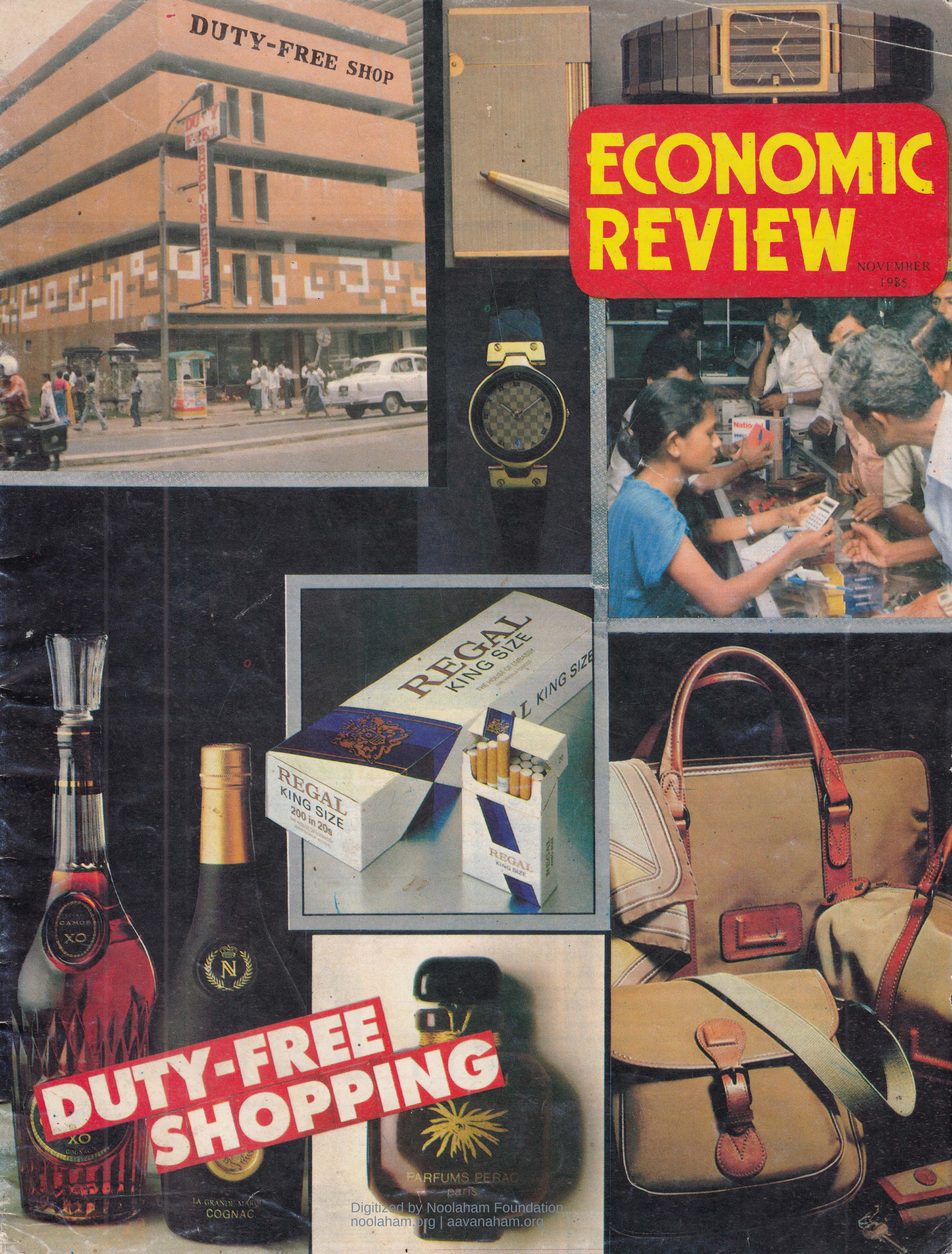
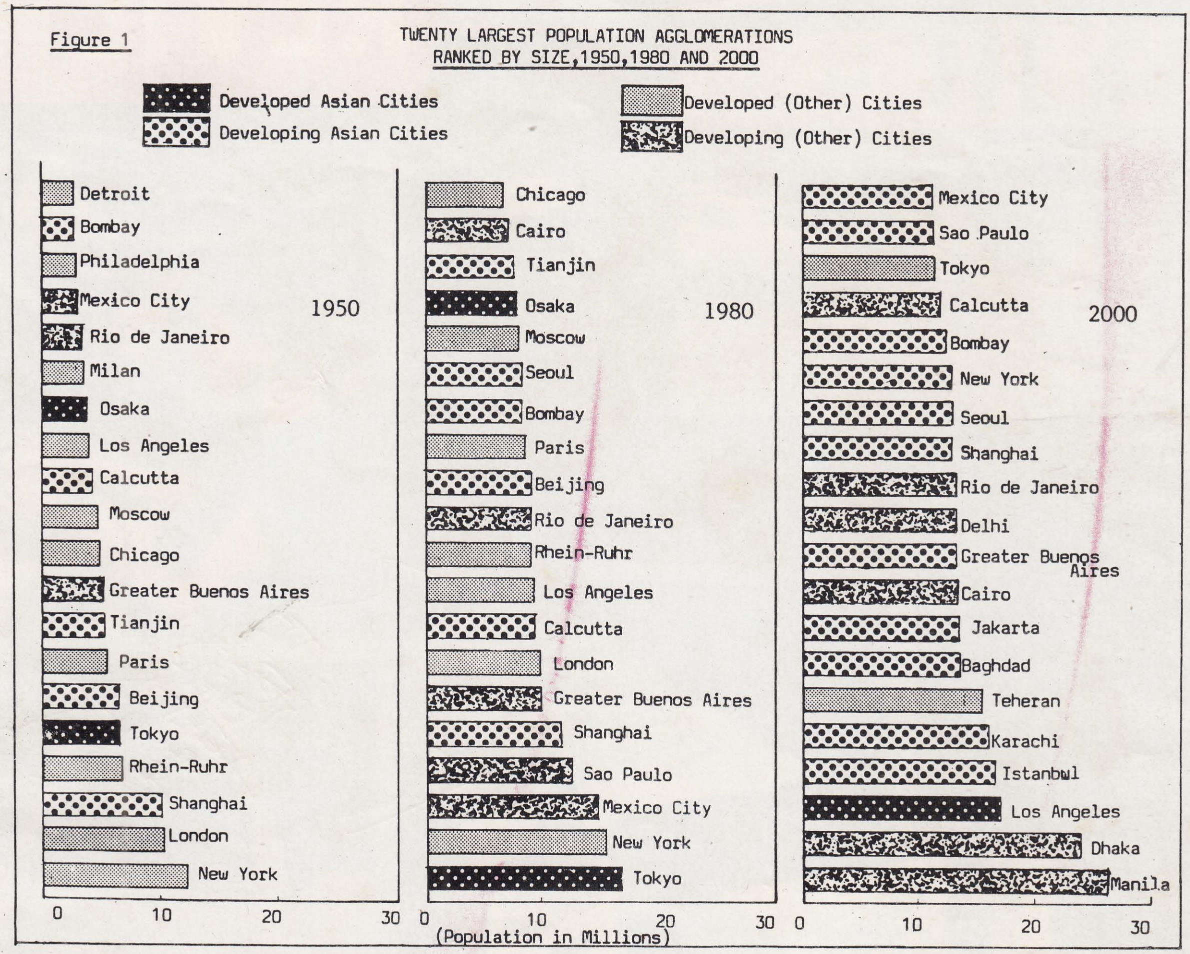
ECONOMIC REVIEW

NOVEMBER 1985



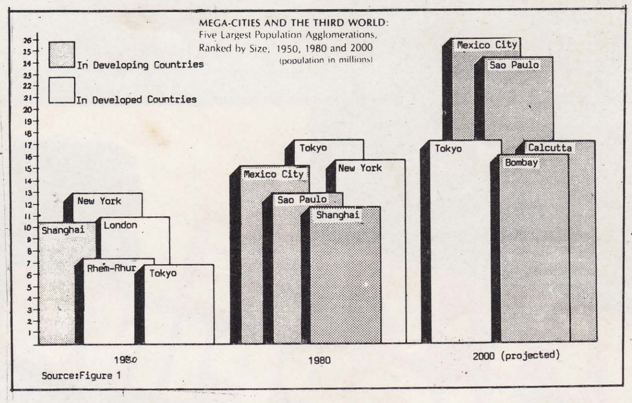
PROJECTED POPULATION SHIFTS FROM DEVELOPED TO DEVELOPING WORLD



Based on data from United Nations,Department of International Economic and Social Affairs,
Concise Report on the World Population Situation in 1983

PROJECTED POPULATION SHIFTS FROM DEVELOPED TO DEVELOPING WORLD

These UN population projections reveal clearly the dramatic shift in numbers from the developed to the developing world. Significant for Sri Lanka is that by the year 2000 three of the world's largest population agglomerations will be based in neighbouring India; while two others will be located in Pakistan and Bangladesh. According to these projections India's population will overtake that of China by about 2025; and the populaton of Nigeria, Indonesia, Bangladesh and Pakistan together will surpass those of the United States and Soviet Union combined.



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COLUMNS

SPECIAL REPORT

FEATURES

THE ECONOMIC REVIEW is intended to promote knowledge of and interest in the economy and economic development process by a many sided presentation of views & reportage,facts and debate.

THE ECONOMIC REVIEW is a community service project of the People's Bank. Its contents, however, are the result of editorial considerations only and do not necessarily reflect Bank policies or the official viewpoint. Signed feature articles also are the personal views of the authors and do not represent the institutions to which they are attached. Similar contributions as well as comments and viewpoints are welcome.

THE ECONOMIC REVIEW is published monthly and is available both on subscription and on direct sale.

NEXT ISSUE

* The Budget 1986 - A discussion of the economic rationale behind the budget; its impact on revenue, expenditure trends and socio-economic implications
* An analysis of the slackening growth trends in the Newly Industrialised Countries
* Socio-economic problems in Sri Lanka's major irrigation schemes
* Paddy production picks up with Maha harvest

COVER DESIGN

Palitha Kannangara

DIARY OF EVENTS

Nov

1 The cost of living figure for October 1985 was 550.0 the Department of Census and Statistics announced. In September it was 547.5.

2 Air Lanka's duty free sales had become a good profit earner for the company and won an award as the number one inflight tax free operator of the year, the airline announced. The 'Frontier' magazine listed Air Lanka with two charter operators, Britania Airways and Monarch Airlines, for the inflight tax free Operator of the Year award for 1985.

3 The draft estimate of Revenue and Expenditure of the Government for the financial year 1986, presented in Parliament, showed a total Expenditure of Rs 67,000 million and a total listed Revenue of Rs 37,256 million. Taxes on production and expenditure is the largest item of revenue (67%); and the vote for Public Debt expenses is the highest item of expenditure (24%).

8 The Development Secretaries Conference has recommended that seven government owned corporations and business undertakings that are continuously losing money and "beyond rehabilitation", should be closed down or offered for sale, stated a press item. These ventures are the Government Owned Business Undertakings of Shaw Industries and Vijaya Tiles, the Fertilizer Manufacturing Corporation, Stage 11 of the Steel Corporation, the FisheriesCorporation, the Government Owned Business Undertaking of the CEYNOR Development Foundation, and CEATO(a public owned industrial workshop).

11 Colombo's two rival stock exchanges, the Colombo Broker's Association and the Stock Brokers' Association (Guarantee) Limited, will operate a single trading floor beginning Monday, December 2, the promoters announced.

13 The Minister of Finance and Planning Mr Ronnie de Mel presented his 9th successive budget in Parliament.

14 The Customs Preventive Office in Colombo imposed a fine of Rs 2 lakhs on a Colombo businessman following the detection of 15,000 wrist watches in the false bottom of a package containing furniture which arrived from Singapore at Katunayake.

15 The Sri Lanka Tea Board announced that the country's tea production for October 1985 was 15,703,069 kg as compared with 14,943,753 kg for the same month in the preceding year; and a total production of 178,151,057 kg was recorded upto October this year, as against 172,254,165 kg for the corresponding period in 1984.

19 The Asian Development Bank approved a concessional loan of SDR 20.698 million (equivalent to $ 22 million) and a technical assistance grant to Sri Lanka for a trunk roads improvement project, designed to arrest the process of pavement deterioration and improve the present surface conditions of two important trunk roads (305 km) located mainly in the central dry zone of the country; the ADB said. The project roads are major traffic arteries connecting the towns of Ambepussa in the south-west with Trincomalee in the north-west and, likewise, Matale in the south with Anuradhapura in the north.

20 The Minister of Local Government Housing and Construction obtained Cabinet approval to exempt the Sri Lanka Cement Corporation from payment of Business Turnover Tax from 1.1.1984, the date on which similar exemption was given to Tokyo Cement Limited and Lanka Cement Limited. The Sri Lanka Cement Corporation was not in a position to pay the B.T.T. from Janaury 1984 due to increased costs of production and was not able to pass the B.T.T. to the consumer as the other competitors, Lanka Cement Ltd and Tokyo Cement Ltd, have been exempted from B.T.T.

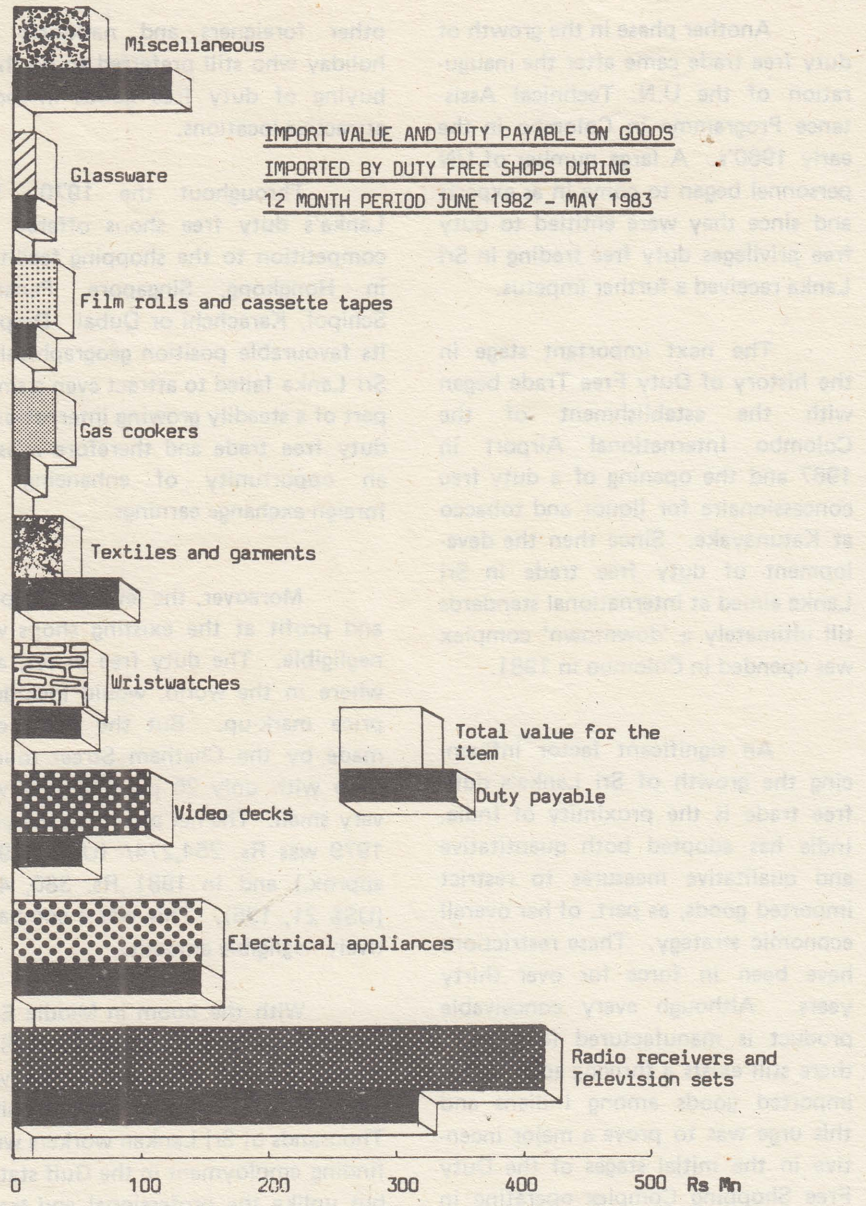
21 Expressing his satisfaction regarding the progress achieved by Sri Lanka with the assistance so far extended by the Asian Developemnt Bank, the President of the ADB has recommended a $ 20 million soft loan for a Development Financing Project, stated a press announcement. This project will provide foreign exchange resources to the Development Finance Corporation (DFCC) and the National Development Bank (NDB) to finance private sector industrial development projects in Sri Lanka.

22 The Supreme Court refused an application, on behalf of the senior customs officers concerned, for special leave to appeal against an order of the Court of Appeal in the current Rs 28 million currency and gem smuggling case.

Bus importers will get concessionary credit from the People's Bank in a move aimed at encouraging the private sector and improving the country's passenger transport system the Minister of Transport announced. Under the credit scheme, bus operators will have to pay 15 percent of the vehicle's CIF value down and the balance in four years. The Bank will finance the importing of new buses with more than 25 seats. The country needed about 500 new buses for a month of which about 100 were to replace old ones. The private sector operated about 12,000 to 18,000 buses a day as agaisnt the CTB's 6,000.

25 Customs seized four boats outside the Colombo harbour with a cargo of sarees worth about Rs 8 million and the boats, the contraband and eight men were taken into custody. The goods had been unloaded from a foreign vessel, official sources stated.

Completion of work on a final stage of the Randenigala dam of the Mahaweli Project, providing a 485 meters long dam, was marked by an official ceremony. The Randenigala Project which would irrigate one million acres is scheduled to be commissioned in June next year and would add 122 MW of power to the national grid. This increment will bring about power sufficiency until 1995. The West German Government which is financing this project will also finance Rantambe project, due to be launched in February next year.



DUTY FREE SHOPPING

The policy of import substitution, introduced in the early 1960's and enforced more rigidly in the early 1970's was found to have failed in many respects by the time the new governmet assumed power in 1977. A fundamental cause for failure of this policy is seen in the fact that Sri Lanka is geographically a small country, with a narrow spread of indigenous raw materials and therefore the type of development where most of the manufactured goods required are produced locally was not a practicable goal.

If the country was to advance economically, beyond a subsistence level, it was felt that Sri Lanka had to move aggressively into the fields of imports and exports. The first budget of the government in November 1977, emphasised that in order to revive the economy the output from the agricultural, industrial and trade sectors must be increased; and with a view to achieving this objective it was decided to abolish import controls and liberalise trade and exchange payments. The motive behind these 'decontrol' measures was to shift emphasis in the economy towards a greater reliance on "market forces", and enable the country's production structure to gain the most from its comparative advantage. An essential facet of this 'open' economic policy was industrialization with an export bias, together with the concept of free trade, free ports and export processing zones. Duty free trading was naturally an essential part of this programme.

The concept of 'Duty Free Shopping' or Tax Free Trade was not unknown to Sri Lanka before the existing Duty Free Shopping Complex in Colombo was opened in October 1981. There were earlier attempts at Duty Free Trading such as the Airport shop at Katunayake, started in 1972 by the Orient Co. (Ceylon) Ltd., (subsidiary of the state owned BCC Ltd.), and later one at Chatham Street, Fort, operated by the Ceylon Hotels Corporation. The latter dealt in goods sold not fully duty free, but at a 25 percent rate of duty; while the airport shop was entirely duty free. Both were intended to attract tourists, transit passengers and other visiting foreigners and nationals visiting Sri Lanka on holidav.

The guiding principle behind duty free shopping is that international travellers are justified in purchasing goods without the added burden of import duties, that go into the buying price of consumer goods within countries. Import duties are levied for two basic reasons, firstly they are widely accepted as one way of raising revenue for the government and secondly they serve to protect industries in the home country.

The extent to which duties are applied to imports depends on the respective government's policies towards free trade. There is no uniformity in the enforcement of duties on imports. One country levies little or no duties on its imports whilst another would operate a comparatively high and a wide range of import duties. The well known example of no import duty countriesare Singapore and Hongkong, while many of the developing countries in this region, such as India, Pakistan and Bangladesh have wide ranging duty rates.

The bulk of international Duty Free Shopping does not take place in the country, but at its port of entry, unlike Colombo which has a 'downtown' duty free complex like the duty free shops in Hongkong or Singapore. Genrally duty free shopping is permitted where the normal trade laws of a country are not applicable, such as at airports, in aircrafts, on ships and at country boundaries and the Duty Free Trade is very big business worldwide. It is estiamted to have amounted to more than US$ 5 billion in 1984.

The history of Duty Free Trade in Sri Lanka goes back to the colonial times where it was restricted to trade in ship stores only. In this trade Sri Lanka was not able to derive much benefit, as most of the ships belonged to foreign companies which were stocked in the Singapore or HongKong harbours. After granting of Dominion Status the demand for duty free goods increased marginally with the increasing establishment of High Commissions and Embassies in the country. However, the increase was not remarkable for the first 10 years of our post-independent era as most of the embassies were accredited to Sri Lanka from India.

In the late fifties and early sixties when the Socialist bloc countries opened embassies in Sri Lanka, the country's duty free trade received a further boost. The shipsstores duty free trade was revived once when the Suez Canal was closed in 1956; since vessels had to come round a long way via the Cape they had to be stocked up in Colombo.

Another phase in the growth of duty free trade came after the inauguration of the U.N. Technical Assistance Programme in Colombo in the early 1960's. A large number of UN personnel began to come in as experts and since they were entitled to duty free privileges duty free trading in Sri Lanka received a further impetus.

The next important stage in the history of Duty Free Trade began with the establishment of the Colombo International Airport in 1967 and the opening of a duty free concessionaire for liquor and tobacco at Katunayake. Since then the development of duty free trade in Sri Lanka aimed at international standards till ultimately a 'downtown' complex was opended in Colombo in 1981.

An significant factor influencing the growth of Sri Lanka's duty free trade is the proximity of India. India has adopted both quantitative and qualitative measures to restrict imported goods, as part, of her overall economic strategy. These restrictions have been in force for over thirty years. Although every conceivable product is manufactured in India, there still exists a thriving appetite for imported goods among Indians and this urge was to prove a major incentive in the initial stages of the Duty Free Shopping Complex operating in Colombo in the 1980's.

As indicated earlier apart from the airport Duty Free Shop, another shop although not entirely duty free, but with a standard duty of 25 percent for all goods purchased with foreign currency, was opened in the 1970's at Chatham Street, Fort, and run by the Hotels Corporation, mainly for the benefit of tourists. There was also the airport shop which was entirely duty free and primarily intended to attract tourists, foreigners, transit passengers and nationals on holiday. But, these shops made no significant impact on the potential custom from tourists and other foreigners and nationals on holiday who still preferred to do their buying of duty free goods in more attractive locations.

Throughout the 1970's Sri Lanka's duty free shops offered no competition to the shopping facilities in Hongkong, Singapore, Penang, Schipol, Karachchi or Dubai. Despite its favourable position geographically, Sri Lanka failed to attract even a small part of a steadily growing international duty free trade and therefore missed an opportunity of enhancing its foreign exchange earnings.

Moreover, the level of turnover and profit at the existing shops was negligible. The duty free prices, any where in the world, would include a price mark-up. But the net profit made by the Chatham Street tourist shop with only 25 percent duty was very small. The net profit for the year 1979 was Rs. 254,274/- (US$ 16,950 approx.) and in 1981 Rs. 380, 435 (US$ 21, 135). This was a comparatively negligible amount.

With the boom in Middle East employment at the start of the 1980's it was realised that Sri Lanka was missing still another opportunity. Thousands of Sri Lankan workers were finding employment in the Gulf states, but unlike the professional and traditional upper income types who went abroad earlier, these workers were most enthusiastic about their purchases of consumer durables. They used most of the earnings they had saved to purchase radios, cassette recorders and other electrical goods but they by-passed Colombo and generally went on to Singapore to get the goods of their choice.

Opening of new Colombo DFS Complex

Apart from the need to attract more of the earnings of migrant workers back to Sri Lanka there were many other reasons advanced for giving the country's duty free shopping system a new lease of life. The increasing tourist traffic from neighbouring countries, India particularly, and the enhanced exchange quotas given to these tourists presented Sri Lanka with another opportunity for more foreign exchange earnings. With several big foreign funded projects being mooted there was also a fast growing expatriate community in the island; while more Sri Lankans who were living abroad were availing of the relaxed travel regulations to visit the country of their birth. Furthermore, it was found that wages and other costs in the Asian countries where successful duty free shops were located , were moving up faster than those in Sri Lanka and there were possibilities for attracting part of their custom using our comparative advantage of cheaper rentals and labour costs.

A strong case was made for setting up of a more sophisticated and competitive duty free shopping complex and the Ministry of Trade and Shipping was granted government approval to 'go ahead' with it. It was decided that space of about 35,000 sq. ft was needed for the complex. The airport at Katunayake could not provide it and the choice fell on the 5 floor building at Kollupitiya. On October 30, 1981 the Duty Free Shopping Complex was opened at this central location in Colombo.

A duty free shopping scheme had been under consideration since the mid nineteen seventies, yet no action was taken because the government at that time was not decided on the issue and also because of the restricted economic policies towards imports. There were two suggestions on where to start this venture. The first suggestion was to start it in Colombo and the second was to open four Duty Free shops in four tourist resorts; but operating such a scheme along with the numerous import controls under the existing policy was considered a major problem.

With a change of government in 1977, however, overall policy changes and measures were adopted to liberalise trade in accordance with the new economic policy. As a first step the existing controls and regulations were completely abolished. Any person was now free to import upto a certain value under Open General License. Another step in this direction was the establishing of the free trade zone at Katunayake. The opening of the 'Duty Free Shopping Complex' may be regarded as a further step in these liberalised economic policies of the government.

The foremost objective of this new DFSC was, in the words of the then Minister of Trade, "to impart a consumer satisfaction, give an impetus to trade and be of immense service to the country's economy by earning a rich slice of foreign exchange. The new venture is the first full blooded move in the country for Duty Free Shopping".

The Minister made a more eloquent plea for the complex on another occasion when he said "Anywhere in the world it stands as a brave symbol of free open market enterprise where persons travelling abroad with foreign exchange could buy what they wished with their foreign currency, at dutyless prices. The idea of opening this complex on local soil was to divert foreign exchange that would otherwise have been spent in Singapore or Male or elsewhere by returning expatriates to their own homeland".

Something Different

"At the cheapest prices the widest range of products" was the objective of Ministry of Trade at the time of opening this venture. In keeping with this objective the infra-structure for the shopping complex was provided by the government on a no profit no loss basis. The intention was to ensure that the overhead costs of the allottees were kept at a minimum.

The specific objectives of the Complex and organisational details were spelled out as follows in a statement by the Ministry's Additional Secretary on the occasion of its opening.

"Our objective is to attract duty free shoppers by offering at the cheapest prices the widest range of products saleable to duty free shoppers.

To achieve the objective, we had at the outset to ensure that all reputed products will be available for sale at the cheapest prices. Hence, it was decided to allocate shops to sole agents or sole distributors of reputed products on the basis that it is they who will be in a position to offer the most competitive prices since they as sole agents and distributors get the best prices from suppliers.

The infra-structure for the shopping complex will be offered by the government on a no profit/no loss basis to ensure that overhead costs to the allottees are at the lowest level.

Arrangements have been made to permit the facility of importing on special concessionary credit terms from suppliers, goods to be sold in the duty free shops for foreign exchange.

Customs and Exchange Control formalities have been kept to a minimum consistent with over-all control to ensure that the goods imported for the duty free shopping complex will be sold only against foreign exchange and only to categories entitled to duty free privileges.

Goods in commercial quantity will normally not be handed over the counter to purchasers but will be delivered at the air port/ sea port for direct re-export.

The customs department will exercise checks at the air port/ sea port to ensure that goods sold for re-export are re-exported by the purchasers. A custom office has been established at the duty free shopping complex itself to expedite formalities and exercise supervision.

In the case of "incoming residents" the lowest duty free entitlement has been doubled from Rs. 1,000/- to Rs. 2,000/- for purchase from the Sri Lanka Duty Free Shopping Complex. This would mean that if an "incoming resident" makes purchases abroad he will have an entitlement of Rs. 1,000/- while if he makes his purchases from the Sri Lanka Duty Free Complex his entitlement will be Rs.2,000/-.

By selecting a large number of allotees to run these shops who are agents for different brands, a competitive situation will be created resulting in the consumer having a wide range of goods from which to select at different prices. This will also ensure that allotees will have to charge the lowest margins and depend on "turn over" for profits.

A sustained advertising campaign will be launched both here and abroad not only to draw personal shoppers to the duty-free shopping complex but also to attract "mail-order business" in which there is vast potential. This is the beginning".

A large number of shop allottees were permitted to sell similar products with the competition among each other to ensure the lowest possible price. In the meantime an intensive publicity campaign was launched both in Sri Lanka and abroad to draw the attention of duty free shoppers. There was also a plan to start a "mail-order business" for duty free goods but this proposal has not been implemented yet.

Overview

The Duty Free Shopping Complex could be identified as a pioneering venture in collaboration, between the government and private sector. Thus. while the government provides the infrastructure facilities for the Complex the private sector runs the shops within it.

After the complex was opened in 1981, it became quite popular among incoming Sri Lankans as well as foreigners. The prices of goods offered, less duty, were very attractive and well behind open market prices; and in some instances the prices were less than prices in Singapore. Shops were kept open from 9 a.m. to 7 p.m. for 6 days of the week and customers wishing to buy goods, could buy them over the counter for foreign exchange without any difficulty. At the outset there were no gate restrictions or personnel restrictions and anybody who wished to go in could do so, whether they had any exchange entitlement or not. Large numbers of those who earlier travelled to Singapore or Bangkok were now attracted by this new venture located in a 4 storeyed building at Kollupitiya.

The regulations covering imports, purchases and paymets (See Box) were laid down very clearly and were amended occasionally to suit changing situations. Figures from the records of the shops in the Complex show that at the beginning of 1983 the number of persons who entered the DFSC between January and April 1983 average 31,000 a month. The average monthly sales during this same period was Rs. 132.6 million with some individual shops recording about US$ 70,000 for a days collection.

Among the goods available are a variety of television sets of sizes varying from 12 to 26 inches and costing upto about US$ 600, video cassette decks, tape recorders, mechanical grinders, fans, cameras, air conditioners, electric shavers, calculators, musical instruments such as guitars, pianos and organs; fridges, washing machines, carpets, perfumes, textiles and garments, elegant over-coats and blankets from Kashmir, soft toys and games, different kinds of Whisky and other liquors and various makes of foreign cigarettes and tobacco, plastic equipment and kitchen utensils.

But this streamlined venture did not continue to run in accordance with the ideals of its founders for more than a few months. No sooner had its functioning been sized up than the "cloak and dagger men" were observed moving into action.

Smuggling or the illicit trade in goods, bullion and currency has been one of the less salutory features of trade among many business communities. Smuggling has been long known in Sri Lanka too, though in recent decades it appears to have attracted much attention and gained in proportion. Many of these elements have exerted influence in the local business community too and when the suggestion for the complex at Kollupitiya first came up it was elements such as this who opposed it.

But ultimately when the venture began functioning, disregarding their protests, some of these very same elements decided to get into the duty free shop business following the principle that 'If you cannot avoid getting beaten by them you better join them'.

It is elements such as these who were quick to look for the loopholes and exploit them to their own advantage. Duty Free goods,meant to be traded for foreign exchange, soon found their way into the open market and could be bought in local currency at a 'price'.

Action had to be taken and three shop keepers at the D.F.S.C. were seriously warned by the Ministry of Trade for the first time in March 1982 (after three months of the opening) for intentionally bending the rules under which they were allowed to do business within the Complex. The three shops were all big names in business, with international connections.

But that was only the beginning. By 1982 it was common knowledge that there was an organised illicit trafficking of goods by groups of racketeers who moved at will in and out of the Complex. There were reports that smugglers who carried on their activities between Sri Lanka and Singapore turned their attention to these shops and met with hardly any obstacles. It was not difficult for a person to purchase anything from the DFSC via these racketeers. They even formally setup shop, keeping their assistants on the main road opposite the DFSC with a price list and a calculator to give bargain hunters possible prices and collect their orders, while they were busy collecting black money and making purchases inside.

Such was the situation at this time that it was officially confirmed in a reply given by an assistant liasion officer (an employee of the Complex administration) to a writer who made certain allegations against the Duty Free Shop administration. This reply appeared in the Daily News of March 26, 1982.

The following charges were made by a shopper against the restrictions introduced in 1982 on those wishing to enter the DFSC. "Nowhere, in the world is a customer asked to pay to enter a shop; nowhere in the world is a customer not permitted to take his wife into the shop". The liaison officers reply was as follows:

"To both these allegations I would like to ask him one question. If he was aware of any duty free shop in the world where racketeers dominated, thuggery and corruption was at its highest level, a place which within 3-4 months had become the distribution point of black money and forged currency, an international show place which had ultimately got labelled a "racketeers" paradise. We had a place like this in Sri Lanka till 1.3.1982". (before enforcement of new entry restrictions).

In an attempt to curb the activities and abuses of the "racketeers" (as they were called) the authorities brought in new measures to restrict entry into the DFSC by introducing an entrance fee of Rs. 20/- per person. It also restricted entrance only to passport holders. The exchange between the writer referred to above and the liaison officer of the DFSC came about following the introduction of these two new regulations.

Duty free traders commenting on these restriction state that there are no such curbs on movement of shoppers exercised in any other duty free centre in the world. They argue that the concept of duty free is nullified when a fee has to be paid by a customer to trade. However, the situation had so deteriorated that the authorities had no other way of shutting out the unnecessary crowd that crept into this place and helped, the 'racketeers' in their activities.

The second restriction of disallowing any person other than a passport allowance holder to enter the complex caused much difficulty for genuine customers. As a result of this regulation a husband attempting to use his hard earned money from abroad could not take his wife with him to these shops to choose her desired utilities for her household. Normally, such purchasing is done by the wife who enjoys selecting items for the household, as one form of relief from her routine household work. But with this restriction a husband loses the chance of having his wife and children accompany him on his shopping spree.

Yet before these restrictions were introduced the corridors of the five floors of the Kollupitiya DFSC were packed with non-customer traffic, leaving hardly any room for genuine customers to move on. The two new restrictions helped to relieve such a situation.

Cost and Benefits of the DFSC

A government levies duties on imports for two basic reasons. Firstly, they are widely accepted as the most convenient means of raising revenue for the government, and secondly, they offer derserving or underserving protection to industries in the home country.

The extent to which a government would go in imposing duties on imports depends on its belief in free trade by that government. The fastest moving goods in the duty free shops are normally those whose duty rates are high and from which government received high revenues. The government therefore took a calculated risk in the belief that the revenue lost from import duties would be covered by the oreign exchange earnings from the duty free shops. Every time a Sri Lankan or foreign consumer purchases a duty free good from within the DFSC or outside there is a loss to revenue. This revenue is the import duty that the consumer would have paid had he made his purchase from the open market.

Most of the items imported by shops in the duty free complex are subject to duties of hundred perent or more if they come in through the open market. Estimates have been based on the assumption that at least 75 percent of the value had to come into government coffers as duties on each item if imported duties were charged. The value of imports into the duty free shopping complex for the year 1984 was Rs. 829 million and it may be assumed that if at least 75 percent of these goods were charged a duty about Rs. 642 million would have accured to government revenue.

(continued on page 10)

DFSC IMPORT, PURCHASE AND PAYMENT REGULATIONS

Imports

Duty Free shop holders will be permitted to import their requirements on 180 days D.A. Terms (Document and Acceptance) with Letters of Credit. However, where the exchange control so permits, D. A. Terms will be allowed without Letters of Credit. Such imports should be strictly for sales at the Duty Free Shops. The goods imported for D.F. Shops should be cleared on bonding entries only. If any person is found to default in complying with these conditions his D.A. Terms will be withdrawn. The shoppers can import only the listed items allowed by the Ministry of Trade. A Bank guarantee should be given for each item. Each shop gets a Bank guarantee for Rs 50,000/- for their shop and Rs 1,000,000/- for the bonded warehouse which is a concession given only to the Duty Free Shop owners.

The D.A. Terms mentioned above means that Sri Lanka's Duty Free Shop importers are allowed 180 days or 6 months credit from their imports. Therefore the foreign exchange to be paid to them can be saved here for that period which is a big gain in foreign exchange. The shop owners also can settle payment sometime after selling their imports.

Payment for Purchases

Only the following form of payment can be accepted for any purchases made at the Duty Free Shops.

1. Foreign Currency (Cash)
2. Travellers cheques
3. Cheques drawn on non-resident foreign currency accounts and External Accounts.
4. Credit Cards specified by the controller of exchange.

No other personal cheques are accepted. Certain currencies precribed by the Controller of Exchange are not accepted and these are notified from time to time.

Each shop is given a Foreign Currency Imprest by the Controller of Exchange to enable them to return balance money to the customer for their payments on purchasing. A monthly statement has to be furnished to the Controller of Exchange every month on their transactions.

Requirements for Sales for the different categories of customers

1. All foreign passport holders not claiming Duty Free Concessions under any other category of personnel listed here.
2. Diplomatic personnel.
3. Foreign personnel employed in development projects in Sri Lanka.
4. Incoming residents (Sri Lanka passport holders).
4. Foregners with resident visas.
5. Incoming residents (Sri Lanka passport holders).

There were inquiries from operators in some countries in South and East Asia who desired to run shops in the complex; but it was decided not to permit foreigners operating shops in the DFSC.

Entitled Categories of Personnel

Tourists

Sales of non cosumable items to tourists at the DFSC are allowed only on the basis that those items will be taken with them when they leave the country. These items can be used during their stay in the country. The sales of such items are expected to be noted in their passports.

There are no quantitative or other restrictions regarding items sold for delivery at the airport.

Diplomatic Personnel

Diplomatic personnel are allowed to buy anything without restrictions, if they have got the item-wise clearance crertificate from the Ministry of Foreign Affairs. The customs officers in the complex maintain a record of diplomatic personnel buying, to check any malpractices occuring.

Foreign Personnel Employed in Projects

If these persons possess residence visas for six months and over they are treated similar to incoming Sri Lanka residents and are entitled to a maximum baggage concessions granted to incoming residents.

If such persons desire to purchase goods to be taken out with them when they leave at the end of their stay, such sales are treated as sales to tourists.

Incoming Residents with Sri Lankan Passports

All incoming residents with Sri Lankan passports need to get a Duty Free Baggage allowance endorsed on their passports by the Customs Department. Deductions are made for all baggage previously cleared against their allowances and only the net amount entitled could be used to buy in the DFSC.

Sales to Sri Lanka Passport Holders on a Temporary Visit

Such persons who have no Duty Free allowances can purchase at the Complex, but the goods are delivered to them at only the airport, at the time of departure. They are however, entitled to the consumable items applicable to tourists, under the approval of the customs.

Sales to Foreigners with Resident Visas for 6 months and over

Foreigners residing for employment in projects here are permitted a Duty Free Baggage allowace of Rs 20,000/- each for two adult members of a family and an endorsement about the goods bought by them is made in their passport. If they have already used a part of their duty free baggage allowance at the airport, then only the balance can be used for DFSC buying.

Limitation of Bagage Allowances of DFSC

A. Baggage of persons returning to Sri Lanka after a period of stay abroad of less than ninety (90) days is entitled upto Rs.2,500/- If he does not bring anything on this allowance he is entitled to buy upto Rs 3,750/- from the Colombo DFSC.

b. After a period of stay abroad of (90) days and over but less than (365) three hundred and sixty five days his entitlement goes upto the value of Rs 12,500/- for shopping in the DFSC.

C. After a period of three hundred and sixty five days and over, he is entitled to buy goods upto a value of Rs 25,000/-

Earlier the baggage allowance authorised for a Sri Lankan who travelled abroad and returned to the island staying less than 90 days was Rs 1,000/-, and more than 90 days and less than 180 days Rs 5,000/-. After a period of stay abroad of 180 to 365 days Rs 10,000/-, 365 days to 730 days Rs 15,000/-, and over 730 days Rs 20,000/-. But since then the authorised allowances were increased to these levels to offer more inducements to buy from the DFSC.

At the early stages of the DFSC goods could be purchased from the DFSC for travellers cheques and foreign currencies such as US. Dollars and Sterling Pounds by both Sri Lankans as well as the foreigners; but no sooner some shop owners and other unscrupulous elements started using forged 'black' foreign currencies to obtain duty free goods from the shops and sell them outside at high profits, the Government introduced new regulations specifying that only travellers cheques should be accepted from Sri Lanka.

This requirement was introduced from March 1982, only 5 months after the opening of the DFSC. An entrance fee of Rs 20/- was introduced for each customer who wished to enter the premises. Foreign tourists however, were allowed to make their payments using foreign currencies.

Earlier the free baggage allowances for duty free shopping authorised for Sri Lankans was valid 180 days; but this was reduced to 90 days by the Minister of Finance in his Budget Speech for 1985.

Quantity Restrictions

The list given below indicates the limitations in the number of each item that could be purchased by a single customer. As mentioned before a tourist can buy only the consumable items - liquor, cigarettes, cigars and tobacco, perfume and chocolate etc. come under this category. Any other durable item bought by a tourist, must be taken out of the country when he leaves. If not, he has to pay the normal import duty imposed on that particular item.

LIST OF QUANTITIES TO BE SOLD TO EACH SRI LANKAN PASSPORT HOLDER

1.	Electrical items or electronic items	1
2.	Electrical fans, table, ceiling or pedestal	1
3.	Cassette tapes	6
4.	Video Cassette tapes	3
5.	Pocket radio	1
6.	T.V.	1
7.	Calculator	1
8.	Gas Cooker	1
9.	Pressure Cooker	1
10.	Rice Cooker	1
11.	Dinner Sets	3
12.	Glass Wine Set	3
13.	Cutlery Sets (each of knives, spoons, forks)	6 (1 set)
14.	Tea set	3
15.	Fountain Pens	3
16.	Ball Point Pens	3
17.	Wall Clocks	1
18.	Clock (Desk or Alarm)	1
19.	Camera	1
20.	Toys	6
21.	Umbrellas	3
22.	Garmetns	3 pices
23.	Blankets	6
24.	Razor Blazers	6
25.	Film Rolls	1
26.	Brief Cases	1
27.	Suit Cases	3
28.	Wrist Watches	7
29.	Toilet Preperations	3
30.	Toilet Soap	3
31.	Toilet Powder	2
32.	Torches	2
33.	Musical Instruments	1
34.	Key rings	3
35.	Air pots	1
36.	Typewriter	1
37.	Photo Album	3
38.	Telephone	1
39.	Footwear	3
40.	Records	3
41.	Weighing Scales	1
42.	Vacuum Flasks	1
43.	Spectacle frames and lenses	3
44.	Smoking Pipes	3
45.	Shaving Sets (Electric)	1
46.	Shaving sets (Non- electric)	2
47.	Hand Bags	3
48.	Cigarettes	200 or 50

49. 2 regular size bottles of wine and one and a half litres of spirits. Beer Cans (Half a case)

50. Toilet water not exceeding a quarter litre and a small quantity of purtume

* All items unlisted should be sold at the rate of 1 unit per customer. All items sold in excess of these quantities should be delivered at the point of embarkation only.

LOCAL INDUSTRY AFFECTED

The Chairman of Siedles T.V. Industry Limited, the local firm attempting to compete with the imported product and build up an indigeneous T.V.hardware Industry, has drawn pointed attention to the availability of duty free imported sets on the local market and the threat such imports pose to local industry. The 1984 restictions imposed at the D.F.S.C. appear to have afforded some relief to the local industrialists. To quote the Siedles Chairman-

"One of the biggest problems we faced earlier was the unfair competition" we had from imported TV sets which found their way to the open market at more or less duty-free prices. Needless to say, this affected the sales, particularly of our 20" model which was introduced to the market at the end of 1983. The bulk of the stocks we had on our hands at the commencement of the year represented this model.

In this context, I must say that the introduction of stricter controls by the authorities at the Duty Free Shopping Complex towards the end of 1984 was an obvious boon to local industry. The changed circumstances contributed to an appreciable upturn in our sales.

PAYABLE DUTIES (ESTIMATED) 1982-83

(Summary of values and payable duty on goods imported by duty free shops for period of one Year from 01.06.82 to 31.05.83)

(Rs.'000)	Total Value	Duty Payable
Liquor	13,960	26,111
Cigarettes & Tobacco	6,650	33,252
Wrist Watches, Wall Clocks etc.	56,673	53,107
Radio Receivers and Television Sets	414,457	317,678
Video Decks	106,126	63,675
Electrical Appliances and Household Goods (Electric Cookers, Blenders, Refrigerators, Fans, etc.)	147,865	147,990
Gas Cookers	32,355	11,324
Glassware	16,236	16,236
Musical Instruments	4,195	2,517
Textiles & Garments	38,084	81,826
Calculators & Adding Machines	12,919	7,692
Camera & Photographic Equipment	10,177	6,330
Film Rolls & Cassette Tapes	31,512	18,374
Perfumes	8,475	42,374
Confectionery	894	894
Jewellery (Imitation)	197	197
Cigarette lighters, Thermos Flasks & Jugs,etc.)	2,877	1,814
Total	901,652	831,390

The table above indicates tne official value of Duty Free imports for the Colombo DFSC during the 12 months from 01.06.1982 to 31.05.1983 and the duty payable on these imports during this year. According to these statistics Rs. 901.7 million worth of goods had been imported. The highest value for items, worth Rs. 414.5 million were recorded for the Radio Receivers and Television sets sector, with second largest imports worth Rs. 106.1 million being recorded in the Electrical Appliances and Household Goods sector. Wrist Watches and other clocks, as well as the Textiles and Garments recorded considerably high imports compared to the other sectors.

The loss to Government Revenue from duty free perfume imports was as much as Rs. 42.4 million. This was the item where duty payable was the highest for any single item.

The total duty payable which did not accure to Governmet Revenue was Rs. 831.4 million. This figure was more than the total government expenditure of the Hospital and Health Services for 1985 which amounted to Rs. 806 million, according to the Government's Estiamtes of Revenue and Expenditure for 1986.

On the other hand it can be argued that when comparing the value of imports into the duty free shopping complex, with the sales there has been a considerable profit and gain in foreign exchange to the country. The following figures will illustrate this position more clearly.

The total sales made by the DFSC in the year 1984 was Rs.1,048 million. These imports and sales generated a profit of Rs. 426 million (Sales value less Import value) which amounted to a 51.4 percent in foreign exchange.

It is necessary, however, to consider whether all the transactions that generated such profits were "genuine". If the buyers were "genuine" and transactions within the law the country's economy would have stood to gain, but if the reports of all the malpractices purported to have taken place in the DFSC were correct the benefits to the economy would have been minimised. ("Genuine" buyers are those foreign nationals and incoming residents who purchase goods with their own exchange generally for their own use and not those who purchase with illegal money and do so for purposes of trade.)

The possibilities of a large number of illegal transactions taking place seems to be evident in an analysis of the sales figures of some Duty Free Shops in the DFSC during 1984. These figures give the position during two different periods namely:

1. When sales and deliveries over the counter were taking place.
2. The 4 months after August 1984 when delivery of purchased items was only from the Port premises.

Table 2 Value of Sales of Some Shops in the DFSC in 1984 (Rs '000)

	Shop A	Shop B	Shop C	Shop D	Shop E
January	3,356	3,338	3,326	1,246	3,992
February	3,905	3,327	2,817	995	3,245
March	2,364	2,219	2,627	1,024	1,655
April	2,932	3,715	2,549	1,017	1,787
May	2,507	2,563	3,201	1,175	2,426
June	2,225	1,853	2,741	686	4,065
July	1,496	1,860	3,010	713	2,691
August	769	916	2,460	479	1,305
September	36	396	249	76	125
October	203	1,467	2,199	359	1,038
November	1,275	748	2,180	297	441
December	441	457	1,421	292	493

The DFSC sales have always been open transactions as in any other shop where goods may be purchased. Upto August 1984 collection and delivery of purchased items was also as in the open market where customers could pay and collect their items over the counter. Abuses in this 'open system' led to a change in the procedures.

The malpractices within the whole system kept increasing since the DFSC began operations in October 1981. As generally happens, certain restrictions became necessary after a few months of DFSC operations; the restrictions being the need to produce a passport at entry point; passport holders to have their exchange entitlements marked on the passport; and charging of a fee of Rs 20/- for entry. Those abusing the free and open entry system were quick to find means of getting round these restrictions. It was necessary for such elements to make their way into the DFSC each day; as their illegal transactions, in connivance with some shop owners and even officials, had now become an organised business.

When public pressure against such abuses grew too strong there was an official clamp down and the Ministry of Trade and Department of Customs warned some of the shop owners and even ordered closure of some shops owing to their illegal activities. But steps to eradicate completely the malpractices taking place could have seriously affected business within the Complex and therefore the authorities faced the two extreme situations of either closing down the complex or moving it out of 'town' into the airport premises; or on the other hand allowing the complex to stand where it is and turning a blind eye to the malpractices. The in-between position however was adopted, which was to introduce further restrictions and these inevitably have led to much controversy. From August 1984 the authorities introduced three new restrictions:

DUTY FREE TRADERS PROTEST-THREE CHANGES AFFECTING BUSINESS

Three changes in procedures were introduced at the DFSC from 1984 with a view to reducing malpractices and tightening up controls. These include (a) delivery and collection of goods purchased at the DFSC from the customs premises in the Port, (b) bringing the bonded warehouses under dual control, (c) stopping re-bonding. These three new regulations irked the DFSC traders who protested. Reasons for their protests are given below.

"In the case of the first change, the main problem arising from the requirement that delivery can only be made at the T-2 Warehouse in the Customs premises is that several customers are not prepared to suffer the inconvenience of making this extra journey and going through the time consuming procedures and documentation necessitated thereby. Also, we have had several complaints from customers that the goods delivered to them are found to be damaged or some of the contents pilfered. The damage is caused in the process of loading, unloading and storing the goods for delivery at the Customs premises, and this usually happens with fragile items like glassware. The pilfering takes place with goods like packages of chocolates, cigars, cigarettes, beer and liquor. Furthermore, we have noted from the reaction of customers that they are reluctant to make purchases of expensive and delicate items like watches, cameras, jewellery, etc. when they are not able to take immediate delivery, but must await delivery elsewhere with the uncertainty of not knowing when and in what state it will be made.

The delivery of goods from the shops was stopped because the Customs Officers complained of the large number of touts and brokers who were both inside and outside the Complex, waiting to acquire the sold goods from those customers who purchased only to re-sell. But we note that these same persons have managed to gain admittance to the Customs premises with "passes" and they are even there with their vehicles to help customers transport their purchases of items such as fridges, TV receivers, air-conditioners, etc. It then raises the question whether it is reasonable to persist in a procedure which deters customers and reduces business.

The second change requiring dual control of the bonded warehouses leads to unnecessary delays by us having to wait for Tide-Waiters, sometimes resulting in the loss of sales. The cost of opening a warehouse is now Rs 100/- per visit. This makes it most uneconomical as several such trips are required due to the lack of storage space in the small area allocated for each shop.

The third change stopping re-bonding affects us thus. Prior to this stoppage, purchases were made by us by negotiation in respect of quantities in bulk such as container loads. This practice enabled us to obtain rock-bottom prices on certain items resulting in our shops being the cheapest duty free shops in the region, and this attracted several foreign buyers from neighbouring countries. We were able to help each other by re-bonding the goods we did not deal in and passing on the credit facility obtained when ordering on D.A. terms permitted by the Controller of Exchange. The stopping of re-bonding now prevents us negotiating for purchases in bulk quantities and thereby, our prices have increased, making us less competitive with the duty free shops of other countries in the region.

In addition to the adverse consequences of the above three changes introduced after the 'acid throwing' incident, we are also badly affected by the B.T.T. levied on our sales. The 10% turnover tax has resulted in our having to hold over our stocks as the duty on duty paid items for the local market has also been reduced. We find that some items we stock such as calculators are cheaper in the local market. Hence, we lose customers as even foreigners are aware of the local prices outside the Complex.

For the above reasons, we find ourselves now in a very grave financial situation. We were, as it is well known, carrying stocks costing several millions ordered in good faith and in the hope that we would be allowed to continue to trade on the terms and conditions operative when the Complex was established. These new restrictions have brought us to the point of not being able to finance our businesses and even the commercial banks appear to have lost faith in the economic viability of the Duty Free Scheme as presently operated since they refuse to extend any further assistance or facilities to us.

1. All goods sold from the Duty Free Shop to be delivered to the Customs at the Colombo Port premises and collected by shoppers only from there.

2. The bonded warehouse previously in the hands of shop owners were brought under the dual control of the Customs and shopowners.

3. Re-bonding was no longer permitted.

The Duty Free Traders Association maintained that these measures affected their business and gave their reasons in a strongly worded protest. (See Box).

An analysis of the sales statistics in the Table at right shows the heavy drop in sales after August 1984 in the shops within the Complex. A comparison of the sales from these 5 shops in the months of July and August shows that sales had dropped to 48.6%, 50.8% 84.2% and 51.5% respectively in the month of August. The figures also reveal that the drop continued for some shops after August. One view was that a part of the sales before August were not 'genuine' transactions, and the nearly 50 percent drop in sales were largely this type of transaction. The other view, however, is that the restrictions kept out shoppers. Apart from the inability of shoppers to go into the Complex freely, and restrictions on shop owners moving their goods as they wished from their bonded stores, other factors such as the drop in tourist traffic and a slower in-flow of the returning migrant workers have also contributed to the drop in sales.

The Duty Free Traders Association maintained that 30 of their 36 members had an over 40 per cent drop in sales after the restrictions were brought in. Of these 30, as many had 13 shown a drop in sales of over 60 per cent and 7 a drop of as much as over 80 percent. The traders also released figures (given below in Table 3) of shoppers visiting the DFSC before and after the restrictions, stating that these measures had caused a heavy loss in trade for them.

According to this table the inflow of local customers has dropped nearly 50 per cent while the number of foreign customers dropped almost 60 per cent. However, it is difficult to imagine that such a large number of

operations of the DFSC? With all the abuses of the system it is hard to see how the estiamted 51.4 percent profit in 1984, of the DFSC, could have been a foreign exchange gain to the country.

Had duty been charged all these imports may not have been made, but once they were made the country was deprived of all duties. For 1981- 82 the possible amount of duty payable was over Rs 800 million.

Table 3 Number of Customers Visiting the DFSC Before and After the New Restrictions were Imposed

Month	Local	Foreigners	Total
Before Restrictions			
January 1984	11,290	9,809	21,099
February	7,991	9,293	17,284
March	7,736	10,247	17,983
April	7,313	6,657	13,970
May	8,694	6,324	15,018
June	9,769	7,532	17,301
6 month total	52,787	49,862	102,655
After Restrictions			
January 1985	6,377	3,429	9,806
February	3,700	2,919	6,619
March	4,400	3,051	7,451
April	4,795	3,600	8,445
May	4,460	3,920	8,380
June	(4,025)	(2,344)	(6,369)
6 month total	27,757	19,263	47,070

genuine local customers would forego use of their duty free allowances merely because of the restrictions. Some argue that it was more likely the fall in traffic was the result of a drop in the entry of un-authorised persons who visited the Complex for the purpose of illegal transactions; while on the other hand the drop in foreign customers was related to the drop in tourist arrivals.

All were in agreement, however, that there were severe malpractices in the entire system - the authorities saw it and the traders admitted it. The vital question then was - did the country's economy benefit from the

There was still another way in which the economy and the country were not benefitting up to 1985, and that is through the loss of turnover taxes. All other business establishments paid BTT on their sales, but not the DFSC shops till the Minister of Finance introduced a 10 per cent levy with his 1985 Budget. In making his case the Minister said:

"At present goods sold at the Duty Free Shopping Complex are completely free of import duty and turnover tax. These goods can, therefore, be sold at very low prices. The prices at the Duty Free Complex in Sri Lanka are in most cases lower than those in other duty-free shopping centres. Many of the items purchased at the Duty Free Complex are often re-sold at a profit of around 20 per cent. Iam of the view that it should be possible to impose a turnover tax on goods sold at the Duty Free Complex without unduly depressing sales. Such an imposition would also afford some relief to local manufactures, some of whose products compete with products sold at the Duty Free Complex. I propose, to levy a Turnover Tax of 10 per cent sales in the Duty Free Complex. I anticipate a revenue of around Rs 100 million from this source".

This statement also supported the view that a good part of the merchandise coming into the Duty Free shops were being sold in the open market at a profit of at least 20 per cent, though trade sources placed it at an even higher level.

According to some sources more than 50 per cent of the Duty Free sales were channelled on to the open market for re-sale; the items entering the open market being mostly electronic equipment, liquor and glassware. However, most of the foreign liquor (Whisky,Brandy, etc.) did not go straight into the open market but to the affluent who had arrangements with the brokers to get it into their hands. Local industries, such as the local liquor and distillery industry could have been affected. Clear evidence of such an impact was seen on the local TV set assembly industry.(See Box)

A further likely loss of revenue as a result of DFSC sales may be estimated from the Customs Statistics for 1981 and 1982. The 1981 imports of Whisky and Brandy were valued at Rs 14.9 million and Rs 7.6 million and import duties on these were Rs 19.8 million respectively. In 1982 the value of imports went upto Rs 33.6 million for Whisky and Rs 11.9 million for Brandy; but the revenue during this year was only half the previous year for Whisky (Rs 10.6) and for Brandy only (2.8 mn) (Sunday 24.3.83).

There was strong evidence that liquor had been smuggled out by the case load when it was transported from the Customs bonded stores to the Duty Free Shopping Complex. But no action could be taken on this because all the paper work was ready to prove that these cases of liquor were brought to the DFSC and sold.

Whisky sales in Sri Lanka doubled in 1982 according to the sales figures of the Scotch Whisky Association of UK, going up from 25,000 to 48,000 cases. But dealers outside the DFSC were not at all happy about it. Their records did not reflect any increase in business despite a drastic drop in the type of liquor sold in the Duty Free Shops (CDN 22.I.83).

On this basis the Government could be losing several millions of rupees by way of revenue through such leakages of goods imported for the DFSC. These goods ultimately reach the open market though they were intended to go into the hands of passport holders with foreign currency.

A further effect observed was that who imported goods for resale in the open market and paying the usual duties were badly affected as they could not compete with the same goods channelled into the open market from the DFSC. Some of the traders who hitherto were in the import business found it essier to obtain and sell d duty free goods.

In 1984, there was also a drop in proceeds from excise duty on locally made foreign type liquors (Beer, etc.) and this was attributed to the competition from DFSC sales and the government had to bear an estimated loss of Rs 90 million. In the meantime price of local-origin of liquor, such as coconut arrack, which is consumed mainly by the less previledged was increased by Rs 6/- per prrof litre (up from Rs 3/- per bottle) inorder to raise government revenue to cover the excise duty loss from foreign type liquor.

In 1983, action was taken by the Ministry of Trade to close down one shop for selling six bottles of 'Lliquor' to a Sri Lankan who was not entitled to any duty free allowance.

There were innumerable instances when malpractices were reported from the DFSC.

Despite all restirctions it was not possible to prevent goods from leaking out. Even today it is not uncommon to see various luxury items meant for the DFSC available in the local market. There are some unscrupulous businessmen and shop owners in the city who would offer any specific item available at the DFSC at a slightly higher price and these prices are certainly more attractive than on those goods for which even 100 percent duty has been paid officially. Some of them openly have a list of items available and even arrange for delivery together with a bill issued from the Duty Free Shops that trade in these items. This illegal traffic in duty free goods has roused protests from local manufacturers who find their business affected. They complain that they pay duty on imported components and their products and if they are to compete they should be entitled to a rebate on this duty.

New premises at Hotel Ramada Renaissance

With increasing illegal activity being reported at the DFSC there were proposals from time to time to shift the Duty Free Shopping Complex to various places. The first proposal was to shift from its location at Kollupitiya to a site at the former Havelock Race Course at Reid Avenue, where there were plans to put up a complex with ultra modern facilities. Another proposal was to shift the complex to the Colombo Airport at Katunayake where intensive airport security and restrictions on movement could be applied. This site was strongly recommended after the incident where a customs officer attempting to enforce the rules was the victim of a can of acid thrown at his face.

Meanwhile, construction work was completed on the Trans Asian Hotels Ltd., a joint venture of the American Hotel Ramada Renaissance and the Sri Lanka Insurance Corporation.

The fact that the Insurance Corporation and Duty Free Shopping Complex both come under the Ministry of Trade and Shipping influenced the decision to shift the DFSC to the hotel's Travel Centre which is located in this building. The building appears to be almost custom built with central air-conditioning, escalators and more spacious facilities than that available at the Kollupitiya DFSC premises. There was sufficient room for 49 shops at these new premises but when the shifting took place in June 1985, 40 out of 42 shops at Kollupitiya shifted to these premises.

The management of the complex has from its inception continued to be in the hands of the Ceylon

(continued on page 16)

WORLD DUTY FREE TRADE

For more than 30 years duty free shops have served world travellers. These shops were usually located at airports, on board planes and on ferries, at national boundaries and 'down-town' in cities. These duty free shops in restricted "Free Zones" at airports, or on board airplanes and internal ferries channelled domestic or imported products to international consumers for foreign exchange. Globally and geographically the largest tax free market consisting of 60 per cent of the world's total belongs to Europe.

Table 1 Total World Sales of Duty Free Shops

Product Group	Top 500 shops Value US$ Mn.	%	All Value US$ Mn.	%
Drinks	860.0	35%	1,050.0	35%
Fragrances	515.0	21%	630.0	21%
Smokes	590.0	24%	720.0	24%
Others	485.0	20%	600.0	20%
Total	2,450.0	100%	3,000.0	100%

Source: *'Best 'n' Most" 1984.*

Table 2 Duty Free Sales by Region

Region & Continent	Top 500 shops Value US$	%	Other shops US$	World Total US$	%
Nordic countries	407.0	16.6	13.0	420.0	14
British Isl.	428.0	17.5	22.0	450.0	15
Central Europe	658.0	26.8	42.0	700.0	23
Eastern Europe	22.0	0.9	8.0	30.0	1
Europe Total	1,515.0	61.8	85.0	1,600.0	53
North America	336.0	13.7	44.0	380.0	13
South America	73.0	3.0	17.0	90.0	3
Central America	15.0	0.8	25.0	45.0	1
Caribbean	20.0	0.8	25.0	45.0	1
America Total	444.0	18.1	106	550.0	18
Africa North	18.0	0.7	22.0	40.0	1
Africa Central/S	26.0	1.1	34.0	60.0	2
Africa Total	44.0	1.8	56.0	100.0	3
Middle East					
Indian Ocean	68.0	2.8	112.0	180.0	6
Near East Medi.	27.0	1.1	43.0	70.0	3
Middle East Total	95.0	3.9	155.0	250.0	9
Far East & East Asia	316.0	12.9	94.0	410.0	14
Australia & Pacific	36.0	1.5	54.0	90.0	3
Asia & Pacific Total	352.0	14.4	148.0	500.0	17
Total	2,450.0	100.0	550.0	3,000.0	100

Table 3 Sales of Merchandise Continent Wise in 1984 (%)

Continental	Drinks %	Fragrances %	Smokes %	Others %	Total %
Total Europe	32.2	20.9	26.6	20.3	100
Total America	40.3	20.5	19.6	19.6	100
Total Africa	34.1	13.6	18.2	34.1	100
Total Middle East	44.2	26.3	24.2	5.3	100
Total Asia & Pacific	42.6	22.5	17.6	17.3	100
World Total	35.1	21.0	24.1	19.8	100

Source: *The Best 'n' Most 1984.*

Spirits, perfumes and tobacco products are typical examples of what are considered "luxury products" and upon which the authorities impose high rates of tax, duty and other charges. Taking into consideration the high duties and taxes usually applied to these products it is not surprising that these often account for about 80% of the turnover in tax free shops.

Frequnetly a tax free shop enjoys a highly international mixture of customers who together represent a very broad spectrum of different tastes and preferences. Today there are more than 500 such duty free outlets.

A survey conducted and published in Sweden's Duty Free Shop world guide series "Best 'N' Most" in DFS 1984, reveals that the world's top 500 Duty Free Shops sell tax free goods amounting to a combined value of US$ 2,450,000,000 stated in consumer prices. Travellers spend US$ 860 million on wines and spirits; US$ 515 million on perfumes and cosmetics; US$ 590 million on cigarattes, cigars and tobacco; and US$ 485 million on other items (including writing instruments, fashion, audio, visual equipment, lighters, cameras etc.) (Table 1).

Some estimates of World total sales figures, which include all world airport shops, sky shops, sea shops and 'down town' shops have placed the figure at not less than US$ 5 billion annually.

Tax free shops exist in more than 100 countries although not all of those countries have well decorated or well stocked outlets. Airport shops or national carriers with on board sales account for over 60% of the $ 5 billion world duty free trade.

Table 2 shows the geographical distribution of Duty Free sales among the top 500 shops and other shops. Their distribution is based on individual shops total sales which are then added together for each respective country and presented for 5 "Continents and 14 sub-markets".

Table 3 illustrates the geographical distribution of merchandise sales among five world regions. According to this table the wine and spirits (drinks) in all markets are the most important product group and in Europe represents 32.3% of all duty free sales.

The outlet with the largest gross sales in both 1984 and 1985 has been London's Heathrow airport averaging US$ 90 million per year, Gatwick airport in

INDIAN SHOPPERS AT THE DFSC

Enjoying a shopping spree in India has always been a privilege of a fortunate few Sri Lankans. People from various walks of life including certain types of businessmen have been engaged in this one way stream for years. The opening of the Duty Free Shopping Complex in Colombo resulted in a dramatic reversal in numbers in the flow of traffic.

After the opening of the Colombo DFSC there began a steady trek of Indians from across the Palk Strait whose sole intention was to shop for duty free goods in Colombo. At the time this venture was opened Indian nationals were permitted to take out US$ 1,250 for personnel expenses but from around June 1983 this amount was reduced to US$ 300 by the Government of India. This resulted in a dramatic drop in the number of shoppers coming in from India.

There were very broadly four types of Indians who came to Colombo for shopping at the DFSC; (1) affluent Indians from the big cities, (2) middle and working class Indians, (3) school children and teachers, (4) persons hired by businessmen in the South of India to act as 'couriers'.

The largest number that came from India belonged to the fourth catogory. All travel arrangements, together with a meagre living allowance, was provided to them and they were despatched by train and ferry across the Palk Strait or by air as couriers for businessmen who offered them a small monetary incentive. They generally seemed to be very poor and uneducated and many were not even literate. They were totally unused to the ways of city life and in Colombo they could be seen sitting on the pavements near the DFSC and in lobbies around the Comples, poorly dressed, and even cooking their meals in the vicinity. It was not unusual to see one of them with a load of duty free goods on his head attempting to get across the busy street opposite the DFSC oblvious of all on coming traffic. The majority of Indians who came to Sri Lanka as tourists were from this category.

According to statistics of tourist arrivals during the first seven months of 1982 there were 79, 692 Asian tourists visiting the country, as against 52,406 Asian visitors during the same period of the previous year. The larger number of arrivals in 1982 was identified as the increased number of tourists who were coming in from India for shopping at Colombo DFSC. Throught 1981 there were 89,000 Asian tourists as agaisnt 135,000 in 1982; in 1981 only 13 percent were Indians whereas in 1982 the proportion had gone upto 21 percent. In the first 6 months of 1983 the number of Asian tourists was almost 100,000 and then the number fell dramatically.

There was a regular pattern in which these couriers who came as tourists acted for the business syndicates on either side of the Palk Strait. Their ferry or air tickets and necessary money for expenses were provided by the Indian counterpart, while the operators at this end assisted with transport, meals and lodging. These people were given lists of goods to be purchased and instructions to go to a particular shop. All procedures were attended to for them and all they did was collect the goods and get back to Indian as scheduled, where they handed over the goods to their principals and collected a small fee for their services. On several occasions these persons were held by Customs Officers for being involved in malpractices either at the DFSC or at Port of entry and departure. Among the most common offences were the following:

(1) Customs at the Colombo International Airport, Katunayake found Indians entering the country without any money; they had made false declerations they were carrying US dollars. It was also found that they had attempted to smuggle Indian and Pakistani currency into the country.

(2) Indian nationals were caught within the Complex trying to walk out with expensive goods by tendering receipts of purchase with falsely paid endorsements on them. Investigations revealed that touts possessing forged paid stamps were accosting Indians in the Complex, getting purchase receipts written by salesmen by-passing the cashiers counter, and making false 'Paid. stamps on the receipts.

(3) Attempts by Indian nationals to leave the country through a port but not having with them their duty free purchases. When a penalty was imposed on these persons they did not have money to pay a fine.

(4) Detention of Indians who were trying to bring in bullion or Indian goods for sale here in addition to their official foreign exchange.

These Indians however, brought no further benefits to the economy unlike other tourists. Apart from their payment for the duty free goods they spent very little. Most of them existed on the cheapest meals, transport and accomodation and on an average US$ 7 per day unlike other tourists from the region whose expenses averaged around US$ 50 per day.

According to reports in the Indian press. in 1983, upto June about 800 passengers passed through Madras airport daily to purchase at the DFSC in Colombo. One of the most popular items they carried was Video Cassette recorders averaging about 100 per day. Indian school children, particularly girls in the age group of 9-16 years were also big customers at the DFSC, and they carried away cosmetics and dolls; while the boys purchased wristwatches and cameras. Other Indian nationals showed greater interest in the wide range of electrical goods available.

Following the restrictions introduced by the Indian government and later the ethnic disturbances in Colombo the number of Asian tourists came down from an average of about 31,000 a month up to May 1983 to about 3,000 in September 1983. The number of foreigners entering the complex also fell drastically from around 20,000 a month in early 1983 to around 3,000 per month in 1984; while turnover in more than 50 percent of the shops at the DFSC fell by over 60 percent. A major slice of Colombo's DFSC business was taken away with the fall in numbers of Indian shoppers.

U.K. which has averaged around US$ 40 million per year is also an important outlet. The other major outlet in Europe was Amsterdam airport, which has averaged sales of about US$ 78 million per year. The two airports in Paris the Charles de Gaulle and Orly also had a total of a US$ 100 million in sales in 1985. Frankfurt, Brussels and Zurich were the other important continental airports. The Viking Lines of Finland, Stena Sessan Line of Sweden, Silja Line of Finland, DSB Ferries of Denmark, Sealink British Ferries of U.K. and Townsend Thorssan Ferries U.K. were other important outlets. Together all these outlets in Europe accounted for nearly 25 percent of world duty free sales.

In Asia, Singapore, Tokyo and Hong Kong airports were leaders accounting for about 15 percent of total duty free sales according to the publication 'Best 'n' Most' which lists Colombo Airport as 90 among the top 100 duty free outlets in 1985.

Shipping Lines, a subsidiary of the Ceylon Shipping Corporation which comes under the Ministry of Food and Shipping. The Management of the DFSC from its inception was in the hands of this Company.

The rent charged at the new premises is comparatively high, as seen in the table below:

Rent per Sq. Metre

	Old Premises (Approx)	New Premises
Ground Floor	Rs 753.00	Rs 1,300.00
1st Floor	Rs 550.00	Rs 975.00
2nd Floor	Rs 403.00	Rs 875.00
3rd Floor	Rs 387.00	Rs 875.00
4th Floor	Rs 387.00	

The rent charged at the new premises is almost twice the rent charged at the earlier location. The cost of electricity at the Complex is also divided among the shoppers according to the floor area of their shops.

Security services are provided by Police and Customs, while a private security firm also provides guards at the gate and the Ceylon Shipping Lines has appointed a Liaison Officer and other staff who recover the entrance fees and attend to other administrative functions of the Complex.

The Wider Issues

Shop owners in the Duty Free Shopping Complex were asked for their suggestions on how operations in the Complex could be made more effective. The suggestions emanating from almost everyone of them were that 'over the counter' deliveries and the earlier rebonding facilities be restored. However, the authorities maintained that from past experience it was difficult to keep down malpractices without these restrictions and also that these malpractices had taken place with the assistance or connivance of duty free traders or their employees. One of the objectives in setting up of the DFSC Complex in 1981 was to divert to Sri Lanka foreign exchange that would otherwise have been spent in other countries by returning expatriates and visiting foreign nationals. Another objective was "to give an impetus to trade" and " to be of immense service to the country's economy by earning a rich slice of foreign exchange". It is not easy to measure in quantitative terms the extent to which these objects have been achieved upto date, but what is clear is that at the start a considerable amount of foreign exchange was diverted to the DFSC by returning expatriates and visiting Indian nationals. The situation, however, changed with more regulations being introduced both at the DFSC and in India. This trend in turn adversely affected the foreign exchange earnings of the Complex.

What has yet not been fully assessed is the extent to which activity of the DFSC has become part of the abuses of an essential facility of liberalised trade and how far part of DFSC business has been sucked into the activity of the 'underground economy'. Within an 'underground' or 'black' economy incomes earned are not reported to either tax authorities or reflected in the country's national accounts. Such 'unofficial or parallel' economic activity results in a flouting of exchange control regulations and a high degree of tax evasion, which in turn reduces the value of available tax incentives, distorts the entire economic planning process and does serious damage to the economy. There is no doubt however that activities of an 'underground' economy tend to grow with greater regulation of the economy, high levels of taxation and bureaucratic and other avenues of corruption. In Sri Lanka's case while the economy was liberalised it was necessary to maintain a degree of control or regulation. The result is that unscuplous businessmen have made every attempt to get around the regulations.

In this process activities that are hard to officially control have come into existence and invalidated the very objectives for which the regulations were introduced. For instance, a certain degree of regulation by the financial authorities is necessary for stability in financial markets and therefore controls are brought in on interest rates and credit disbursements. Such controls have given rise to a Black market' for money, sometimes called the 'curb market' where the interest received by lenders is far greater that on the official rates and these earnings are generally not reported to tax authorities. This is also happening in foreign exchange markets where regulation has been necessary. Here, as a result of distortion in exchange rates and controls the over invoicing of imports and under invoicing of exports and unofficial dealing in foreign exchange has become highly profitable. Even worse is the illegal trafficing or smuggling of gold, gems and foreign currency all of which help the smuggler to amass foreign exchange abroad, which is a means for some individuals to transfer their assets out of the country and also provides foreign exchange to be sold at a 'price' in the 'black market' domestically. Here too a 'black market' exists for currency parallel with the official market, and furthermore large untaxed incomes are created. This situation is worsened, and such illegal transsactions thrive, in a situation where persons in public service find themselves in control of powers that can be used to generate private gains. The private use of public power is obviously improper and illegal but, has unfortunately today become a fact of life in many of those countries which have been compelled to maintain a degree of regulation and controls in their economies.

Liberalisation of the economy while meant to minimise and even eliminate many of these ills has also opened more opportunities to smugglers and similar parasitic elements. Thus, when unscruplous businessmen find that there is more to gain in their 'underground' activity the broader issues arise as to how far controls should be introduced or liberalised facilities made available. Considering the regular reports that appear in the press of organised smuggling activity (a sampling a recorded in the Diary of Events on page 2) and the unfortunate incidents and adverse publicity, that have marred the history of the DFSC the issue needs to be faced how far the gains from the DFSC and liberalised trade of which it is a part could more profitably benefit Sri Lanka's economy.

(This Special Report is from a study by W.G.S. Waidyanatha of the Bank's Research Department).

Cowpea Producers Marketing Problems

Cowpea farmers were facing a marketing problem with the increased imports of mysoor dhal, according to an Agricultural Research and Training Institute Food Commodities Bulletin issued in October this year. Coincedently, this issue was raised by the ARTI around the same time that the Minister of Finance was preparing to announce relief measures for these farmers in his 1986 Budget. The question remains, however, whether the 70 percent increase in the government's guranteed price for cowpea, as announced in the Budget, would solve the problems of these farmers.

Cowpea is the main locally produced substitute for mysoor dhal which is imported from India. It is superior in many of its properties and more or less equal in protein content to mysoor dhal. Though consumers have shown a preference for both taste and appearance of the imported dhal the locally produced cowpea dhal has always been offered at a cheaper price.

Cowpea cultivation was introduced into Sri Lanka in the late 1930's and since then it has undergone many developments as a food crop. Local scientists have introduced a number of new improved varieties; a guaranteed price was introduced in the late 1950's while the area under cultivation and level of production was gradually increased over the long term. In 1983, when the highest cultivated area and production was recorded 81,000 acres were cultivated and a production of 1,043,000 bushels was recorded, according to estimates of the Department of Census and Statistics. By increasing their production cowpea farmers have been able to save a considerable amount of foreign exchange for the country, which would normally have been spent on the import of mysoor dhal in order to provide the poorer income groups with a basic protein requirement at a reasonably low cost.

According to the ARTI though during the months of August and September 1985 cowpea retail prices had been constant (around Rs.15/40 per kg. for cowpea whole grain, and Rs. 19/40 per Kg. for cowpea dhal) and not gone up, the demand for cowpea dhal was either stagnant or decreased in the retail market, mainly due to the increased imports of mysoor dhal at a cost of around Rs. 500 million per annum. As a result the current farmgate prices are showing a great deal of uncertainity and thus can cause hardships to the farmers and in the long run have detrimental effects on the progress of the crop. Another trend resulting from the lack of a market is the drop in production since 1983. According to Agricultural Ministry figures cowpea production which was 26,111 mt. tons in 1983 came down to 23,718 mt.tons in 1984, a drop of 9 per cent. The acreage under cowpea during this same period was reduced by as much as 24 per cent. Further more, purchases of cowpea by the Paddy Marketing Board under its Floor Price Scheme for minor food crops declined substantially in 1984 when compared with its purchases in 1983. The trend in production and acreage under cowpea over the past 15 years may also be observed in the following figures maintained by the Department of Census and Statistics.

(The figures of the Ministry of Agriculture differ from those of the Department of Census and Statistics).

The government has with the Budget now increased the guaranteed price for cowpea from Rs. 5.00 to Rs.8.50 per Kg. However, it is doubtful whether this 70 per cent increase in farmgate price will in the long run be of benefit to the farmers, as well as the crop, since such an increase could also eventually lead to an increase in retail prices. At present the existing price difference in the retail market

COWPEA PRODUCTION AND EXTENT CULTIVATED

Year	Extent Cultivated in acres	Production in Bushels '000
1970	10220	113
1971	10130	92
1972	13570	108
1973	13760	109
1974	14270	115
1975	24640	197
1976	28580	257
1977	36100	326
1978	33210	419
1979	34580	376
1980	55900	559
1981	66210	655
1982	78230	735
1983	80550	1043
1984	69290	737

Source: *Cencus and Statistics Department*

between mysoor dhal and cowpea has been found to be just enough for survival of the cowpea market. In a situation where the price of mysoor dhal will remain the same under free imports and the price of cowpea dhal increase substantially due to the increase of its farmgate price, cowpea dhal can lose its position in the retail market, since it would not be able to compete with mysoor dhal. This could again, in the long run, create unfavourable effects for the crop and thereby hardships for the farmer.

On deciding between mysoor dhal and cowpea dhal in the retail market, the difference of palatability and taste is as important as the price difference between these two items. If the palatability and taste of cowpea is to be improved in order to divert consumer preference from mysoor dhal to cowpea scientists and researchers should be encouraged to introduce new varieties which are more tasty and of higher quality, and encouragement and incentives also offered for improving processing systems. When consumers turn away from this product those agriculturists and scientists working towards improving it can be discouraged.

If the recent trends cannot be reversed and consumers are allowed to shift from cowpea to mysoor dhal, spontaneously, cowpea farmers should be able to use their land for other purposes which give them more or an equal level of income and also be able to save more or an equal amount of foreign exchange for the country.

In its Review of the Economy in 1984 the Central Bank emphasises that, except for a few crops, the production of other minor food crops fell considerably in 1984. Among those recording a drop in production were Groundnuts (-63%), Green Gram (-37%), Soyabean (-23%), Kurakkan (-22%) Gingelly (-72%) Blackgram (-67%), Cowpea (-9%), Chillies (-20%), Red Onions (-88%), Potato (-48%), Sweet Potato (-16%) and Maniok (-51%).

There is no specific reference by the Central Bank to the adverse impact on these crops from imported substitutes, but it states that the following serious problems constrained the development of this sector "Lack of adequate extension services and non-availability of high yielding seed varieties in sufficient quantities seem to perpetuate improper cultivation practices leading to lower yields. This fact together with imperfect market conditions result in poor producer margins constraining new investment in this sector. Lack of easy access to institutional sources of credit is another drawback which holds back progress of this sector. Another area which deserves attention is the development of an efficient system of marketing for these products. There is a lot of potential for the development of this sub-sector. Particularly, with the expansion of the food processing industry, animal feed production etc. there can be greater demand for these products. Their potential can be realized only if these constraints are minimised or removed. This requires an integrated development package for this sector." The policies adopted and the way they were implemented which enabled the country to move towards selfsufficiency in paddy needs to be extended in favour of these crops as well.

FINANCE

Progress and Problems of Development Financing

The primary focus of the government's medium term (1980-1990) strategy has been on issues connected with the structural transformation of the country's productive capacity. Government funds, through its public investment programmes, have been channelled into public sector projects whose objective has been to assist in this transformation; while the development banks and other financial institutions were expected to assist the private sector to achieve this same objective. The private sector has been assigned an important role in the strategy of structural transformation in the medium term and in recent years with this objective in view the government has provided a variety of incentives for private sector development. However, the results so far have not been upto expectations. While there had been a favourable response to incentives in sectors such as paddy, construction and tourism, industry has moved relatively slowly (except in garments and petroleum products). This slow progress in the latter sector has been accounted for partly due to external factors, such as recession in the developed world in the 1980's and partly to biases in the structure of incentives in the economy.

The government has recognised in its investment programme for 1985-89 that much potential exists in non-traditional industries, particularly, factory industries, small scale and cottage industries. Its declared policy in this regard is to rely more on private entrepreneurship and initiative, while government action is directed towards the provision of basic infrastructure and maintaining an appropriate system of incentives. "It is anticipated that all remaining avenues of efficient import substitution will be exhausted soon and export-oriented manufacturing closely related to the country's resource endowments will have to be built up. A crucial element in the medium term strategy of the Government will be the restructuring of the investment pattern of the country. Public investment is projected to decline from current levels (i.e. 14.9 percent in 1985)to about 12 percent of GDP by 1989. Over the same period, the relative share of private investment is expected to increase from about 10.3 percent to 13.3 percent of GDP".

In this context it is of interest to look back on the performance of one of the government sponsored financing instituions whose intention is to help in achieving these very objectives. * The NDB recently celebrated its fifth year of existence. It is an appropriate time to review its progress, to examine its own objectives and to consider how far it has been able to achieve these.

This Bank was established in January 1979 and was envisaged to be a significant plank in the government's new economic and development strategy. Its broad aim was the financing of private enterprise through loans and equity. Specifically it set out:

(1) to become a significant source of term financing and equity
(2) to stimulate development of the capital market
(3) to assist the rural sector through a comprehensive refinancing programme for small and medium scale industries,
(4) to engage in project promotion
(5) to be willing to accept a higher level of risk than commercial banks by having a more flexible and innovative approach.

There is no doubt that the Bank has achieved its broad aims of acquiring a considerable presence in the field of Development Finance. In these intitial years of its existence it has approved financing of 179 projects totalling Rs 1,784 million, in

Of the NDB's Rs 600 million subscribed capital the Government holds 67%, Central Bank of Ceylon 17%, People's Bank 8% and Bank of Ceylon 8%.

nearly all varieties of businesses from partnerships and individuals to large private and public sector companies. This level of activity has enabled a total investment of Rs. 6,823 million to be mobilised, creating employment opportunities for more than 10,000 people. Its business turnover has increased steadily in these 5 years and from 17 projects in 1980 it approved 73 projects in 1984.(The table below sums up the NDB's performance over this 5 year period and generally indicates the type of investment taking place in recent years.

type of financing has attracted competition through leasing schemes started by other financing institutions.

In attempting to stimulate investment in productive and viable projects, however, the NDB has had to face many direct problems in financing and also problems arising from inherent defficiencies in the economic and incentive system. There is for instance the problem why agricultural and industrial output, exports and investment failed to achieve steady growth in the 1980's; the reasons

exports and a deceleration of valuable foreign exchange earnings for the country,.

In addition real wage costs have risen progressively for the export sector as a whole from 1979 to 1982 with the tea boom resulting in a decline in 1983-84, albeit to levels still above that of 1978. Real wage cost increases have been more moderate for domestic goods, (that is, goods not traded in world markets) suggesting a weighting of profitability away from exports towards domestic goods.

GROSS APPROVALS OF NDB FINANCING FACILITIES BY SECTOR 1980-1984

Amounts in Rs. Mn.

	1980			1981			1982			1983			1984			TOTAL		
		Amount			Amount			Amount			Amount			Amount			Amount	
	No	Loan	Equity	No	Loan	Equity	No	Loan	Equity	No	Loan	Equity	No	Loan	Equity	No	Loan	Equity
1. Food Beverage and Tobacco							03	20.30		04	88.50	1.35	04	48.66		11	157.46	1.35
2. Agriculture, Agro Business and Fishery				01	5.80		02	39.40		03	27.28	25.00	07	33.72		13	106.20	25.00
3. Textile and Wearing Apparel	01	14.00		04	66.85	6.20	04	29.80	3.00	02	5.48		11	44.42	0.55	22	160.55	9.75
4. Wood/Paper Products	01	8.00								01	5.20		03	18.95		05	32.15	
5. Rubber and Leather Products	02	8.00		02	30.30	3.00	05	53.70	5.89	04	11.99	0.45	12	68.35	0.5	25	172.34	9.84
6. Metals and Chemicals (incl. Petroleum & Engineering)	06	107.70		04	41.80		08	124.80	3.89	11	54.45	7.31	20	111.68	1.23	49	440.43.	12.43
7. Hotels	03	79.00	2.50	06	81.20	5.05	07	66.50	0.83	09	61.17	2.00	04	23.59		29	311.46	10.38
8. Service Industries	04	63.50	3.75				03	31.40		03	47.10		07	126.66	26.00	17	268.66	29.75
9. Miscellaneous				02	9.00					02	5.00	3.00	05	19.9		09	33.90	3.00
TOTAL	17	280.20	6.25	19	234.95	14.25	32	365.90	13.61	39	306.17	39.11	73	495.93	28.28	180	1683.15	101.50

In terms of innovativeness and greater risk-taking the NDB was keeping to its objectives. It has made a conscious effort to pioneer certain types of projects and to finance projects which would not have been implemented due to difficulty in obtaining finance from any existing financial institution. These projects include successful ventures in shrimp farming, agro industries, polishing and treating of gem stones, computer software, and foliage plant production for export. The specific innovative financing schemes have been loan syndications and co-financing of projects and equipment financing schemes. In equipment financing a sum of Rs 31.65 million was advanced within a short period and the success of this

according to the review may be found in the behaviour of relative prices and real costs facing these sectors as determined by the exchange rate and tariff structure of the economy. The movement of various cost indices for exports gives some indication of the changing competitiveness of Sri Lankan exports in world markets. The evolution of these indices, relative to corresponding indices for non export activities, show the attractiveness of export oriented activity relative to non-export activity within the national economy. When rates of profit are higher for domestically oriented activities, resources are likely to flow away from actual and potential export ventures to competing uses in non-export sectors, resulting in poor growth of

Also the real capital costs have been higher for the export sector. Real interest rates (that is, nominal rates deflated by own selling price) have risen dramatically since 1979, reaching average rates of 19.1% and 29.3% in 1981 and 1982. Until the export price boom in 1983-84, interest rates had been more moderate, although sometimes still quite high, for the non-traded sector. Comparing real wage and real interest costs between domestic goods and non traditional exports, it appears that apart from the initial devaluation in 1977, the post liberalization period has not witnessed any special attempt to structure production costs in favour of non traditional exports.

The conclusion is that in contrast to production as a whole, import activities faced extremely low, mostly negative rates. Between 1979 and 1983, it was significantly more profitable to borrow for import trading than for domestic or export production.

The trade-oriented activity of the Commercial Banks reflects the strong demand for credit due to low (often highly negative) real interest rates faced by the commercial sector. Lowering economy-wide interest rates is not the solution to this problem, states the NDB. Real interest rates in depositors are still barely positive in Sri Lanka, so that lowering them further would seriously jeopardize the development of the financial sector which is crucial for growth, while not eliminating the problem of bias against exports. The NDB Chairman, Mr. C.A. Coorey suggests that the solution is to raise the relative price of exports through exchange rate adjustment and tariff reform so that the viability of exports will not be destroyed.

The Chairman's overview of the economy in the 5 year period of 1984 makes reference to the Sri Lanka's balance of payments and debt service position, indicating that post-1977 investment has been largely foreign financed, which reflects the constraints in raising domestic savings, despite increases in real income.

One result has been the increase in recent years of the total external debt service ratio of goods and services. The review states "depending on how one wants to look at it, Sri Lanka's high debt service ratios are as much a reflection of poor export performance as "too much" borrowing. It is not sufficient to be satisfied that external debt build up has gone into higher investment rather than to higher consumption or widening budget deficits. Future balance of payments viability depends crucially on the quality of investment undertaken; efficient foreign exchange earning projects yielding relatively quick returns lend a great deal of flexibility to external finance management, allowing the country continued and steady access to foreign savings to keep it on a high investment-high growth path. The urgent need for infrastructure projects to provide adequate electricity, irrigation, transport and communications which lay the basis for future expansion of tradable goods production imposes severe constraints on external debt management. For technological reasons, such projects tend to require long gestation periods while the direct services they provide are non-tradable (in world markets) and hence generate foreign exchange only indirectly through the tradable production they facilitate. Thus the ability of Sri Lanka's traditional tree crop exports to earn foreign exchange in the meantime becomes all the more significant. The sharply improved macreconomic picture in 1984, largely on account of temporarily high tea prices, vividly illustrates the importance of a strong export sector to the country's economic well being.

The poor output performance of the major export crops and the economy's uneven pattern of growth in the 1980's, apart from considerations of income and savings generation, are therefore causes for serious concern".

Also, the performance and experience of the Bank over its 5 years of existence has brought into focus the need for:

- Increasing investment particularly in the tea crop sector and export oriented undertakings.
- Diversification of industrial output, especially into high value added activities.
- Structuring of production costs such as wages, interest rates, tariffs etc. in favour of exports.
- Providing long term credit facilities at reasonable rates of interest for private sector development.
- Realistic and timely adjustments of the exchange rate.
- Increased domestic savings.
- An active securities market.
- Larger investment by both the public and private sectors in foreign exchange earning/saving projects yielding relatively quick returns.

Among the direct problems that the NDB has encountered, in attempting to stimulate investment in productive and viable projects have been a scarcity of well-researched and properly planned projects, due to lack of expertise in both private abd public sector organizations in many of the basic business disciplines; and a shortage of new entrepreneurial talent willing to identify and exploit new oppourtunities made available under the Government's open economic policy.

Other areas which have caused concern are the inadequate management arrangements made by borrowers generally for the efficient and timely implementation of projects and specifically for obtaining the transfer of technology. Very often, the latter area has been left entirely in the hands of the supplier of machinery or the foreign investment partner. Legal covenants included in machinery supply arrangements, technical collaboration agreements and joint venture agreements have not been followed up on many an occasion resulting in considerable loss to the local company.

A surprisingly large number of companies also lacked adequate accounting and financial control systems. This has resulted in failure and undue delay in preparing proper accounts at regular intervals so that the management has no knowledge of the state of affairs of the business and therefore cannot and does not take timely action to deal with financing and/or operating problems.

Further more a considerable number of business establishments, although "public" companies in corporate form, are in fact "family concerns" with shares being closely held and management often unprofessionally organised. This situation has resulted in the business of these companies being severely restricted due to the inadequacy of equity capital. Capital expenditures, have often been financed by short term borrowings resulting in an unbalanced capital structure with a severe strain on liquidity.

Another major constraint in stimulating investment has been the shortage of equity finance for manufacturing projects; but the scarcity of equity inhibits the growth of enterprises and has caused serious financial problems for existing businesses, which have placed too great a reliance on borrowed funds to finance their ventures.

The NDB's aim of assisting the development of the capital market and widening the base of share ownership in Sri Lanka was implemented relatively recently with the forming of the Capital Devellopment and Investment Company Ltd. (CDIC) in January 1984. The CDIC, sponsored mainly by the NDB, was due to make equity investments in enterprises where the existing equivalent is considered insufficient for the viability of such projects.

This experience of development financing has brought into focus the constraints and contradictions that exist in Sri Lanka's economic environment itself. On the one hand are the government's policies towards enlarging and aiding the private sector; while on the other hand its financing aims are frequently obstructed by the fact that officially unambiguous signals are not being given for improving the environment for the private sector. The strongest of these signals to the private sector in any economy is the interest rate; which continues ar a high level.

Yet another issue causing deep concern for all development financing institutions is the feeling that though the private sector was expected to play a crucial role in investment activity and the necessary funds are available it does not have the capacity and resources to absorb more productive investment funds.

Specific policy directions have also appeared to be an urgent need, particularly a statement defining precisely the path of industrial development, states the Chairman in his review.

He also raises the following broad issues which need to be examined and settled if the government's goals of economic development are to be realised:

- What is the impact of the open economic policy of the Government on the industrial development of the country?
- What specifically are the industrial sectors in which Sri Lanka has comparative advantage and how should these be supported and developed?
- The availability of cheap labour and industrial raw materials, such as rubber and other agricultural crops, have often been cited as factors which should attract investment to Sri Lanka in labour intensive and resource based industries. It is also said that Sri Lanka should benefit by the drift of industries from highly industrialized countries on account of their high costs of production. If so, why has this drift been confined only to sectors such as the garment industry?
- What else should be done to enhance Sri Lanka's comparative advantage in other industries?
- Are the promotional strategies presently adopted cost effective? Should they be changed from one of general seminar type publicity and ad hoc investment promotion missions in foreign capitals, to that of a specific and direct approach to potential investors whose profile in marketing and cost structure indicate they could benefit most from those factors in which we have comparative advantage? How can such investors be identified?
- What is the most appropriate incentive structure for local industrial investment?
- Are the export incentives presently offered adequate and effective?
- Are our infrastructure and costs conducive to the establishment of competitive export oriented undertakings?

FOREIGN NEWS REVIEW

THE DOWN TURN IN THE NICS

Taiwan, Singapore, Hong Kong and South Korea are countries whose 'growth' rates during the past 10 to 15 years have given rise to a new addition among the acronyms in the field of development economics - NIC's-Newly Industrialising Countries. Such performances have been cited by proponents of almost every strand of economic and political thought to promote their particular point of view. These range from the now ubiquitous supporters of free trade and liberalisation who proclaim that these dynamic economies achieved their high growth rates by reducing government regulation, introducing incentives to industry and generally freeing the supply side of the economy; to those who believe that these countries have in fact had a substantial degree of government planning and control. Now however, these economies are faltering and again their experiences are being used by analysts of economic and political trends in support of their viewpoints. Both the original high growth rates and the recent downturns have been exhaustively documented. As this table from the 'Asian Wall Street Journal' of October 14 reveals nearly all of Asia's export dependent economies face depressed growth rates in 1985 and 1986. Therefore, it would perhaps be more useful to analyse those features of the dynamic nature of these economies as well as of the slowdown of the past year or so which would be of much relevance to the Sri Lanka situation.

ASIAN ECONOMIC GROWTH

	GDP (US$bn) 1984	Real Growth 1984	GDP Rates (%) 1985	1986
Japan	1,233	5.8	4.6	3.8
China	269	10.8	10.1	7.3
India	191	4.6	5.2	4.6
Australia	174	5.4	3.9	2.0
Indonesia	83.5	5.2	2.4	3.2
South Korea	83.2	7.7	4.1	4.7
Taiwan	57.5	10.4	4.6	4.6
Thailand	42.0	6.0	4.1	4.4
Malaysia	32.6	7.3	4.4	4.7
Philippines	32.5	-5.6	-3.2	0.8
Hong Kong	31.8	9.8	5.2	4.7
Singapore	18.4	8.2	-0.8	2.5

The Asian Wall Street Journal asked five economists to estimate growth rates for 12 Asian countries. Their predictions were averaged to construct this chart. Projections were supplied by Nomura Research Institute, Bangkok Bank Research Office, Eric Nickerson of Bank of America, Willard Sharpe of Chase Manhattan Bank and Thomas Layman of Crocker National Bank.

Are the conditions these countries compatible with those of a less developed nation like Sri Lanka? To what extent can we draw lessons from the economic developments in the NIC's These and other allied issues will be examined and analysed in detail in our December issue.

SRI LANKA'S ECONOMIC LIBERALISATION POLICY REFORMS

Premachandra Athukorala

This paper contains extracts (relevant to our Special Report) from a wider paper, prepared by the author on request and with financial support from UNICEF Colombo; and published under the title "The Impact of 1977 Policy Reforms on Domestic Industry" in the Seminar Papers series of the Sri Lanka Association of Economists. Dr. Athukorala, who till recently was a lecturer at the Department of Commerce, University of Sri Jayawardenapura and has published widely in the specific areas of trade, industry and investment, is now attached to the La Trobe University's School of Economics in Australia.

INTRODUCTORY

In most of the less developed countries "political independence" led immediately to a concern with industrialization as a means of restructuring their economies with a view to end "economic dependence". The policy orientation in Sri Lanka during roughly the first decade of independence constituted a clear departure from this general pattern. During this period the Sri Lankan government was commited largely to laissez faire policies which ensured the continuity of the basic structural features of the classical export economy. It was only since the latter part of the 1950s that a conscious effort has been made towards industrialization.

In line with the then prevalent ideological bias in development thinking and policy orientation in almost all LDS(Hughes, 1980: 15-16); the development strategy chosen by Sri Lanka was "forced" import subsitution through stringent import controls, direct government involvement in production activities in critical areas, and other direct government controls on trade and finance. Some ad hoc reform efforts notwithstanding, this "autarkic" policy stance continued in the ensuing period until the policy reforms of 1977.

Import substitution industrialization (ISI strategy) in fact brought about significant structural changes in the classical export economy inherited from the colonial past. At the time of independence there was little manufacturing activity in the economy other than the processing activities associated with primary export products.

By 1970, the share of manufacturing increased upto about 10 per cent. With the passage of time diversification took place with a wide range of goods, including some investment and intermediate goods, being produced locally.

Despite these changes, in a overall assessment the net outcome of ISI strategy appeared to be negative. The industrial structure evolved during this period was characterised by a plethora of problems which hampered sustained industrial expansion.

Industries were highly capital intensive and hence did little to releive the unemployment problem. While the share of manufacturing increased from about 6 per cent in 1963 to 10 per cent in 1972, the share of employment in that sector increased only from 9.2 to 9.6 between these two years. Being heavily dependent on imported inputs, industry remained more or less an "enclave sector" with little "linkage" effects on the rest of the economy. Many of the early import substitution industries were established by large trading houses to ensure the markets for hitherto imported consumables. One basic drawback which emanated from t this tendency was that much of the industrial capacity established was intended to cater to the requirements of upper-income domestic consumers. As incentives to reduce costs were blunted by high effective protection, there was evidence of substantial inefficiencies and financial losses which invariably implied erosion in consumer welfare. Apart from these, there were additional structural limitations hindering the operation of state industires owing to haphazard planning and various deficiencies in day-to-day management. Given the predominance of state enterprises in producer-good industries, their operational limitations not only caused severe damages to resource allocation and consumer welfare, but also generated pressure on public savings generating budgetary pressure.

Above all these limitations, the major factor which constrained the long-term viability of ISI was the dismal record of the industrial sector in accomplishing envisaged balance of payments relief. In practice, ISI did not diminish the economy's external dependence, but merely changed its nature.

While the importance of consumer goods was reduced substantially, this was achieved at the expense of increased reliance on imported capital goods and raw materials, resulting (contrary to expectation) in an even more rigid dependence on imports. Added to this, a large share of industrial production took place at costs that are not competitive in terms of world market prices, and it was not uncommon to find some firms that actually used more foreign exchange than they saved.

On the other hand, despite some policy attempts since the mid - 1960s the industrial sector failed to penetrate export markets, and even by the mid-1970s total earnings from manufactured exports (3% of total exports) covered only 6 per cent of total annual import requirements of the industrial sector.

Unanticipated import curtailments brought about by adverse market conditions of traditional exports, coupled with adverse movements in the terms of trade, continued to be the major constraint on industrial expansion notably in the first half of the 1970s. By this time, it had become quite clear that unless there was a significant break-through in export orientation of industry, import constraints might continue to cause industrial stagnation.

It was against this background that in 1977 a new policy package which constituted a drastic departure from the autarkic policy stance of the preceding two decade was introduced.

BASIC ELEMENTS OF THE POLICY PACKAGE

The industrialization strategy embodied in the new policy package is based on the now-popular neoclassical diagnosis of the widespread failure of ISI in less developed countries. It ascribes this failure basically to excessive protection and government intervention in the economy which resulted in distortions in factor and product markets causing inefficient allocation of resources. The policy prescription which follows from this dignosis is to take "decontrol" steps in the direction of greater reliance on market forces, rather than on direct controls to guide the allocation of resources so that the country's production structure is brought in line with its comparative advantage. The major elements of Sri Lanka's policy package formulated in line with this thinking are summarised below. It should be noted at the outset that in the process of implementation, certain policy tools have indicated noteworthy deviations from the originally proposed form. A clear understanding of these deviations is an essential pre-requisite for our ensuing analysis of the impact of the policy reform.

Liberalization of import trade and exchange payments, accompanied by an exchange rate reform and tariff reform

Retaining only a limited list of items still under specific licencing, the bulk of import trade was placed under open general licencing. With regard to the latter category, in place of the hitherto existing direct controls, a tariff structure or six rate bands with provisions to give "reasonable" effective protection to local industry, was introduced. The tariff reform was immediately followed by the setting up of the Tariff Reform Commission, transformed in 1980 in to Presidential Tariff Commission(PTC). The assigned task of this instituion was to revise the overall tariff structure to attain the twin objectives of achieving neutrality in protection across various industries and reducing the overall level of protection.

The exchange rate reform which was introduced as an essential element of the trade liberalization attempts, comprised the unification of the dual exchange rate (which existed under the Foreign Exchange Entitlement Certificate System since May 1968) at a depreciated (46.2 per cent against the US$ in terms of the non-FEEC rate) level and allowing the new unified rate to float in response to basic developments in the foreign exchange market.

The trade and tariff reforms were aimed, among other things, at improving capacity utilization of local industries, eliminating excessive administrative regulations which had given rise to corruption, uncertainity and delays, discouraging private initiative, removing the bias against export production generated by high quota premiums on import-substitution production, and encouraging a correct pattern of domestic industries based on international comparative advantage. Reducing the bias of the incentive system towards high capital and import intensity in domestic manufacturing, and increasing relative profitability of production of exports and other tradables (import substitutes) against non-tradable activities, were among the objectives of the exchange rate reform.

In recent years there has been much concern by the proponents of the policy reform, including the World Bank, that tariff revisions and exchange rate policy during the post-reform period have not kept up with the original plan of liberalization (World Bank, 1981

Table 1

STRUCTURE OF PROTECTION FOR MANUFACTURING INDUSTRY : ASSISTANCE TO INDUSTRIES IN TERMS OF EFFECTIVE PROTECTION ON DOMESTIC SALES-1979 AND 1981

	1979	EPC* 1981
(1) Food beverages and tobacco		
Meat, fish and dairy products	0.95	0.54
Fruit and vegetable products	1.26	1.85
Confectionary, bakery & cereal products	1.70	0.88
Spirit, alcohol and areated water	0.25	1.10
Other food products and tobacco	-.36	1.34
(2) Textile, wearing apparel		
Textiles	0.95	1.37
Wearing apparel	3.47	2.38
(3) Chemical, petroleum, rubber & plastic products		
Petroleum & petroleum products	0.45	1.24
Salt and salt based chemicals	0.93	1.56
Pharmaceuticals	0.12	1.30
Other chemicals	0.90	1.07
Oils and fats	1.88	10.07
Rubber products	2.14	2.35
(4) Wood, paper and pulp	1.88	1.53
(5) Non-metalic mineral products (Clay, soil and cement products)	1.47	0.91
(6) Basic metal industries and Machinery (excluding transport equipment)	0.70	1.29
(7) Ferrous and nonferrous metal products (other than machinery)	3.85	2.07
(8) Transport equipment	1.52	0.87
(9) Electrical goods	2.05	2.42
(10) Optical and Photographic goods	0.50	1.96

Note: *The Effective Protection Coefficient (EPC) is the ratio between value added per unit of gross output in the absence of tariff (i.e. at "world" prices) and value added per unit of gross output made possible by the tariff structure.

Source: *Presidential Tariff Commission (The estimates are based on the Cordon method").*

and 1982, Lal and Rajapathirana, 1985). Data presented in Tables 1 and 2 in fact support this criticism. A comparison of sectoral effective protection coefficients for 1979 and 1981 shows that the variance of the degree of protection afforded to individual sectors has increased over this period against the original objective of attaining a "neutral trade regime" (i.e. removal of policy-induced distortions in the allocation of resources among sectors). Moreover, for the majority of the sectors, the magnitude of the effective protection coefficient was significantly higher in 1981 compared with 1979. It seems that in the process of subsequent fine turning of tariff rates, policy makers have given prominance to the politically sensitive objective of giving protection to local industries on a selective basis at the expense of the original objective of achieving neutrality in protection. However, it is important to keep in mind that, whatever the magnitudes of new tariff rates and their variablity, the drastic shift from quantitative restriction to tariffs per se would undoubtedly, have reduced the overall level of effective protection through eliminating the scarcity premia attached to such restrictions.

Real effective exchange rate (REER) for both exports and imports have tended to decline over the past three years or so following the relatively higher levels recorded in the immediate policy reform years (Table 2). This pattern suggests that over the time the degree of direct depreciation achieved through the floating exchange rate system plus indirect depreciation implied in various incentive schemes lagged behind the rate of domestic inflation (measured by the GDP deflators). However, throughout the period, the REER for manufactured exports remained at a higher level compared with that for total exports reflecting the favourable treatment accorded to the former under the existing selective export incentive schemes. The REER for manufactured exports also has remained at a higher level compared with that for imports suggesting a bias in favour of producing manufactured goods for the export market than for the domestic market. However, this bias has tended to reduce in recent years reflecting the impact of upward adjustments in import duties. The REER for imports in recent years is suggestive of the fact that despite upward adjustments in import duties, on the average, imports have become relatively cheaper than their local substitutes.

Removal of Price Controls

Except for a few "essential" consumer goods, price controls which existed with regard to a wide range of products were removed. The purpose of these decontrol measures was to make profits more responsive to efficiency and market orientation rather than to administrative decisions by the However, "administered prices" still remain for the products of most of the public corporations.

Adoption of measures to attract direct foreign investment (DFI)

The new policy envisages DFI to play an important role in the process of industrialization, as a supplement to scarce domestic capital, technology and managerial skills. In particular, it is expected that foreign investors, thanks to their technological expertise and marketing skills and their greater ability to resist protectionist pressures within their home economies, can be instrumental in penetrating international markets for manufactured exports.

Steps to limit expansion of public sector investment in industry (and other areas) and to rationalise the operation of existing public sector ventures

The new policy envisages that "the public sector will concentrate on essential areas that are not attractive to the private enterpreneur either because the investment involved is too large or because the financial rate of return is not attractive" (Budget Speech, 1978 : 30). With a view to making public enterprise more efficient and commercially viable and to eliminating the distortionary impact on the rest of the economy emanating from their operation, a four-element rationalization programme was announced in 1978: (a) setting up of minimum standards of financial viability, (b) requirement that they compete on equal and non-discriminatory terms with the private sector, (c) "professionalization" of the top management, and (d) privatization or closing down of uneconomical and inefficient projects (CB ROE, 1978 : 57) 4. The previous practice (which existed since 1957) of reserving certain industrial sectors for public investment only has been terminated.

The experience over the past seven years shows that the ratationalization programme lost much of its rigour in the process of implementation. Despite widespread inefficiencies across various public enterprises, privatization has gone in a big way only in the textile industry. In 1983 the government authorised private sector participation in projects of several corporations (including Ceramics, Leather, State Mining and Mineral Development, Petroleum, Hardware and Mineral Sand), but to date this initiative has not generated tangible

Table 2

REAL EFFECTIVE RATE (REER) ESTIMATES FOR EXPORT & IMPORTS , 1975-83 (RUPEES PER US$, BASE YEAR 1980)

	1975	1976	1977	1978	1980	1981	1982	1979	1983
(1) Total Commodity Exports	6.95	8.24	9.72	11.56	11.34	12.83	12.66	11.39	11.56
(2) Manufactured Exports	17.07	16.60	23.01	25.19	18.91	21.56	21.85	21.85	16.61
(3) Total Commodity Imports	N.A.	N.A.	N.A.	14.47	16.57	17.98	18.15	18.75	18.70
(4) Trade-Bias Index	....	....	...	.....	.....	.....	....	.....	......
Total Exports	N.A.	N.A.	N.A.	0.56	0.59	0.71	0.79	0.85	0.83
Manufactured Exports	N.A.	N.A.	N.A.	1.08	1.11	1.20	1.22	1.19	1.16

Notes: a. The REER for exports, measured at one point in time, is the real return to exporters, in local currency, from exporting goods worth one unit of foreign exchange (one dollar in this case) and is estimated as,

REER = (OER (1-TX+SB) px / pd

OER = Official exchange rate (Rs. per US$)

TX = Export tax rate

SB = The rate of total effective subsidies

P x = Index of export prices

P d = Index of domestic prices (the GDP deflator has been used in these calculations)

In the same vein, the REER for imports measures the real cost to the importer of importing one dollar worth of goods and is estimated as, REER = (OER (1+TX) Pm/ Pd

b. Ratio of nominal effective exchange rate for exports to nominal effective exchange rate for total imports.

Source: ***Complied by the author for the forthcoming World Bank study, The Timing and Sequencing of a Trade Liberalisation Policy: The Case of Sri Lanka.***

results. Contrary to the originally declared policy, a number of corporations have been accorded preferential treatment including higher tariff protection (Cutbbertson and Khan, 1981 : 90). In addition, the continual practice of licensing of certain imports has provided indirect protection to certain state industries. (CBC, ROE 1978: 71). Even after the elapse of about six years since the introduction of the policy reform, in his 1985 Budget Speech the Finance Minister had to observe that, "unfortunately some public corporations are becoming an intolarable burden on the Budget and on the people of the country....Unless we do something immediately to improve their efficiency the implications for the future are likely to be serious" (p. 12).

(e) Emphasis on Export Development

To establish a sound institutional background for the export development drive, the Export Development Act No 40 was enacted in 1979. Under the Act, the Export Development Board (EDB) was established in 1980 with the assigned tasks of formulating export development programs and monitoring their implementation, and co-ordination of the activities of various government bodies responsible for various aspects of the export development drive. Under the auspices of the EDB, a specific export development policy package including direct cash subsidies, import duty rebates, manufacture- in-bond, and various measures aimed at product and market development have been introduced. The EDB, in collaboration with the Central Bank and genous commercial banks,provides both equity and working capital to firms on scrutiny of their export potential. Since 1977 the government has taken steps to streamline and improve fiscal incentives for export production at successive stages finally limiting tax holiday concessions only to export ventures (by the 1983 budget).

In addition to these explicit measurer, the government has also taken steps to remove rigidities in the labour market and to "tidying up" its functioning through informal repression of militant trade unions. In particular, the erosion of trade union power through the dismissal of a large number of workers following the strike in 1980 helped to contain real wage growth (Lall and Rajapatirana, 1985).

To sum up, in the process of actual implementation, many elements of the policy package have left much to be desired when viewed from the original objective of achieving neutrality in the overall industrial incentive structure. There are still policy elements inherited from the past without undergoing modifications to fall in line with the new strategy. Despite this "unfinished" nature of the agenda, the overall policy reform undoubtedly marks a substantial break with the industrialization policy of the previous restrictive regime. Let us now pass on to examine the implications of this new policy orientation for trends, patterns and development consequences of industrialization.

Sectoral Distribution of New Firms

Throughout the recent period, the textile and garment sector has been the major area of attraction for both foreign and local capital. However, for the former this degree of concentration is much higher than that of the latter. More than 50 per cent (33 out of 65) of the GCEC projects are in this sector. This supports the view that ,"getting round the quota" motive (the desire to utilize Sri Lanka's export quotas in foreign markets as a way out of stringent quota restrictions which the investors face in their home countries) was a major factor behind the recent upsurge in direct investment flows to Sri Lanka. Out of the FIAC projects, more than 62 per cent (71 out of 114) are in sectors other than in textile and wearing apparel. And most of these projects are of "import-substitution" type. According to a recent field survey, out of the total output of FIAC approved projects only 44 percent is exported, and out of the total number of firms in operation only 36 percent exported even a small portion of their output (Ministry of Finance and Planning, 1984).

In an overall comparison, capital goods industries, and light manufacturing industries indicate a relatively lower number of new projects compared with the other sectors. An analysis of changes in the import structure over this period shows that these are the sectors which were severely affected by trade liberalization. Next to textiles, the other sectors which have been areas of attraction are food products, chemical and rubber based products (mainly PVC products, roofing material, paints and other inputs used in construction industry) and non-metalic mineral products (clay, sand and cement products, bricks etc). In the case of various food products, protective tariffs coupled with relatively low purchasing power of local consumers, have continued to ensure a profitable market for local produce compared with high-priced imports. Various products in the other two categories, because of their "cuasitradable" nature, are naturally protected from import competition. On the other hand, some of them , especially those in the chemical and rubber based product groups are highly import dependent, and therefore have benefitted from import liberalization.

Business Failures and Other Impact on Existing Firms

Table 3 which is based on the MISA Survey (1980) compares for each three-dight ISIC sector the number of manufacturing units which were supposed to be in production by July 1980 and the number found inoperative during the course of the survey. The average business failure rate for the total number of companies (3018) is about 20 per cent. In an inter-sectoral comparison various food producing sectors (1 through 4), ferrous and nonferrous metal sectors and chemical products indicate relatively low failure rates compared with the average rate. On the other hand, machinery and equipment, electrical goods and other light-manufacturing sectors indicate relatively higher rates. In general, this overall pattern closely corraborates with the pattern of setting up of new production units and therefore the same reasoning seems valid here. The MISA Survey did not cover the textile and wearing apparal sector. However, information given in successive issues of the Review of Economy of the Central Bank suggests that this sector (especially the spinning and weaving subsector) was among the most affected. For instance in 1978 out of 1300 firms in this sector, which were on the mailing list of the Central Bank annual industrial survey, 200 firms informed of the closing down of their business.

Production units in the "unorganised" sector (unapproved units, mostly cottage industries) bulk large in the industries which a priori seem to be highly vulnerable to competition from imports (e.g. textile, jaggery, pottery, blacksmithy products, sugar-cane syrup). However, no data is available on business failures in this sector.

Table 3

SECTORAL DISTRIBUTION OF DISPLACEMENT OF MANUFACTURING UNITS, 1977 - 80

	Units in operation as per Ministry Records, Sept. 1980	Inoperative units servey results	Business failure rate (%) (2) / (1)
	(1)	(2)	(3)
(1) Food, beverages and tobacco	291	58	19.93
Meat, fish and milk products	19	05	26.31
Fruit and Vegetable products	19	07	36.84
Confectionery, bakery and cereal products	141	23	16.31
Spirits, alcholic beverages & areated water	15	03	20.00
Other food products and tobacco	97	20	20.61
(2) Chemical, petroleum, rubber & plastic products	995	78	7.83
Petroleum products and petro-chemicals	223	32	14.35
Salt and salt based chemicals	13	02	15.38
Other chemicals	79	25	31.64
Pharmaceuticals, medical supplies & cosmetics	69	0	0
Soap, oils and fats	208	17	1.95
Leather and rubber products	403	02	0.49
(3) Wood, paper and pulp	278	84	30.21
(4) Non-metalic mineral products (clay, soil and cement products)	312	55	17.62
(5) Basic metal and machinery	162	43	26.54
(6) Ferrous and non-ferrous metal products (other than machinery)	379	78	20.54
(7) Transport equipment	240	68	28.33
(8) Electrical goods	267	84	31.46
(9) Optical and photographic goods etc.	92	31	33.70

Source: Ministry of Industries and Scientific Affairs 1980 *Survey of Industries to Ascertain the Impact of Import Liberalisation (Unpublished official document).*

Only for hand-loom textile production, there are some tentative estimates prepared by the Ministry of Textile Industries which suggests that out of about 111,000 handlooms that existed in the country about 30,000 had ceased to function by 1980 (People's Bank, Economic Review 6 (1) : 29). The IDB survey (1980) provides some useful evidence on the relative impact of liberalization on approved and unapproved units at the aggregate level. This evidence is summarised in Table 4.

Table 4

THE IMPACT OF TRADE LIBERALIZATION ON MANUFACTURING : A COMPARISON OF APPROVED AND UNAPPROVED UNITS (1977-1979)

	Approved Industries	Unapproved Industries	All Industries
(A) Percentage distribution of number of firms according to the "nature" of impact:			
i. Closed down	8.6	3.1	4.3
ii. Adversely affected	15.8	26.9	24.6
iii. Benefited	37.6	18.5	22.5
iv. Unaffected	38.0	22.5	48.7
	100	100	100
	====	====	=======
(B) Percentage changes in selected performance indicators between 1977 & 1979*			
i. Investment	+69.7	-20.9	54.4
ii. Production	+20.5	-6.0	12.8
iii.Sales	+14.1	-28.0	-1.6
iv.Profit	+ 7.1	-16.1	-6.0
v. Employment	+39.0	-28.7	+6.5
vi. Raw material usage - Local	-15.0	-16.1	-15.4
Foreign	+30.2	-27.6	+14.2

* For the purpose of these calculations, value figures for 1979 have been converted into 1977

Source: *Compiled using data from, IDB (1980), A Study of the Effects of Liberalization of Imports on Local Industries unpublished working paper)*

Export Expansion, Import Dependence and Balance of Payment Implications

Total industrial exports have indicated considerable growth dynamism in recent years. Current SDR value of these exports (excluding petroleum products) increased from the level of SDR 30 million in 1977 to SDR 354 million in 1984. Their share in total exporters in these two years was 6 per cent and 26 per cent respectively.

In a disaggregated analysis, the expansion of manufactured exports appeared to be rather lopsided. The growth has predominantly emanated from a single item, wearing apparel (garments). This was in fact, the only item in this category which indicated a significantly higher real growth (58%) for the period 1978-82 compared with that for 1970-77 (33%). Among the other items (at 3-digit BTN level) only sea-foods, rubber goods and ceramic-ware indicated average positive real growth during 1978-82. Even in these cases the growth was rather spasmodic and, for most of the items, average growth rates were lower than those recorded in 1970-77.

From a policy point of view, an aspect of manufactured export expansion which is perhaps even more important than changes in absolute export levels (as discussed above) is the degree of export orientation of manufacturing output. The overall export orientation of manufacturing appears to have some-what improved over time. In 1976, the "export coefficient" (the ratio of exports to total gross manufacturing output) was 12 per cent. This increased to 18 per cent in 1978 and then to 24 in 1980. Yet sectoral estimates indicate that only a few product categories (at 3-digt I SIC level) namely wearing apparel, leather goods, rubber and plastic goods, ceramic-ware, and non-ferrous metal, have contributed to this favourable trend. The Export Coefficient of each of the remaining product categories has declined in 1980 compared with 1978, reflecting an increase in "domestic market orientation"..

Given the heavy emphasis of the policy on foreign investors in the process of export-oriented industrialization, it is pertinent here to examine the role they have played in recent export expansion. Table 5 summarises the findings of a recent study related to this aspect. According to the table, exports by foreign firms increased by 244 per cent between 1979 and 1982 compared with 163 per cent between 1977 and 1979. In both periods, these growth rates were higher than growth rates of total manufactured exports from fully locally owned Sri Lankan firms. Nearly 57 per cent of total export increment between 1979 and 1982 was brought about by foreign firms compared with their 36 per cent contribution between 1977 and 1979. As a consequence the foreign firms share in total manufactured exports increased from 24 per cent in 1977 to 31 per cent in 1979 and then to 46 per cent in 1982. The table also shows that this growth dynamism was due mostly to the expansion of activities in the KIPZ. According to disaggregated estimates (not reported in this Table) about 61 per cent of total exports by foreign firms in 1979 comprised of wearing apparel and this share increased to 77 per cent in 1982. In summary, this evidence supports the view that foreign investors have played an important role in recent expansion in manufactured exports. However, the original expectation that they would contribute towards the establishment of a highly diversified export structure has not materialized.

Table 5

ROLE OF FOREIGN DIRECT INVESTMENT IN MANUFACTURED EXPORT[a] EXPANSION : BASIC DATA (BASED ON SDR VALUES)

	1977-79		1979-82
1. Growth[b] (%)			
Exports by firms with FDI	162.6		243.7
Exports by fully locally-owned firms	151.7		132.6
2. Contribution (%) to export increment			
Firms with FDI	35.5		56.7
Exports by fully locally-owned firms	64.5		43.3
	1977	1979	1982
3. Percentage contribution of firms with FDI to manufactured exports	23.6	30.8	45.5
IPZ firms	-	3.6	31.3
Non-KIPZ firms	23.6	27.2	14.2

Notes: a. Excluding petroleum products
b. These estimates relate increase in exports between the two end years of each subperiod.

Source: *Athukorala, 1984, chapter 5 (Estiamtes have been made using firm-level Customs export data).*

Redistributional Aspects

The industrial structure of Sri Lanka, as it evolved in the 1960s, led to a high degree of concentration of asset-ownership contributing to income inequality in the economy (Karunatilake, 1976: 187: Hewavitharana, 1979-26). At the initial stage of private sector expansion in manufacturing in the early 1960s, the industries were set up by a handful of enterpreneurs who until then had been involved in import and wholesale trade. Generous and indiscriminate tax concessions awarded, heavy protection; and favourable treatment in exchange allocation helped these entrepreneurs to expand rapidly forming themselves into a new rich class. The wealth this class was able to amass over a short period of time in many instances, exceeded the inherited wealth of people who had been connected with the plantation economy over a hundred years. A survey conducted by the Treasury in the early 1970s found that out of a total investment of Rs. 275 million in industrial undertakings each with a capitalization of over Rs. 1 million, Rs. 205 million (or 75%) was held by eleven family groups (Budget Speech 1973: 35). Moreover, out of the total number of companies which were formed during this period more than 84 per cent were private companies reflecting the increased concentration of wealth (Ibid). In 1966, the top 6.2% of the firms accounted for 63.3% of total industrial output. In 1974 the top 7.5 per cent of the firms accounted for 89% of output.

We do not have sufficient evidence for a detailed analysis of the changing pattern of wealth and income distribution related with industrial changes since 1977. Nonetheless, there is evidence which suggests that the degree of concentration has in fact increased since then. Firstly, during the period 1978-82, 927 manufacturing companies were formed in the private sector of which only 67 (7%) were public companies. Moreover, most of these private companies (about 75 per cent) were subsidiaries or affiliates of existing companies. Even in the case of public companies a close look at their share ownership structure suggests that most of these companies are not "broad-based" in a strict sense. Secondly, an analysis of the ownership pattern of joint-ventures approved by the GCEC and FIAC shows that almost all of the local collaborators belong to the top bourgeosie of the country. Thus, the recent increase in foreign capital inflow has given this class further opportunity for expansion providing access to foreign technology, marketing know how, and cheap and easy foreign financing (Bastian, 1984: 44-45). Thirdly, we have already noted that with trade liberalization, a significant number of small and medium scale firms went out of production in the face of severe import, competition, while llarge scale firms, mostly those with foreign capital links could face the new market situation successfully.

Fourthly, we have also observed that during this period "wage to value added ratio" in industry recorded a decline reflecting an uneven distribution of value added in favour of non-labour factor owners. This evidence supports the view that "by the current liberalization, the process of concentration of income has gained a coherence and consistency which it lacked before" (de silva, 1982:486).

CONCLUDING REMARKS

The analysis shows that the spurt in aggregate industrial production recorded in 1978 slowed down in subsequent years indicating a rather erratic pattern in annual growth rates. The growth momentum in industry has been much lower than that of trade and services sectors which are directly linked with the essence of the new policy. At the sectoral level, the pattern of industrial growth seems rather lop-sided, emanating predominantly from the wearing apparel industry, some industries within the chemical and related products sectors and industries enagaged in the production of some inputs for the construction industry.

The available circumscribed firm-level data, supplemented with data on sectoral growth rate differentials, suggest that the nature of the impact on a given producer is not necessarily correlated with the degree of effective protection provided by the existing trade regime. While there is little doubt that the degree of effective protection contributes to the ability of a given producer to face competition from imports, there seems to be other, perhaps even more important, fundamental structural factors such as the nature of ownership (foreign vs. locally owned), the scale of operation, the pattern of local demand, and protection gained through the very nature of the commodity involved, which determine the net impact of trade liberalization on his performance. In particular, the impact has been more adverse (or less favourable) to small-scale producers whatever the type of products they produce. This observed pattern cast doubt on the adequacy of the blanket approach embodied in the present tariff related industrial assistance policies in promoting a "desired" pattern of industrial development.

Despite the government's stated desire to make the private sector the driving force of the economy, the aggregate share of public enterprises in the organised manufacturing sector has not shown any decline in the post-liberalization period. With regard to the private sector operation in the economy, a process of "deindustrialization" resulting from shift in resources to non-tradable sectors, is discernible.

The degree of export market penetration of product sectors with the exception of the garment sector, still remains insignificant and does not show any sign of improvement. The inflow of foreign direct investment has shown an upsurge since 1977, but, as yet, foreign capital participation is limited only to low-technology and unskilled-labour intensive export industries, (mainly garments and import substitution product sectors). Increased import-intensity in domestic production has limited the net balance of payments impact and spread effects of industrialization. The fortune of the industry sector still depends very much on foreign exchange generated by the traditional export industries as in the ISI era. Employment in the organised industry has somewhat expanded, but this expansion has originated mostly in the garments industry while in most of the other sectors the level of employment has either declined or remained stagnant. While we do not have adequate data on the unorganised manufacturing sector, the existing circumscribed data base leads one to surmise that when both organised and unorganised sectors are taken together total level of industrial employment might have even declined. Real wages per industrical worker has tended to decline in the face of an increase in the share of value added accruing to the industrialist. The pattern of industrialization over these years might have further strengthened the tendency towards a higher degree of wealth and income concentration in the economy.

Why has progress not been up to expectations. Economists who maintain a profound faith in the basic neoclassical tenets behind the policy reforms, usually ascribe the blame for this failure to inadequacies in the industrial and trade policy package (World Bank, 1981, 1982, 1983: Lal and Rajapathirana, 1985). In particular, the existing discriminatory tariff structure which has led to distortions in resource allocation, the anti-export bias built into the incentive structure, and continued government involvement in direct production sectors have been highlighted as major limitations. The Industrial Policy Mission of the World Bank which visited Sri Lanka in 1983 has, therefore, suggested further policy measures to ensure "a system of neutrality of incentives between import substituting and exporting activity". These measures include the introduction of new export incentive measures or expanding and refining the existing ones, reducing the existing barriers to import, and reducing the government's claim on domestic resources (World Bank, 1983:53-62).

The view is frequently expressed in Sri Lanka policy circles that the impressive growth and development record of the South-East Asian countries was due firstly to free trade, and secondly to the very low level of

FINANCE MINISTERS OF IMF- WORLD BANK MEMBER COUNTRIES DISCUSS GLOBAL ECONOMIC ISSUES

Gamini Abeysekera

Dr Gamini Abeyesekera, Additional Director, Economic Affairs Divison, Ministry of Finance and Planning who was a member of the Sri Lankan delegation led by the Minister of Finance & Planning Mr Ronnie De Mel to the joint Annual Meetings of the International Monetary Fund and World Bank in Seoul, provides an on the spot assessment of these deliberations. The Finance Ministers of the member countries of the IMF and World Bank, who are also governors of these institutions, usually gather every year at the joint Annual Meeting of these two multilateral institutions in Washington DC, and once in three years the sessions are held in a member country. This year it was held in Seoul South Korea.

Prior to the formal meetings of the Governors of the Fund and Bank several other important meetings are held. These include the meetings of the Group of Ten (G-10) and Group of Twenty Four (G-24) which represents groups of industrial and developing countries respectively. At these meetings, each group formulates a statement summarising the major international economic and financial issues which they consider timely and vital for discussion as well as the stand that should be taken by each Group in regard to those issues. The G 10 and G 24 meetings are followed by the Interim Committee Meetings and Development Committee Meetings attended by the Ministers, Senior Officials of Finance Ministers and Central Banks. At the Interim Committee Meeting, matters pertaining to the IMF are discussed while the Development Committee Meeting focusses on World Bank related issues.

The main subjects dealt with and the key issues highlighted at the entire series of meetings held in Seoul, including the Joint Annual Meeting of the Fund and Bank may be summarised as follows:

(a) The world economic outlook in general, and its implications for growth and developmetn of the developing countries in particular;

(b) The world debt problem and alternative approaches to find solutions;

(c) The problems in the international monetary and financial system, with special reference to allocation of SDRs by the IMF and the need for a General Capital Increase by the World Bank;

(d) The question of protectionism in international trade and the need for greater capital flows developing countries; and

(e) The functioning of the exchange rate system and issues pertaining to surveillance and adjustments.

Most of these subjects have been dealt with by the Fund and the Bank on several previous occasions. Therefore, the meetings in Seoul reflected a continuation of the dialogue while taking stock of the current situation and focussing on possible policy action. Although no concrete decisions were made at the Seoul meetings, it was possible to observe a greater convergence of ideas expressed by industrial and developing countries on a number of key issues. According to a majority of speakers, successful resolution of the world debt crisis and other financial and monetary problems and attainment of sustainable development in all parts of the world would require a combination of appropriate policies by both industrial and developing countries. The consensus, expressed by the Governors, that the path to global prosperity lies in a co-ordinated strategy involving both industrial and developing countries, amounted to assigning the Fund and the Bank, a major role as co-ordinators of such a strategy. Furthermore, in regard to the need to support appropriate strategies with adequate financial flows, the roles of the Fund and the Bank were stressed more explicitly.

Global Outlook Not Encouraging

The world economic outlook was interpreted by several speakers as not very encouraging. They noted that the recovery of the industrial countries was fragile and faltering. Among the treats to sustainable world economic growth they cited the slowdown in investment, continuing high levels of real interest rates, weak commodity prices, structural budget deficits and volatile exchange rate movements. The speakers from developing countries argued that a global recovery cannot be attained and sus-

public intervention. Perhaps with the exception of Hong Kong (which is not typical of developing countries), for other countries (and indeed for Japan) this view is in sharp contradiction with actual facts. As a number of studies have highlighted, the economic success of these countries is not so much the result of "natural" market forces as of determined government policy aimed at "creating comparative advantage of the future".

The explanation for this discrepancy between predictions of the neoclassical economic paradigms and the real economic experience of developing countries must be found in the peculiarities of their economic structures, in particular the lack of a dynamic industrial capitalist class with a declared industrialization mission as well as various imperfections in the market structures. In most of these countries capital is still at its mercantile stage of development. Trade and other non-tradable sectors are still its favoured fields of investment, and industrialization is usually considered as a "forced" alternative; added to this, the developing countries have inherited from their colonial era a very imperfect market structure where the "market" and "social" comparative advantages differ among themselves.

tained unless and until the economic base of developing countries is strengthened; and hence the importance of recognising the interdependence between industrial and developing countries was reiterated by these speakers. They elaborated on this argument by stating that developing countries ought to have greater access to trade, capital and technology also involving enhanced resource transfers from the developed world, if they are to efficiently take part as partners of development so that industrial countries can also expand their economies.

In the context of the need for co-ordinated action by all countries, many speakers from developing countries argued that the burden of adjustment must be shared fairly and equitably by industrial countries as well, without passing it entirely on to the developing countries. Their greivence was that despite severe and continued adjustment efforts launched by developing countries, certain policies pursued by the developed economies or the absence of required policies in such countries have made adjustment efforts ineffective or even more difficult. Therefore, the Governors from the developing world urged the industrial countries to be more concerned with the global effects of their domestic macro economic policies and also to follow more enlightened policies towards trade and capital flows. In this context, many speakers called on the United States to reduce its fiscal budget deficit in the hope of reducing interest rates and accordingly the debt service burden of the indebted developing countries. On the other hand, some Governors appealed to the Federal Republic Germany and Japan to follow more expansionary fiscal policies to stimulate the growth rate of industrial countries caused by the slowdon is US growth in recent years. Virtually, all Governors cited protectionism in the industrial countries as a major threat to expansion of exports of developing countries and world trade and warned that it would aggravate the problem of servicing their external debt and impair the achievement of sustainable and balanced growth in the world.

The Crisis of Overborrowed Latin America and Poverty Stricken Africa

One of the major issues which was debated at length during the Seoul meetings was the debt crisis faced by some of the developing countries. The difficulties of the over-borrowed Latin America and the poverty stricken Africa, and the resulting implications of their indebtedness to the international economy dominated the speeches of several key speakers. For instance, James Baker, the Secretary to the Treasury of USA went to the extent of putting forward a three point plan towards solving the debt problem. According to the Baker Plan, there are three main components that must get together in formulating a package deal; i.e. the Commercial Banks, the World Bank and the IMF. His plan is that first,Commercial Banks should provide $ 20 Bn. in new money over three years to 15 big debtors including Mexico, Brazil and Yugoslavia who do not have access to borrowing. Second, an extra $ 9 Bn. over three years should be provided by the World Bank together with the Inter American Development Bank mainly with a view to mobilising more private capital through co-financing arrangements. Third, another $ 2.7 Bn. consisting of payments due to the IMF Trust Fund over the next six years, should be reserved for the poor countries faced with chronic balance of payments problems. The crux of the Baker plan appeared to be the belief that more official lending would encourage more private capital flows and facilitate rescheduling of debt. However, the importance of Baker's plan lies in the readiness of USA to evolve an action oriented programme to resolve international debt problems with the assistance of both multilateral institutions and commercial bankers.

Another important issue that received the attention of the policy makers assembled in Seoul was the problem of stagnating Africa. The problem of Africa was recognized as much more deap seated than merely a debt problem. In the African context, the debt problem was viewed as a manifestation of more fundamental deficiencies related to a host of factors including climate, population growth and structural weaknesses in the economy. Hence, it was pointed out that a more broad based approach to Africa's problems has to be evolved by the multilateral agencies. The efforts of the World Bank in extending assistance to Sub-Saharan Africa were commended by many speakers. However it was felt that the new special three year facility for these countries started in July this year by the Bank, with about 1.2 billion dollars would not be adequate. Therefore it was suggested that the International Development Association (IDA), the soft-loan window of the World Bank for poor countries, should be directed to provide more resources to Sub-Saharan Africa. Another proposal made in this context, was to augment the World Bank's special facility with the IMF Trust Fund money.

Surveillance Asymmetrical

Every Governor who spoke at the joint annual meetings of the Fund and the Bank, dealt with the respective role that these two institutions should play in the international economy. In regard to the role of the Fund, the view point expressed by the developing countries in general, was that the Fund should be flexible in its dealings with individual countries in the face of a constantly changing international economic environment. They also argued that the "surveillance" of the Fund has been asymmetrical since it has been effective only incase of those developing countries who nad to resort to assistance from the Fund, while it was not at all effective in regard to the industrialised countries. The developing countries shared the view that both deficit and surplus countries should be subject to international monetary and financial discipline of a general nature. They pointed out that without such an agreement for strengthening and broad basing the surveillance function of the Fund, it would not be possible to maintain stability and growth in the international economy.

While appreciating the need for better co-ordination of the policies of the IMF and the Bank, several Governors warned that it should not result in cross-conditionality in regard to assistance of developing countries by the two institutions. In this context Sri Lanka's Finance Minister Mr. Ronnie de Mel, stressed that all country programmes of the Fund should be linked to financing. He also warned against the danger of the Fund becoming a "credit-rating agency". In other words, the developing countries emphasised the fact that there should be no enhanced surveillance by the Fund, if there is no recourses to additional fund resources. They also argued that conditionality should not be applied as a general principle to all borrowing countries alike. In regard to additional resources required for low income countries, the speakers welcomed the idea that the IMF should allow the Trust Fund reflows to be used for concessional balance of payments assistance. Nonetheless, they stressed that such an arrangement should not in anyway weaken the case for replenishing the resources of the multilateral agencies.

ENHANCING INTERNATIONAL CAPITAL FLOWS

Focussing on the role of the World Bank, many Governors particularly from the developing world, appreciated the need for increasing the capital base of the Bank. They argued that an expanding role of development financing can be undertaken by the World Bank and its soft-loan window - IDA, only if their capital resources are expanded. It was also pointed out that efforts to increase private capital flows should not be treated as a substitute but only a supplement to the development finance that the World Bank can extend. While appreciating the efforts of the World Bank in assisting Sub- Saharan Africa affected mainly by natural clamity and the Latin American countries burdened with enormous debt servicing problems, the developing countries in Asia put forward another strong perspective in regard to development finance. Mr. Ronnie de Mel, Sri Lanka's Minister of Finance and Planning being a lead speaker on this subject, stressed that while the debt crisis deserved much attention it should not result in a shift of emphasis away from other developing countries. He argued that the countries which have shown satisfactory progress through the implementation of difficult adjustment programmes should be rewarded for their prudent economic management instead of being penalized for their efforts. In other words, he emphasised the need to ensure that concessional lending will not be curtailed to the developing countries particularly in Asia, which have shown a satisfactory progress, and that they will not be crowded out by the over-riding considerations related to the Latin American debt problem and the African situation.

A CONTROVERSIAL SUBJECT

In regard to the promotion of international capital flows, which is a major responsibility of the World Bank in its role of financing development, a proposal had been made to establish a Multilateral investment Guarantee Agency (MIGA). This was another important issue that became the subject of a somewhat controversial discussion at the annual meetings of the Fund and the Bank in Seoul. The main objective of MIGA was announced as the stimulation and expansion of private capital inflows or foreign direct investment into the developing countries. It was revealed that MIGA would cover non-commercial risks of the investors through a system of investment gurantees and provide an appropriate legal and policy environment conducive to private capital inflows. There was, however, no unanimity about the merits of this proposal as the responses of the developing countries, in particular, were mixed. Nonetheless, some countries signed the Draft Convention to establish the MIGA and it appeared that many others would fall in line.

Several other technical issues related to the operations of the Fund and the Bank such as a further allocation of Special Drawing Rights (SDRs) and Access Limits were also discussed during the meetings. Although no consensus was reached or no specific decisions were made, the exposure of a large number of issues related to the international monetary and financial system at these meetings proved to be useful to sesitise the policy makers and provoke their thinking about such issues. Practically every Governor agreed that improvements are needed in the functioning of the present system. They felt that the international community must create conditions that will make it possible to establish better relations among the countries in the world as well as speedier development in the low income countries with a view to achieving global prosperity. Similarly, they recognized the need to continue the efforts of the developing countries to restore their external balances and effect structural changes required for sustainable growth. They concluded that twin goals of 'adjustment' and 'development' were not incompatible, and that adjustment was a pre-requisite for longer term growth and development. The Governors in general, expressed their hopes regarding the ability and potential of the IMF and World Bank to help countries in achieving adjustment and development.

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