing the entities to be privatized and those to be prepared for privatization.

(iii) Effective regulatory framework introduced by the government. Privatization calls for economic reforms particularly by way of deregulation and lifting of barriers to entry in order to allow market forces to dictate economic activities and thereby improve efficiency. However, as this can lead to a monopolistic situation which can impact adversely on consumer interests, the government has taken every possible measure to control environment, giving due attention to price, quality and delivery of service. In the case of public goods, regulatory measures are adopted in a rigorous manner.

(iv) Increasing Bumiputra participation in the corporate sector. The Master Plan spells out that in respect of ownership of wealth, the privatization policy forms an integral part of the Government strategy in realizing active participation by Bumiputra in the corporate sector since the policy encompasses also the transfer of Government trust companies to the Bumiputra. In addition, the privatization programme is used as a vehicle to correct the imbalances in the corporate sector by providing Bumiputra wider opportunities to participate in the privatization of non-trust agencies.

(v) Changes in the Law. The Government has amended a number of laws which were considered as impediments to a rapid privatization process. These amendments were in respect of both the laws which had general applicability like the Constitution and the Pensions Act and related to those of specific subject areas like Telecommunication and Electricity. The Government foresees that many other laws still need to be amended for the same purpose.

(vi) *Capital market intervention*
A strong capital market, particularly a broadened stock market is a must in implementing an effective privatization programme. Giving due consideration on this factor, the Government has introduced some reforms to ensure an attractive stock market (Kuala Lumpur Stock Exchange) which will lead to the mobilization of equity capital by way of portfolio investments. This is very important in the face of competition in attracting direct investments from China.

(vii) *Ensuring un-interrupted funding*
The privatization process involves several types of expenditure such as the cost of conducting feasibility studies, restructuring of potential candidates and compensation for employees under a Voluntary Retirement Scheme. To face these financial requirements, the Government has set up a Privatization Fund to ensure that the Government has a more efficient alternative to financing management. This Fund is expected to be self-financing with part of the privatization proceeds being used to fund it.

(viii) *Effective monitoring mechanism*
An effective monitoring system has been established to ensure that privatized entities comply with their contractual obligations under the concession agreements. When privatized entities violate the provisions of agreements, stern actions like termination of the agreements are taken against them.

Control over foreign participation

In the privatization process, every possible measure is taken by the Government in order to ensure that the bulk of investment opportunities is made available to local investors. Foreign participation is promoted only in the following cases-

(i) Where there is a special need for expertise to upgrade efficiency.

(ii) Where foreign participation is necessary to promote export markets.
(iii) Where the supply of local capital is insufficient to absorb the shares offered.
(iv) Where the nature of business requires global linkages and international exposure.

Foreign participation in a privatized entity is limited to a maximum of 25% of its share capital. For projects of strategic and national importance, foreign ownership will have to be widespread in nature so as to ensure that no one foreign party will have undue influence on the company.

Policy on Personnel

The Government has clearly spelt out some policy stances in relation to personnel affected by privatization:

(i) No personnel can be retrenched within the first 05 years of privatization, except on disciplinary grounds.
(ii) Upon privatization, affected personnel will be offered a package on no less favourable terms and conditions of service than those enjoyed by them while working with the Government.
(iii) Affected employees are given an opportunity either to join or not to join the privatized entity. Those who do not wish to join the privatized entity will be offered two schemes of service, one which replicates the Government scheme of service, and another which is commercially oriented. Under the latter scheme, employees are entitled to purchase shares and to enjoy bonuses that are declared.
(iv) A particular percentage of affected employees (normally 10%) in a government entity will be given, after privatization, the option of being retained in the entity which will be converted into a regulatory authority.

Performance Achieved

The Master Plan points out four areas in the measurement of the performance of the privatization process. In this paper the performance is assessed in terms of these four areas.

(i) Efficiency gain

From 1983 to 2002, 471 projects have been privatized in the different forms mentioned earlier. Of them, 346 projects were related to existing public agencies and departments. The remainder (125) were associated with new projects that were privatized in the form of BOT or BO. Among these privatized entities, Malaysian Air Line, North South Highway, National Automobile Project, Postal and Telecommunication Department and National Sewerage Project were nationally important both in terms of the capital involved and service delivered.

The following **Table** shows the efficiency of some privatized entities in terms of selected criteria.

Agency/Criteria	Before Privatization	After Privatization
1. Tenaga Nasional Bhd.		
* Electricity generated per Employee	800 kwh	1,390 kwh
2. Institut Jantung Negara		
* Medical Procedures handled:		
per doctor	557	721
per staff	37	48
3. Telekom Malaysia Bhd		
* Response to complaints	80%	95%
4. North South Highway		
* Travel time from Bukit Kayu Hitam to Johore Bahru	15.4 hrs	7.5 hrs.

(ii) Growth

Privatization and economic growth have been closely related. In many instances, privatization has led to corporate expansion and greater utilization of growth opportunities through private sector motivation. Privatization has also resulted in the generation of multiplier effects in the economy. Efficient service delivery, increased output in productive sectors and service sector and expanded export market are the key areas of them. More specifically, implementation of various BOT projects and granting of licensed activities have contributed greatly to the increase of domestic output. These projects have expedited infrastructure development rapidly at a time when the public sector is cutting back its capital expenditure in the face of budgetary constraints. Ultimately, the Malaysian Government was able to bring the negative growth recorded in the economy in 1985 to one which recorded 4.2% by 2002 in real terms.

(iii) Relieving administrative and financial burden of Government

Privatization has been successful in reducing the administrative burden of the Government particularly in terms of personnel and financial obligations. The relief has been very significant with the privatization of large entities like the Dept. of Telecommunication and the Ports Authority. The following **Table** gives details of the reduced financial burden to government during the period from 1983 to 2003.

o Sale of Government Interest	RM 24.2 bn.
o Savings on Operating Expenditure (annual)	RM 7.7 bn.
o Savings on Capital Expenditure	RM 125.2 bn.

The Government was able to transfer about 117,750 employees from the public sector to the private sector through the privatization programme. At the same time, the expenditure incurred on administrative matters has been reduced remarkably due to there being no new recruitment, promotions, training, implementation and progress monitoring by the Government.

(iv) New Economic Policy

The NEP clearly says that the distributional pattern of wealth in the economy and participation in the corporate sector have to be changed in favour indigenous people. The another objective is to channel the money saved through privatization into areas of social development like poverty reduction and other relief measures focusing on needy families. By 2002, Malaysia has been able to ensure at least 30% participation of Bumiputra in all privatized entities. The assets concentrated on other citizen groups like Chinese and Indians are now being transferred to the Malays, deviating from the racial bias distributory pattern. The ultimate objective of the privatization programme is to ensure that every citizen in the country is a stakeholder in the corporate sector.

Conclusion

An effective and systematic privatization programme has been one of the reasons for the rapid development achieved by Malaysia. The privatization programme in Malaysia has unique characteristics that have contributed to its success. Political commitment, better planning, smooth implementation and effective monitoring are the principles associated with its uniqueness. These principles are substantiated by the following factors which provide a sound basis for success of the privatization process.

(i) Political stability and will.
(ii) Well coordinated administration mechanism.
(iii) Decentralized implementation setup.
(iv) Strong evaluation and approval procedures.
(v) Time-bound Action Plan.
(vi) Selection of locally reputed companies.
(vii) Proposals being developed by the entities themselves.
(x) Strong capital market and private sector.
(xi) Effective regulatory mechanism.
(xii) Continuous monitoring of performance.

However, it is noted that some privatized entities were not as successful as expected due to reasons associated with undue political interference, lack of transparency, and natural monopoly which led to arbitrary price hikes of semi-public goods.

Electronic Commerce & Marketing Management

Worldwide Web (www) Based Marketing in an Era of Information Technologies

T.A. Dharmaratne
School of Economics
Huazhong University of Science and Technology, China

Globalization is a startling polemical phenomenon that brings nations into **"one global village"** with "one borderless economy". It is stress the comparative advantage theory in economics, and "business world" in referring to the field of **"marketing management"** is as follows:

"...Integration of **business activities** across geographical and organizational boundaries" (Ray Rely: 2001).

"The capacity to treat the **world as one market**, while...dealing with many culturally diverse merchants" (Novel Tichy: 1999).

".... The process by which **markets expand** to include competitors for customers and productive inputs without regard to national boundaries" (Paul Danos: 2000).

.... Doing business with a world wide focus...rather than doing **business in and international market** with the focus from a home - country view point" (Lawrason Thomas 20001).

Owing to the globalization and accessibility of information, new economy has become a worldwide stream, which has the characteristics of information and digital technologies. Therefore, there are several names for it; "Knowledge Economy, New Economy, Digital Economy, Virtual Economy, Network Economy and Information Economy". Whatever the name, we know that it's principally originated from information and digital technologies and network. Digital economy, as the abstracts of whole economic activities acting to electronic network, shows its outstanding foreground and longing degree. Internet makes exceptional revolution on enterprises and marketing motion. Advanced information and network technique are adopted not only in production and marketing management, but also outside of enterprises, as E-business. Therefore, E – business or electronic commerce is the most important innovations in digital economy. Electronic commerce defined as **"the use of electronic transmission medium (telecommunications) to engage in the exchange, including buying and selling of products and services requiring transformation, either physically or digitally, from location to location"** (Greenstein and Fein man, Electronic Commerce 2000). Therefore, E – commerce is almost an absolute necessity in the process of marketing management in an era of digital economy. This electronic medium offers many possibilities and has many advantages. It reduces operational costs; and increase the efficiency due to increased precision and speed. Further, it offers access to local, national or international markets, and allows personalized products and services to be offered. E – commerce also allows specialized marketing due to the many databases available.

At present, a transition takes place in the world from traditional industrial society to the digital economy. Knowledge innovations become an essential part of it. With development of high-speed information network, economic and social activities of people, such as production, marketing, circulation, scientific research, education, medical treatment, and recreation should turn to use electronic networks more and more and this process will be further extended. Digital economy is a new economy from on the precondition of each aspect's assorts and support of society. Especially enterprises are suffering bigger convulsion. It is well proved that not all of the enterprises be able to existent in digital economy environment. Digital economy will force enterprises to work out the veranda of industrial economy and stride over the doorsill of digital economy to become an element of digital economy. Within the framework of digital economy, the "marketing theories, Marketing Conception, Marketing Method, Marketing techniques and Marketing Management Content" would be changed profoundly. It is a difficult and bitter process, which will make enterprise's continual change. Although, the ultimate development direction of network economy is different from industrial enterprise and commercial enterprise, it will be beneficial to both enterprises' acquisition of permit to digital economy and prosperity of digital economy if enterprise management can be adjusted properly to digital economy. Digital economy is playing a more and more important role in the development of world business and economy.

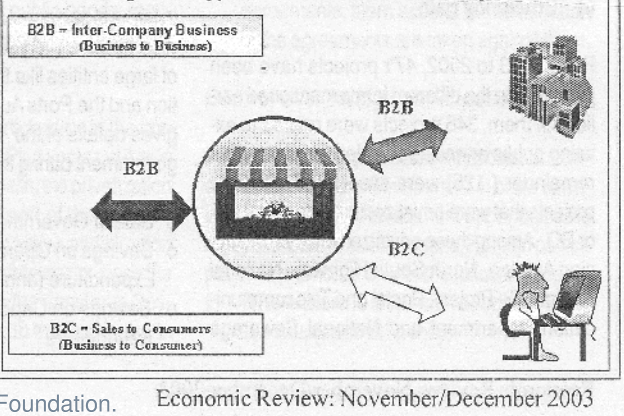
As a result, marketing managers and business managers of the 21st century are experiencing brand-new world. Therefore, new marketing management theories, concepts and techniques have to play a greater role in marketing management in the business world. Based on these theoretical and empirical backgrounds, this paper has following few major objectives.

- To identify and analyzes the impact of electronic commerce on marketing management, in connection to the extended of market mix model with six Ps: People, Product, Place, Price, Promotion, and Partners.
- To review and examine the relationship of E – commerce and market mix (six Ps) in the Customer – Oriented Value Chain.
- To investigation and evaluation the Effects of E-commerce Shopping in concerning to the consumers advantages and disadvantages.

E-Commerce: The New Way of Doing Business

E-commerce is a growing phenomenon that interests many types of businesses. It consists in using electronic means to exchange information, conduct successful business and carry out transactions. It can be applied to both product sales and the presentation of services. It can even be used in the creation of virtual products and services, which are intangible and digitized (e.g. books). These exchanges take place between two major categories of entities: organizations (companies and government) and consumers / individuals. All of these e-commerce activities happen within the framework of two types of business relationships: the exchange of products and services between companies (inter-company business) and the exchange of products and services with final consumers **(Figure 1)**. It should be mentioned that "inter-company" e-commerce (B2B) dominates by far and represents 80 percent of present activities included in a census in USA.

Figure 1: Types of Business Relationships



Web Based Marketing and Market Mix.

Internet-driven e-commerce has had a significant impact on the many ways of transacting business. This paper will focus on one of the most profound aspects of business that has been affected by electronic commerce - the role of marketing. A model commonly used to describe the components of marketing is "**the four Ps**": Product, Place, Price, and Promotion. Although this model covers a large portion of marketing activity, it lacks a measure of the focus on the players involved. For this reason we have included **Partner** as a fifth "P", to reflect the many changes that are occurring with intermediary and outsourcing firms; a sixth "P" is the **People** or prospective customers. Customer demographics in cyberspace are significantly different from traditional marketplaces. Therefore, revolves around these six P model, defined as follows. **Six Ps of Marketing are -**

- **People** – prospective customers, either individuals or businesses.
- **Product** – a good, service, or idea to satisfy customer needs.
- **Promotion** – a means of communication between the seller and buyer.
- **Price** – what customers are charged for the product.
- **Place** – a means of getting the product into the customer's hands.
- **Partner** – an intermediary or outsourcing contractor.

The impact of electronic commerce on the six Ps of marketing is summarized in Table 1, while **Figure 2** explained the relationship in Ps with marketing management in following sections.

❖ THE FIRST IS PEOPLE

Market planning identifies the people who are the prospective customers. Electronic commerce may extend, restrict, and/or redefine the customers a company can serve through electronic communication media. For instance, a bookstore opened in a small town may serve only local people. But a bookstore opened on the Internet may serve people worldwide. A local bookstore can serve a variety of people: young or old, rich or poor, women or men, but an Internet bookstore serves only those with Internet access; these people generally have higher than average income and education. Another consideration is the concept of market niches, since the net is composed of thousands of overlapping groups ranging from a few people to perhaps several hundred thousand. Understanding the consumer population in cyberspace and their shopping preferences is essential for success in e-commerce marketing.

The demographics of Internet and Web users continue to change rapidly. For example, the average age of users is about 36 years, with the proportion of females continuing to rise towards the 50% level. Shopping continues to rise in importance among Web users. The most commonly cited reason for using the Web for personal shopping is convenience (65%), followed by vendor information availability (55%), lack of sales pressure (55%), and saving time (53%). The steady growth in personal shopping is expected to continue as online transactions become easier and more choices of products and services become available. Demand for goods and a service varies substantially, depending on the demographics of Web users. The most popular items purchased over the Web are computer software and hardware. Other popular items include travel arrangements, books and magazines, and musical tapes, CDs, and albums. Online purchases of clothing are beginning to grow rapidly.

While business-to-consumer Internet commerce is still in its infancy, business-to-business Internet commerce has already moved through the early adopter stage. Unlike the more traditional e-commerce tool of **EDI** (Electronic Data Interchange) used primarily by large companies through private networks, the Internet makes electronic commerce affordable to small businesses and even home offices. Companies of all sizes can now communicate with each other electronically through the public Internet with appropriate security through such means as "tunneling" via virtual private networks. The growth of business-to-business e-commerce is driven by lower purchasing costs, reductions in inventories, lower cycle times, more efficient and effective customer service, lower sales and marketing costs, and new sales opportunities.

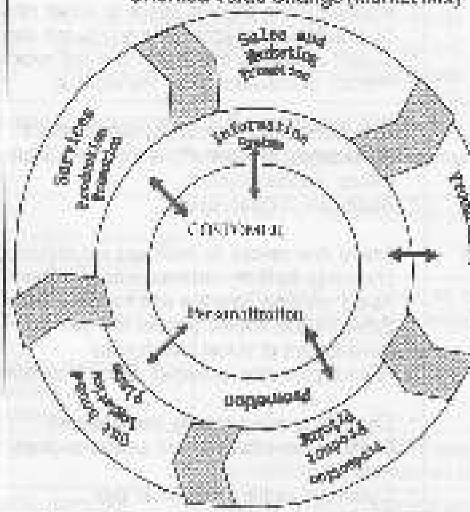
There are two main observations relevant to the people component of the e-commerce market model. First, the potential for niche markets is now very substantial due to the wide reach of the Internet and the potential for customization of products and services. Second, the rapidly changing global demographics of populations with access to e-commerce merits a careful analysis before investment in electronic commerce markets. The potential of e-commerce can be assessed, for example, with inexpensive initial investments in promotional activities on Web and e-mail for monitoring and survey purposes. Many companies are moving into e-commerce markets in this way before committing to on-line sales and service, which may involve major investments in on-line transaction processing, staffing with sales and distribution personnel, and major changes to other aspects of supply chain management.

❖ THE SECOND IS PRODUCT

Major contributions of e-commerce to product change have been to enrich information content of existing products or services, the development of new products or services not previously feasible without low cost digital communications, and the application of mass customization. The enrichment of information content of existing product or services is evident. For instance the Canadian Multiple Listing Service, is a Web-based service that covers all of Canada, and includes a large number of new and resale homes, provides maps to locate properties, supports customized searches, and has a mortgage calculator. There are also many examples of new products or services not previously possible. For example, Canada Trust (recently merged with TD Bank) allows small business owners to check account balances, transfer funds, make payments, etc. Versions are a service that can automatically transmit to information in e-mail form to software users whenever the developer of the product releases an upgrade. Canoe is a major portal for Canadian financial news and data. These products and countless others in such niche markets were not possible before the proliferation of e-commerce. Another major product shift has been the swift movement towards mass customization. For example, Dell Computer sells the great majority of its PCs online, where customers can select the desired features for products that may not have actually been assembled before the order is received. Personalization of information products is also a form of mass customization. It would be exceedingly difficult and costly for a newspaper to distribute 75 individual sheets with different stories, to allow consumers to purchase exactly what they want. Publishing on the Web makes such a business model economically feasible.

The arrival of e-commerce technology such as automated teller machines (ATMs), debit card shopping, on-line banking, and digital

Figure 2 - The Relationship of the Customer - Oriented Value Change (Market Mix)



Source: Greenstein and Feinman, Electronic Commerce 2000 cash, has revolutionized banking and changed the competitive environment. The introduction of **EFT** (Electronic Funds Transfer) and debit cards brings banking directly into stores. Since banking essentially involves the transfer of information, transactions and information exchange can be handled effectively by electronic means, resulting in a decreasing need for physical bank branches. Some newer "cyber banks" have been formed to operate entirely over the Web. Having no physical branches, they do not have this perception of security and stability, but they threaten the supremacy of traditional banks. As examples, ING Direct and Van City Direct operate nationwide as virtual banks, where they are able to pass to customers the savings they realize from a lack of physical presence, in the form of higher interest on savings, and lower service charges.

The insurance industry is also embracing e-commerce as a means of enhancing product offerings. For instance, many dental offices and pharmacies electronically file patient claims to group benefit plans through (Electronic Data Interchange) EDI, resulting in fewer errors as well as more rapid payments. In the investment business, Web sites maintained by brokerages such as TD Water-house for example, provide individual investors with access to stock, bond, and mutual fund trading.

Table 1: The Six Ps Model and its Main Effects

Marketing Mix Component	Effects of E-commerce
People	* Restrict, extend, and redefine prospective customers * Demographic identification of market niches * Enrich information gathering to identify customer preferences and buying behavour * Encourage higher expectation of wider selection, lower prices, better service * Change perceptions and trust of virtual physical institutions
Product	* Enrich information content of existing products or services * Enable new forms of information products and services * Enable mass customization of products and services * Increased attention to copyright protection issues
Place	* Movement from physical space to virtual cyberspace * On-line delivery of information goods and services * Support outsourcing coordination of in-and outbound Logistics * Promote globalization of the marketplace
Price	* New forms of pricing and payment methods * Development of more efficient markets, more competitive Prices * Raise new taxation issues
Promotion	* Enable new options for push and pull technologies. * Encourage facilitate customer initiated information search * Attract customer attention with free information services * Extensive and tailored product and service information * Development of virtual communities * Flexible promotion strategies easily implemented
Partners	* Eliminate or adapt existing intermediaries * Digital intermediaries: web search-engines, directories, Auctions * Coordinate partners via virtual links * Search engines, directories, support customer shopping

❖ THE THIRD IS PLACE

Place refers to the distribution of products or services, including inbound and outbound logistics, and warehousing. E-commerce has caused a shift from physical space to cyberspace for distribution of products such as information and software, and it has greatly facilitated the outsourcing and coordination of inbound and outbound logistics. Historically, the main development in e-commerce was the application of EDI (Electronic Data Interchange). For example, bar-coding facilities at the cash registers of many stores automatically update inventory levels. Ordering, shipping, and subsequent invoicing can also be supported electronically. EDI streamlines distribution by speeding up processes and minimizing errors. Using Electronic Data Interchange, cost savings result from reduced inventories and paperwork, and service levels improve.

With electronic commerce, it is possible to shop in cyberspace through access to electronic shopping malls, Internet banking, etc. There are several issues that relate to the transition from physical space (e.g. department stores), to cyberspace (e.g. electronic shopping malls). These are summarized in **Table 2**. Although electronic shopping malls allow customers to shop at home, physical products still need to be delivered. This normally requires outsourced services such as courier or parcel delivery, adding extra costs for shipping and handling. The quality of logistics services has improved due to e-commerce technologies, at least partially due to the increased competitiveness of this environment. Shipping intermediaries such as Federal Express have improved service while reducing costs, by using Web sites to allow customers to arrange package pickup, track delivery status, and order merchandise on-line.

The cost of delivering products to the customer can range as high as 20 percent of the consumer dollar in physical transportation of goods alone. New intermediaries have been formed to help companies cut costs through electronic means, including companies such as i2 Technologies, which produces supply chain management software and system solutions. These can help to improve the speed at which orders are processed, thus improving a company's competitive position and reducing inventories.

The Web provides an opportunity for new forms of information products, but one of its most important contributions is the delivery of information products. For example, many media sources (television, radio, newspapers, magazines) operate Web sites that deliver news and other information in a variety of formats (video, audio, text, graphics), at little cost to the producers since they simply mimic the form being delivered through the primary media. Many of these products are free on the Web but, of course, they are accompanied by advertising directed to the population sector likely to be viewing them. Others require payment by subscription. At least 50 percent of packaged computer software is sold through the Web, an ideal distribution channel for this product. Software can be advertised through a Web site at low cost and detailed technical information can be made available for potential customers, who are often able to download evaluation copies. Software purchases on the Web ignore international boundaries, and require no movement of physical goods since the software, documentation, support services, and payments are all on-line.

Distribution channels have been modernized for physical and information products, and for services, but in varying degrees. The main change in physical product distribution has been in cost reduction and service improvement, but financial, information, and travel services are now being linked more directly from producer to customer. Major changes have occurred in the distribution of information products, often in new forms, and carried out entirely as virtual transactions. The distribution network now covers the global market rather than a local or national market, and supplying products or services to this global market is causing profound changes to the marketing focus of many firms.

❖ THE FOURTH IS PRICING

E-commerce has made pricing more competitive due to the wide access to information afforded by related media, and it has also enabled new forms of pricing. There are three common pricing strategies, based on cost, value, or competition. Cost-based pricing simply applies a markup on the unit cost of an item. Value-based pricing reflects the valuation that customers place on a product. This valuation can be captured and analyzed through e-commerce tools such as analytical data mining. Competition-based pricing involves setting prices at the same levels as the industry leaders.

Lower pricing through cost leadership can be supported by e-commerce through lower transaction costs as well as more easily obtained information. However, electronic commerce also gives customers the ability to shop around electronically in order to find the best deal. Customers also expect more free information and free services, putting more pressure on companies to pursue a cost leadership strategy.

New pricing models have been made feasible in consumer markets through electronic commerce, including on-line auctions and customer price setting. Web auction sites (ebay, etc.), offer computer hardware and software, antiques, collectibles, vacation packages, etc. Priceline has introduced a new way to sell airline tickets, based on prices specified by customers though the Web. This is not an auction, because consumers simply name their price and let Priceline find a seller. Both businesses and consumers to buy surplus goods or services at bargain prices, a win-win situation for both buyer and seller, can use this approach.

The competitive environment is changing. Barriers to entry are generally low, so the traditional advantages of large companies over smaller competitors are not as clear. E-commerce affects pricing of information and physical products more than financial services because the unit cost of production and distribution of the former is more directly affected by e-commerce. Also, information products supplied via e-commerce are often just different forms of existing media, distributed at minimal cost to the provider, although disruption of existing distribution channels can occur and must be understood in the context of existing distribution agreements. There are many evolving price issues, particularly in payments and taxation. As standards are implemented, new markets will open in the information products area. Few solutions have been proposed as yet for the taxation of information products and services, which can cross international and state/province boundaries unobserved through e-commerce communication on networks.

❖ THE FIFTH IS PROMOTION

E-commerce has affected promotional methods, including advertising, personal selling, sales promotion, and public relations activities. E-commerce can facilitate customer-initiated information search, attract customer attention by providing free information, provide extensive and tailored product and service information, and enable the development of virtual communities. The element of promotion most affected by e-commerce is advertising. For example, Web marketing can facilitate personalization of consumer offering content, also known as one-to-one marketing.

Companies can choose "pull" or "push" techniques to provide information to customers in multi-media form. Pull techniques take advantage of Web user information searches. For example, search engines can be programmed to present advertisements that depend on key words entered by the user. Push techniques are used to gather interest profiles from users when they register for the services, a form of "permission marketing". The intent is to develop continuing relationships with customers. PointCast provides software to support its service on user computers. Based on user profiles, this system periodically downloads current information such as news, stock market, and weather reports.

Maintaining the personal touch through e-commerce can pay off in client relationship development. One approach is to send personal e-mail or to telephone potential customers who have visited Web sites and requested more detailed information on products or services. Another technique is to provide a live chat service via Internet or live phone, such as Etrade Canada and Nortel Networks to facilitate communications between customers and sales representatives. Sales force automation tools include the use of notebook computers to display information from local or remote company databases, or develop on-the-spot quotes for insurance or mortgage products.

E-commerce technology can be used to improve public relations cost-effectively by offering company information, profiles, and promotional information through e-mail, user newsgroups, or Web sites to customers or potential customers. An example is the Strategis site of Industry, which provides businesses with relevant information and promotes business opportunities. Other promotion possibilities are available among people with similar interests or professional affiliations, supported by the idea of "virtual communities". Increasingly, Web sites support visitor interaction through newsgroups and chat lines. The promotional advantages of virtual communities are that users with common interests tend to return, and the site's focus helps to target advertising efforts. An example of a virtual community oriented towards health issues is Achoo.com. This site provides useful information on a variety of health topics, and appears to be supported through revenue from advertising targeted at healthcare consumers.

Promotion activities should portray a desirable image of the company being represented. For example, financial service providers wish to portray an image of security and stability. Thus, public relations will dictate a balance between virtual and physical worlds for the banking industry. Physical product providers must also balance the virtual world of e-commerce marketing and sales with the physical world of place. Conversely, information and information product providers can more ably sustain a pure virtual existence, reflected by the success of many new virtual media companies, with e-commerce offerings that duplicate or complement existing physical products.

❖ THE SIXTH IS PARTNERS

Partnering reflects the growing trend of companies to outsource activities, especially those that are not a part of the core competencies of a company. This concept includes intermediaries that support any of the components of the supply chain. Coordination of partners is typically through "virtual" communication links. Some suppliers have chosen to bypass intermediaries to deal directly with customers through e-commerce. However, additional costs that are incurred as a

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Table 2 Advantages and Disadvantages of E-Commerce Shopping

Shopping Characteristic	Advantages of E-Commerce Applications	Disadvantages of E-Commerce Applications
• Accessibility	• Reduces travel • Eliminates geographical boundaries • Anyone, anywhere, anytime	• Limited to customers with Internet access
• Richness of product information	• More detailed, searchable data • Free trial, download software packages • Multi-media, virtual reality for more realistic evaluations • Third party comments	• Can't touch, feel, smell, try out physical items • Lack of usual physical leisure environments
• Personal touch	• More personalized services	• Direct contact with sales people difficult, unable to establish direct personal relationships
• Security and privacy	• Simple to handle payments • Improved third party security services available	• Concerns about payment security • Awkward to handle very small or very large payments

E–Commerce and Marketing Management

Experiences of Sri Lanka

"Information Technology" (IT) in Sri Lanka has become a rapidly expanding area in many spheres like economic, social and political arenas. However, a utilization of e – commerce for marketing is still unexplored subject area in the field of commerce as well as in many other economic sectors. Therefore, use of e – commerce for marketing activities is not fully utilized in many commercial, industrial, and financial organizations and institutions. Existing evidence suggest that Small and Medium Enterprises (SME) use Internet for their business and marketing. A recent study completed by the Sri Lanka Business Development Center has indicated that 83 per cent of the SMEs use Internet in their business (*Survey on E – Commerce Implementation in the SME sector of Sri Lank: SLBDC, 2002 June*). However, it is not observed that individual consumers use e–commerce for marketing in searching or purchasing of consumer items. The observed relative lack of use of Internet facilities can be attributed a number of factors. These include lack of development in physical infrastructures, financial formation, and legal environment stimulating development of e- commerce in Sri Lanka. There are many factors, as listed that constraints the use of e- commerce in meeting day-to-day consumer requirements of the people.

- ❖High price of computer equipment
- ❖High initial set – up costs
- ❖Cost of telephone connection and charges
- ❖Monthly Internet payment rates
- ❖Financial constraints
- ❖Restriction of using credit cards
- ❖Insufficient access speed-outside Colombo
- ❖Insufficient bandwidth – outside Colombo
- ❖Lack of IT skills among employees
- ❖Lack of IT strategies within the management rank
- ❖Poor English language skills

(Survey on E – Commerce Implementation in the SME sector of Sri Lank: SLBDC, 2002 June).

Human Development Report of the 2002 has indicated that the use of electronic communication in Sri Lanka is far below in comprising to the developed countries, on the other hand in comparison to the South Asia; the situation of Sri Lanka is more encouraging and the flowing statistics have shown that the telecommunication with electronic information systems has rapidly improved, during the last decade in Sri Lanka.

To achieve and maintain a competitive edge in the world economy for Sri Lanka in an environment of economic globalization, it is widely acknowledged the importance of using e – commerce facilities in for domestic business activities. With this in mind, there are some successful attempts at transforming simple electronic trade information system to business-to-business system in the e-commerce environment.

Farming community in Sri Lanka is basically rural area, have hardly heard about computers. The farmers and other rural communities, usually work with their own closed environment. Without any communication with external world, except for their infrequent interface with the field officers. This question has been pointed out plentiful times earlier, but a solution has not yet materialized. As a consequence, the model of "Vishva Gnana Kendra" (VGK) is currently being implemented Islandwide by **the Ministry of Science and Technology**. According to the information technology organization, which is entrusted with above, VGKs are to function as global knowledge centers providing multi Internet service facilities to the public including rural agricultural communities. Thus, the above information centers will make a broad range of information resources available through Internet at the village level. In the first phase of establishment of VGKs, it is expected set up around 100 VGKs in the Island including the war-affected Northern and Eastern Provinces by the end of 2004. The first VGK has already been established at Embilipitiya. There are many objectives that are expected to be achieved from establishing VGKs.

(1) Providing timely and accurate market information to the farmers and fishermen.

(2) Providing agricultural related information to farmers and others.

(3) Addressing the financial needs of the farmer community with the help of banks and other financial institutions and organization.

(4) Effective natural resources management by the introduction of computer based natural resources management techniques.

(5) Dissemination of Health and Educationally important information.

Though it is too early to assess both the performance and impacts of the VGKs, these to large extent will depend on many externalities including socio-economic, political and technological factors.

In resent years, Sri Lanka has made an effort to implement policies conducive to achieving an open market economy. In theory market information would be useful to farmers' decisions regarding what, when and where to grow crops, then when, how and to whom to sell their harvests in relation to the process of agricultural marketing. In practice, the present market information system in **Hector Kobbekaduwa Agrarian Research and Training Institute (HARTI)** has been primarily organized to build up the basic sectors' effects to monitor the price and supply performance of several agricultural commodity markets. A prime goal has been to share that information with other potential users, such as traders, farmers and consumers through the using simple electronic communication techniques.

The Marketing and Food Policy Division (MFPD) at the HARTI, which was established in 1979 is responsible to provide market information and policy advice to various government agencies and committees such as the Monthly National Food Policy Committee (NFPC) and Weekly Cost of Living Review Committee (CLC). Since 1994 this division marketing information collection and dissemination roles have been strengthened through the support of the "Market Intelligence and Food Information" project under the financial assistance of FAO and UNDP. That project provided an advisor and some amount of hardware, such as computers and other data transmission equipments. However, marketing and food policy division's mandate, basic structure

Use of Electronic Communication Techniques

	Telephone mainlines (per 1,000 people)		Cellular mobile Subscribers (per 1,000 people)		Internet hosts (per 1,000 people)	
	1990	2000	1990	2000	1990	2000
Developed Countries						
1. Norway	502	532	46	751	19.3	101.1
2. Sweden	681	682	54-	717	16.4	67.3
3. Canada	565	677	22	285	12.7	77.4
4. Belgium	393	498	4	525	3	29.4
5. Australia	456	525	11	447	17.1	85.7
6. Japan	441	586	7	526	2.1	36.5
South Asia - Developing Countries						
1. Sri Lanka	7	40	(.)	23	(.)	0.1
2. India	6	32	0	4	(.)	(.)
3. Pakistan	8	22	(.)	2	(.)	(.)
4. Nepal	3	12	0	(.)	(.)	(.)
5. Bangladesh	2	4	0	1	0	(.)

(.) Less than half the unit shown

Sources: Human Development Report 2002 and normal operations [illegible] due to [illegible] expansion in coverage. The [illegible] activities have been:-

(1) Increased geographical coverage of [illegible] production and marketing [illegible]

(2) [illegible] broadcasting of prevailing producer, wholesale and retail prices [illegible]

(3) Publication of Weekly [illegible] "Weekly Food Commodities [illegible]" which describes recent price behaviour, "Monthly Food Information Bulletin" which describes the recent food supply situation in country; and

(4) Provision of information to public sector decision makers on specific operational and policy issues regarding the marketing of food crops.

The ultimate goal was to increase the incomes of farmers [illegible] use of the information in negotiating prices and planning [illegible] marketing operations. The project objectives were to [illegible] price transparency and the [illegible] position of farmers [illegible] through the provision of price and market information to farmers, traders and consumers. The most important fact that the entire [illegible] activity is based on the sincerely [illegible] information of farmers, [illegible] telephone computers and [illegible] radios [illegible] important role of networks in the framework of information and marketing. Benefits [illegible] marketing information system should include:

(a) Improved bargaining position for farmers, [illegible] business, [illegible] more well informed about prices and [illegible] conditions.

(b) Competitive prices [illegible] price formation process.

(c) More [illegible] marketing of commodities should [illegible] which contribute [illegible] lowest prices.

(d) [illegible] supply and demand [illegible] between areas and [illegible] and [illegible] marketing periods.

(e) Improved [illegible] by [illegible] timely [illegible] to [illegible]

[illegible] these benefits the information system must provide [illegible] timely and [illegible] reliable information to the farmers.

[illegible] the existing experience especially [illegible] e-commerce is [illegible] has [illegible] the process of [illegible] the use of e-commerce in Sri Lanka. [illegible] significant [illegible] e-commerce in [illegible] technology [illegible] marketing [illegible] technological [illegible] used [illegible]. However, it should be [illegible] the use of e-commerce for [illegible] especially in [illegible] (People, Product, Place, Price, Promotion and Partners) [illegible] strategy further [illegible] to [illegible] marketing [illegible] of economic [illegible].

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[illegible] reduce sales [illegible] high volume [illegible] outgoing [illegible] the danger of [illegible] channels.

[illegible] intermediaries [illegible] as yet [illegible] grows and [illegible] of products [illegible] shopping [illegible] commerce transactions, such as banking and [illegible] have evolved [illegible] and other services [illegible] improved service [illegible] for [illegible] complete shopping. At the same time [illegible] search engines, and [illegible] formed to provide [illegible] services to [illegible] intermediaries [illegible] the world of commerce [illegible] such services [illegible] clear that [illegible] and [illegible] service [illegible] play important roles.

[illegible] new [illegible] services [illegible] to [illegible] in [illegible] products and services [illegible] E-commerce has also significantly [illegible] the [illegible] of intermediaries [illegible] forms. In this [illegible] impact of electronic commerce on marketing is [illegible] marketing mix [illegible] 4 Ps: Product, Price, Place, Promotion, and [illegible] [illegible] advance in information technology, especially [illegible] global market [illegible]

It has increased the [illegible] distributions and [illegible] E-commerce [illegible] to [illegible] and [illegible] it has empowered customers.

This analysis [illegible] comprehensive, [illegible] is only intended to [illegible] of how marketing [illegible] result of e-commerce. For example, the use of [illegible] to build and [illegible] relationships [illegible] particularly relevant [illegible] healthcare, [illegible] products, and [illegible] have [illegible] The main point is that marketing has changed [illegible] that adapt their marketing approaches to the new environment [illegible] will be able to leverage [illegible] to its fullest. [illegible] forced to [illegible] the new environment [illegible]

CONCLUSION

The rapid growth of electronic commerce is [illegible] defining many [illegible] aspects of marketing. The customer [illegible] can be [illegible] through E-commerce. [illegible] existing [illegible]

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