

# SRI LANKA ECONOMIC JOURNAL

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## CONTENTS

### *Articles :*

	PAGE
INAUGURAL ADDRESS — GAMANI COREA	1
REVIEW OF ECONOMIC POLICIES AND PROGRESS 1977 — 1984 — J. B. KELEGAMA	12
REFLECTIONS ON INDUSTRIAL DEVELOPMENT — E. M. WIJENAIKE	58
AN EVALUATION OF AGRICULTURAL POLICY ON THE PADDY SECTOR 1950 — 1985 — N. L. SIRISENA	66
EMPLOYMENT TRENDS — R. B. M. KORALE	98
FISCAL AND MONETARY POLICY IN SRI LANKA WITH SPECIAL REFERENCE TO THE PERIOD AFTER 1977 — H. N. S. KARUNATILAKE	113

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Contents		Page
Inaugural Address	— Gamani Corea	1
Review of Economic Policies and Progress 1977 — 1984	— J. B. Kelegama	12
Reflections on Industrial Development	— E. M. Wijenaike	58
An Evaluation of Agricultural Policy on the Paddy Sector 1950 — 1985	— N. L. Sirisena	66
Employment Trends	— R. B. M. Korale	98
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## **SRI LANKA ECONOMIC JOURNAL**

Articles, comments and reviews for publication, and books for review should be addressed to either the Editor, Sri Lanka Economic Journal, No. 61, Carmel Road, Colombo 3, Sri Lanka or General Secretary, Sri Lanka Economic Association, C/o University Grants Commission, No. 20, Ward Place, Colombo 7, Sri Lanka. Correspondence regarding membership and subscription should reach Treasurer, Sri Lanka Economic Association, C/o Agrarian Research and Training Institute, Wijerama Mawatha, Colombo 7, Sri Lanka.

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## EDITOR'S NOTE

The objective of the Sri Lanka Economic Association is to bring together Sri Lankan economists who live here and abroad, and to provide an active forum for the discussion of economic and social problems in Sri Lanka. It is also a main function of the Association, among others, to promote and facilitate research, surveys and studies in Economics with local and foreign collaboration and to plan and organise teaching and training programmes in Economics.

From the beginning members of the Association felt that it was necessary to bring out a journal on Economics on a regular basis which would provide the means for economists and other social scientists to publish their research and writings. Since the present journal is the successor to the "Ceylon Economic Journal" which was first published in June 1929 by the Ceylon Economic Society, the format of the cover page of this Journal is practically the same as that of the "Ceylon Economic Journal."

The articles appearing in this first issue of the Journal were prepared by the respective writers for presentation at a seminar held in October 1985 sponsored by the Sri Lanka Economic Association entitled "Reflections on Sri Lanka's Economic Experience."



## EDITOR'S NOTE

The objective of the Sri Lanka Economic Association is to bring together Sri Lankan economists who are interested in the development of the country and to provide an outlet for the discussion of economic and social problems in Sri Lanka. It is also a forum for the Association members to present and discuss their research and studies in their fields of interest and to plan and organize lectures and training programmes in Economics.

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# INAUGURAL ADDRESS\*

GAMANI COREA

Vice Presidents of the Sri Lanka Economic Association, Professor Indraratne, Members of the Association, Ladies and Gentlemen.

I wish, first of all, to say how honoured I am to be elected the first President of the Sri Lanka Economic Association. I welcome, most warmly, the initiative of the founder members and of Professor Indraratne to establish this Association. I myself took no part in that initiative and, therefore, feel particularly privileged to be invited to join the Association and to become its first President.

I am glad that this inaugural meeting has enabled our Association to get off to an early start. My first wish is for its success and for a life of vigorous and creative activity. There have been similar associations in the past which produced journals and other publications but unhappily these have died out over the years. For a long period the economists of Sri Lanka have been without a forum. The creation of our Association represents some continuity with the past. But it also signifies the filling of a void that has existed for sometime.

I have learnt that another society of economists has been set up recently. I feel we should welcome its creation. It is my hope that the two bodies will work in harmony and cooperate with each other. We might organise some joint activities not only with each other but also with the numerous other institutes and organisations that are concerned with economic and social problems. As the President of your Association I will do my utmost to encourage such collaboration so as to help create a milieu in which all those engaged in the study and discussion of economic problems could interact with each other and so contribute towards an understanding of the several issues that concern this country.

Many of us who have joined this Association belong to what could be called the first generation of economists in this country. We may not belong to the earlier generation of academic economists such as Professor B. B. Das

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\*The Association held its inaugural meeting on August 15th, 1985.



Gupta and F. R. Jayasuriya who pioneered the teaching of economics. But many of us are part of the generation of economists that first became associated with economic administration and policy making and we have a unique historical experience on which to draw. Some who spanned both generations are no longer with us. Names such as H. A. de S. Gunasekera, I. D. S. Weerawardene, and G. V. S. de Silva come to mind. We greatly miss them on this occasion. Had they been alive they would, I am sure, have joined us and given encouragement and strength to our endeavour. On the occasion of this first meeting it is fitting to recall these names because they too belong to the generation of pioneers.

I have been hesitant in selecting a theme for this inaugural address. A number of subjects come to mind. But as you well know I have, despite regular visits home, been away from the scene in Sri Lanka for a considerable period. Although, like many of you, I was involved in the formulation of economic policy and was associated with the beginnings of institutions such as the Central Bank and the planning agencies there is this distance in time which makes it difficult for me to pronounce in any depth on the developments that have been taking place in the economy of the country. This is perhaps a task that the members of this Association could undertake. Many of you have been intimately involved over the years in the formulation of policy, in the drawing up of plans, in the running of ministries, in the work of the Central Bank. You have a wealth of knowledge and experience to recount. I have the thought that one of the early activities of the Association might be to organise an occasion - possibly a seminar - when our members could get together and reflect on Sri Lanka's economic experience over the years, since Independence. Our generation of economists has lived through this interesting and formative period and it would be of value to see what thoughts we have about that experience, what conclusions we might draw, and what lessons we might learn for the future.

I have myself been struck, even on a cursory look, by some of the changes and modifications that distinguish the economy of today from that which we inherited from colonial times. Some of these changes have strengthened our economic base but at the same time new problems have emerged that were not felt so acutely in the earlier period. I do not wish to enter into detail but some changes are readily apparent. Take for example the structure of the economy and the pattern of trade. Today, we are less dependent than forty years ago on the traditional staples of tea, rubber, and coconut on which the economy of the country was earlier based even though these products still remain of much importance. We have a geographical distribution of trade, both export and import, which is far less dependent on Britain and which has significant linkages with other developing countries. We have developed important new sources of foreign exchange earnings - receipts from our workers abroad, tourism, gems, manufactured goods, and minor agricultural products -



activities which have contributed to a certain diversification in the structure of our economy and of our export trade. The relative importance of the service sector in the economy seems also to have increased considerably.

Most striking of all are the strides we have made in the matter of food production. At the time of independence we were crucially dependent on external sources for our food supply, importing about two thirds of our requirements of rice. We had for long considered this dependence to be a major weakness in our economy and it was the policy of successive governments, and the objective of our development plans, to correct this deficiency. Our progress in this area is certainly notable and a matter for satisfaction. When I reflect on the predicament of the African countries today where a failure on the agricultural front occurring in the context of a global economic crisis has unleashed human suffering on so a vast scale, I realise how much our efforts at food production have stood us in good stead.

I would like this Association to give some thought to our experience in the field of industrialisation. I know that we have witnessed the beginnings of a process of industrialisation in this country. But if we remember the objectives we set and the importance we attached to this process as far back as when the Ten Year Plan was prepared we must admit to a certain disappointment of our hopes. Industrial development is essential to the economic transformation of this country and its tempo needs certainly to be vastly accelerated.

There are other developments in the Sri Lankan economy that strike an observer even on a quick glimpse. Sri Lanka has received a great deal of credit from foreign analysts for a high level of attainment in the social field. Some years ago the World Bank had rated our country high in terms of an index designed to measure what was termed the physical quality of life. I would like this Association to consider what has happened to our performance in this field in the more recent period when we have witnessed a certain reactivation of economic activity but also a process of inflation which has had an impact on income distribution and other social parameters.

I would also be interested to hear what the members of our Association have to say about our experience in building up our technological capability, in upgrading our skills. I am convinced that our future success will be crucially dependent on our ability to take advantage of the new technologies that could transform the opportunities for progress in the years to come. It is not only the developed but also the developing countries that could benefit from the advances being made in communications, information, biology and other fields. But the groundwork for all this must be laid by our educational system and I feel strongly that an association of economists must be heavily preoccupied with the issues in this area.



I have spoken of the changes that have taken place in the economic scene in Sri Lanka. But the fortunes of a small country such as ours, heavily dependent on trade with the outside world, are not entirely determined by our own policies and efforts. We are vulnerable to developments and to forces that come from without. When I looked at some of the indicators of our economic performance there was one that struck me with particular force. That was the truly extraordinary deterioration we have seen in our terms of trade. I was startled to see in the statistics presented by the Central Bank that the index of our terms of trade - the ratio of export to import prices - which registered a figure of 187 in the year of Independence 1948 stands today at 50 ! Even this reflects an improvement in the last two years because two years ago the index was 30 ! This is surely an extraordinary phenomenon particularly for a country so heavily reliant on foreign trade, so open to the world economy, so dependent on the impulses generated from outside for its growth and development.

I ask myself : is it not a considerable achievement that this country has been able to cope with a vastly increased population, to generate a rate of economic growth that outpaced the growth rate of this population, in a context in which its terms of trade and the real resources made available through it were declining so drastically and so dramatically ? It is, of course, true that a deterioration in the terms of trade has been the common experience of most developing countries - particularly in the recent period. But I doubt that there are many such countries which have faced so steep and so sustained a fall in the terms of trade over the last 20 or 30 years. What this all means is that our efforts to accelerate the tempo of development in this country have been undermined and weakened by adverse developments on the external front. Had our terms of trade remained what they were at the time of Independence the resources at our disposal would have been so much greater, the options open to us so much wider, that we would have been in a far better position to speed up the transformation of the economy.

This experience of ours has brought forcibly to my mind the importance of what I would call the external environment for development. It is true that the main burden of a development effort rests with the country, its government, and its people. Internal development policies are crucial to the tempo and pattern of development. But it is also true that these policies could be disrupted or supported by the external environment. In the organisation to which I have belonged - the United Nations Conference on Trade and Development - we have been concerned over the years with precisely this problem, the problem of the external environment for development, the problem of how to create an international framework that is more supportive of the development efforts of the developing countries.

When I reflect on the experience of UNCTAD since its establishment I am struck by the extent to which many facets of this external environment have changed over the years. UNCTAD was established in 1964. That



was a time when the economies of the industrialised countries - the United States, Europe, Japan and the socialist countries of Eastern Europe - were growing at a remarkably rapid rate, in many cases a rate unsurpassed in their earlier history. The fifties and the early sixties saw, as a result, a vast acceleration in world trade. The developing countries wanted to participate in that process. If you look at the platform of the developing countries at that time it essentially amounts to a bid to share in an ongoing process of growth in the industrialised countries and to ensure that its benefits percolate down in a somewhat bigger way. The UNCTAD programme which emphasised the strengthening of commodity markets, the raising of aid flows, the provision of preferential market access for exports of developing country manufactures, more or less assumed that the scenario of rapid growth in the world economy would continue.

In its early years UNCTAD achieved a measure of success in its effort to bring about a sharing of benefits. The system which is now in force of generalised preferences in favour of the trade of developing countries was the result of those earlier endeavours. But in the more recent period changes have affected the earlier scenario. There is no longer the context of rapid growth in the industrialised countries. Their role as a locomotive, or engine of growth, for the world economy has thus been weakened. By the end of the 60's the tempo of growth in the United States and Europe was beginning to slow down. New problems were emerging which acted to constrain growth. There was the beginning of the process of inflation. There were the first signs of turbulence on the world's monetary scene which brought into question some of the fundamentals of the Bretton Woods system. In the early 70's there was the dramatic transformation in the field of energy which saw a fourfold increase in the price of oil. So, by the end of the 60's and the early 70's there was a different scenario, a different framework within which the efforts of the developing countries had to be made.

The new period coincided with the early years of my association with UNCTAD. At first it seemed that some developments would help the efforts of the developing countries. The increase of the price of oil by the members of the Organisation of Petroleum Exporting Countries - all of them developing countries - served as a kind of inspiration to other developing countries. It was thought that for the first time a degree of power was emerging in the camp of the Third World. That feeling encouraged the Sixth Special Session of the General Assembly of the United Nations in April 1974 to adopt the Proclamation and Programme of Action for a New International Economic Order in which the developing countries demanded a greater role in the shaping of international economic relations. That particular phase, with this feeling of new found power on the part of the developing countries, also helped UNCTAD to launch its initiative to stabilise and strengthen commodity markets. The Integrated Programme for Commodities, the negotiations on the Common Fund, as well as proposals made by UNCTAD in a number of other areas, all received a certain impetus from the events of the early 70's.



But, unfortunately, this impetus did not endure. As the 70's unfolded, the stresses and strains on the industrialised countries began to emerge with increasing severity, causing them to adopt more hesitant, more inward looking policies that put a sharp focus on the problems of their own economies. The rise of inflation, of unemployment, of the phenomenon of what came to be called "stagflation" - together with the arms race and the mounting East - West tensions - did not provide a background that was helpful to the effort of the developing countries to bring about an international framework more supportive of their own development efforts. From the later 70's onwards, international negotiations on development issues began to face increasing difficulties. By the 80's, the process of stagflation and the policies introduced to deal with it, culminated in a global recession unsurpassed in the entire post war period. These years saw the whole dialogue between North and South and the quest for a better international framework for development come to a virtual standstill.

The recession seriously affected the industrialised countries where growth rates slowed down and unemployment continued to rise sharply. But its repercussions on the countries of the Third World were particularly devastating. It is no exaggeration to say that over the years since 1980, in most of the countries of the Third World-and particularly in Latin America and Africa - the process of development came, practically, to a halt. The scenario, virtually everywhere, was one of cut backs - cut backs in imports, in budgets, in development plans, in investment, in social programmes, all leading to cut backs in growth and employment. The picture, as I said, were particularly dark in Latin America and Africa but somewhat better in Asia. The Asian countries, as a whole, succeeded in maintaining a positive, though reduced, tempo of growth. This is partly due to the emphasis they placed on agriculture and food production and partly to the continuing boom in the Middle East which provided outlets for the manpower and skills of many Asian countries. It was also partly due to the industrialisation of a number of countries in Asia, specially in East Asia, where a certain competitiveness, a certain dynamism, enabled them to sustain their exports even in an unfavourable global setting. But overall, the experience of the 80's has been one of recession and this broad picture remains with us to this day.

In 1983, when preparing the Sixth Conference of UNCTAD in Belgrade,, we were extremely concerned with this dangerous situation facing the countries of the Third World. We were anxious to adopt a series of measures which would help these countries to get out of the situation of recession. At that time the industrialised countries placed a great deal of faith on their own recovery. They felt that once a process of recovery gets underway in the United States, in Europe, and in Japan, this would suffice to pull up the countries of the Third World without the need for additional actions. We in UNCTAD contested this view. We argued that the process of recovery in the industrialised countries would not be strong enough, rapid enough, enduring enough, to bring about a



real transformation in the world economic situation and to give a real push to the development process. We argued that, together with the recovery of the developed countries, it was necessary to set in motion - consciously and not as a by-product - a process of economic revival in the developing countries by a number of direct actions to move resources to these countries, to strengthen their commodity markets, and to improve access to their markets for manufactures. We argued that in the world economy of today, the impulses for growth and development flow not only from the developed to the developing countries, as in the past, but also from the developing to the developed countries. We argued that a vigorous and sustained process of development throughout the continents of Asia, Africa, and Latin America would stimulate and reinforce the recovery process in the United States, Europe, and Japan.

At Belgrade, a lot of lip service was paid to the theme of interdependence and to its corollary the theme of Recovery and Development. But this acceptance of principle was not translated into actions. We did not get Recovery and Development at Belgrade. Instead, there remained the earlier theme of Recovery and Adjustment - recovery for the developed countries and adjustment for the poorer countries to a harsh and less favourable scene. I am sorry to say that this theme of Recovery and Adjustment persists to this day despite the efforts of the developing countries, of the United Nations, of organisations such as UNCTAD to insist on its inadequacy and on the need to supplement the recovery process in the West with a conscious move to reactivate development in the Third World. I have my fears that the problems we see today in Latin America and in Africa - of external indebtedness and of famine - are not problems that are simply specific to the sectors concerned. The debt problem has not just been caused by a high rate of borrowing. It has been brought about by a general deterioration in the economic climate in which the borrowing countries have to service their debts. The problem of famine in Africa is not just the result of bad weather and drought. Africa has been subject to these hazards from time immemorial. The famine in Africa is also the result of the weakening of the economies of African countries - as a result of the recession, the fall in commodity prices, the shrinking of their resource base, the reduction of their investment programmes and the consequent weakening of their capacity to sustain development in the agricultural sector.

So this is the picture we see today. But we should look to the future and ask what lessons could be drawn from all this in regard to the global scenario that a country like Sri Lanka is likely to face in the period ahead. Could we reckon on an external environment that will be dynamic enough to give vigorous support to our future development efforts and objectives? Or are the prospects for this future environment less favourable than we would wish? In this connection I find quite disturbing the projections now being made in numerous studies regarding the growth prospects of the industrialised countries for the remainder of this century. These studies are practically unanimous in concluding that those countries are not going to return to the tempo of growth - of



around 5% — 6% — that they enjoyed in the 50's and the 60's. What is in store for them, even on favourable assumptions is a growth rate of about 2% — 3% for the next 10 or 15 years. I have been deeply concerned by the implications of this for the developing countries. The industrialised countries might rest content with growth rates of 2% or 3%. Although such rates may have implications for levels of employment, the growth of their population is slow and they have already attained levels of living which do not make continued growth a political and social imperative. But for the countries of the Third World, growth rates of a low order of magnitude continuing for 10 or 15 years spell political and social disaster. For them faster rates of growth are an imperative - rates of over 6% or 7% an year as envisaged in the target for the Third United Nations Development Decade.

But how could the countries of the Third World attain the rates of growth they need on political, economic and social grounds in a setting in which the industrialised countries which served as the locomotive of development in the 50's and the 60's would no longer play that role? This is one of the fundamental issues facing the developing countries in the future. I feel that amongst the answers that suggest themselves there are two which stand out prominently. One of these is that the developing countries should diversify and modify the historical linkages that they have maintained up to now. The economies of most of the developing countries have, as we in Sri Lanka know so well, been oriented towards the industrialised countries because of the legacy of colonialism. If these historical linkages are to prove less effective and less valuable in the future in stimulating growth the answer is to build up other linkages which would reduce the reliance of the developing countries on the impulses generated by the industrialised countries alone. I do not suggest that the countries of the Third World should embark upon a process of wholesale delinking vis-a-vis the developed countries. Their dependence on the latter for technology, for markets, and for finance would remain highly important. But we must accept the fact that in the period ahead this dependence needs to be reduced and this could only happen if the developing countries were to create new linkages, particularly linkages among themselves.

This is why I feel that the theme of cooperation among the developing countries, the theme of South-South trade, must necessarily assume an increasing importance in the period ahead. The developing countries are on the threshold of industrialisation. They must accept the fact that they would not be able to find markets for the products of their newly established capacities in the industrialised countries alone. To an increasing degree they must find other markets as well - in the socialist countries, but most of all in the third world itself. The developing countries are today beginning to acquire a certain capacity to supply each others needs. The industrialisation process would generate a demand for raw materials which the developing countries themselves could supply. They already possess a certain capacity in regard to the production of capital goods, machinery, transportation equipment, construction equipment and so on.



They already have a capacity for the production of a range of consumer goods. It would be necessary to build on these capabilities and to develop a changing pattern of exchange in which the sources of the impulses for growth would be more diversified and flow from a variety of directions. This is the reason why I attach so much importance to such objectives as the establishment of a Global System of Trade Preferences - the GSTP - among developing countries as well as the intensification of cooperation at the sub-regional, regional, and inter-regional levels. This process of cooperation has begun to develop in Latin America, in Africa, in the Middle East, in the ASEAN region, and more recently in South Asia. These efforts are in the right direction and need to be further encouraged. When a country like Sri Lanka looks to the future it must look to the possibility of benefitting from the impulses to growth that are likely to emanate from the other countries of the South.

But South-South cooperation, important as it is, will necessarily be a slow process. If one looks at the next fifteen years, I do not think, it could constitute a full response to the consequences of slower growth in the industrialised countries. There is a need for another answer as well. If the developing countries are to grow rapidly they would need other supportive mechanisms additional to cooperation among themselves. Here, I would focus on the need to readapt and reform the international monetary, financial and trading systems so as to be more directly supportive of the development process than up to now. The design of the Bretton Woods institutions - the International Monetary Fund and the World Bank - as well as the General Agreement on Trade and Tariffs was very much influenced by the prewar experience of depression and mass unemployment in the industrialised countries. These institutions were predicated on the objective of full employment and much emphasis was placed on the need for stability and the avoidance of short term fluctuations in the world economy. The concept of long term growth was given less attention in the design of these institutions. It is true that the World Bank was set up to finance reconstruction and development. But the magnitude of resources that it could mobilise and channel for development was not determined by any assessment of the needs of developing countries for long term resources. Today, the experience of the global economy has shown that stability by itself is not sufficient. It could no longer be assumed that if there were to be stability growth would look after itself. On the contrary, the lesson of the last ten years or so has clearly shown that in the absence of a background of dynamism and growth in the world economy stability itself becomes difficult to sustain. It is because of the absence of such a background that so much instability has emerged in the international monetary and trading systems - characterised by fluctuating currencies, high interest rates, and growing protectionist actions - an instability that is threatening the very survival of these systems.

It is for all these reasons that I have suggested, on so many occasions, that the time has come to set about the reform and adaptation of the international monetary and financial system — and also the trading system - on the



basis of a new consensus that recognises the overriding importance to the world economy of growth and development. I have argued the need for a "development consensus" parallel to and comparable to the "full employment consensus" on which the post war systems were founded. Such a development consensus would be based on a recognition of the importance to all countries of growth and dynamism in the world economy. It would be based on a recognition of the interdependence of the growth process. It would recognise, in particular, that the economic growth of the countries of the Third World spanning the continents of Asia, Africa, and Latin America can be an enormously powerful factor in promoting stability, prosperity, and progress throughout the world including the industrialised countries.

Such a new consensus for development would point to the need to reorder certain aspects of the international monetary and financial system so as to enable it to play a much greater role in channelling long term resources for development than up to now. I feel that the multilateral financial institutions - whether existing or new - will need to be the providers of development finance on a vast scale. I do not believe that the commercial banking system will resume the role of channelling funds to developing countries on the scale of the 70's when private banks were flush with the surpluses of the oil producing countries. The subsequent debt crisis has taught many lessons. I do not see either that development aid - official development assistance - will substitute for commercial bank lending. The climate for increasing aid has become less favourable in the industrialised countries. Some industrialised countries would like to emphasise the flow of direct foreign private investment. Private foreign investment might indeed play a greater role than it has done up to now. But I do not see it assuming the magnitudes needed to bridge the major part of the resource requirement of the developing countries if only because infrastructure financing - for health, education, roads and so on - looms large amongst such requirements and is not usually attractive to private foreign investment. This is not the occasion on which to expand upon the particular ways in which the international monetary and financial institutions should be reformed in order to be more supportive of development. The possibilities are numerous. But there is one requirement that is fundamental. If these institutions are to be invested with much greater responsibilities in supporting development they would have to be organised on a democratic basis with the developing countries exercising a greater role in the decision making processes.

Well these are some of my reflections on the subject of the external environment for development. This environment will be of crucial importance to Sri Lanka's own policies in the period ahead. As a small country Sri Lanka will continue to be dependent on exchanges with the outside world. A closed economy is inconceivable for an island such as ours. But we have to be alert to the changing external scene and orient our policies to the advantage of the impulses for growth that come from without. I believe that the developing countries will have to place a greater emphasis in the future on self reliance - not



autarchy or inward looking growth - but on collective self reliance where they work together both to forge stronger linkages among themselves and influence the evolution of the systems that underpin the global economy.

All these and other issues are for the Sri Lanka Economic Association to take under its wing. I have, however, a final thought to put before you. This is an association of economists. I hope that in addition to the study of various problems in the economic and social field the Association will give some thought as to how we can support and contribute to the teaching of economics in this country. The way in which economics is taught determines the way in which the future generation of economists is moulded. I would like this Association to enter into very close cooperation with those who are engaged in the teaching of economics. I feel more and more - although I did not expand on this point today - that the whole process of education and of technological capability is central to the development process of a country. I have talked about the scenario of the future and I have warned of some unfavourable aspects that are highlighted by recent projections. But let us not forget, at the same time, that technology is not standing still and that new developments are constantly taking place. Already there is talk of a future technological environment based on informatics, microcomputers, genetics and so on. These are opportunities we need to grasp and our Association has a responsibility to further our awareness of these developments and our preparedness to utilise them.

Let me wish our Association once more a successful future. I hope that our numbers will expand. I hope that, at all times, the work of this Association will maintain the quality and the professionalism that is reflected in its membership and that this will always be evident in what we put before the public and what we offer to Government as guides to policy making. I thank you.



# REVIEW OF ECONOMIC POLICIES AND PROGRESS 1977 - 1984

J. B. KELEGAMA

## **New Economic Policies and their Background**

This paper is a tentative attempt to review the economic policies pursued and economic progress achieved in the six years 1978 — 83 while comparing them in some areas with the economic policies and progress in the six years 1971 — 76 in order to explore what lessons can be drawn for future economic development of the country. The attempt is in the nature of an explorative exercise to focus attention on a subject of crucial importance and immediate relevance to the country. It would achieve its purpose, if it results in a serious and intensive discussion by students of economics.

Economic policies in the period 1971 — 76 were designed broadly to achieve welfare and greater equality in the distribution of wealth and income within a framework of a self-reliant economy ; these policies were implemented through state ownership, control and intervention over production, distribution, trade and finance combined with encouragement of national as opposed to foreign enterprise. The new economic policies launched in 1977, on the other hand, were oriented towards rapid economic growth in the context of a free or open market economy by the adoption of measures to encourage and support private enterprise both national and foreign, by minimising of state ownership, control and intervention in economic activities and by allowing the free play of market forces and the price mechanism.

The Government, in 1977, reversed the major economic policies pursued since 1970, which it believed, were responsible for the poor economic performance in the period 1971 — 76, and introduced a package of new economic policies whose main features are as follows :—

- (a) Reducing the role of the state in economic activities : encouragement of the private sector and ending of preferential treatment of the public sector through curtailing monopolies in the public sector such



as insurance and telecommunications ; introducing competition between the private and public sectors as in bus transport ; restoring tax incentives and releasing trade and other restrictions to private enterprise and encouraging self-employment ;

- (b) Open door policy regarding foreign investment :—  
offer of attractive incentives and tax holidays to foreign capital and invitation to foreign banks, which had hitherto been disallowed, to open branches ;
- (c) Privatisation : transfer of unprofitable public enterprises to private sector ownership or management such as the National Milk Board accompanied by de-regulation or liberalization ;
- (d) Transfer of resources from welfare or consumption to investment by limiting consumer subsidies to the most needy groups ;
- (e) Unification of the basic and FEECs rates of exchange and devaluation of the rupee by 55 % from Rs. 7.28 = \$ 1 to Rs. 16 = \$ 1 ; adoption of the policy of a Floating Rupee thereafter resulting in a gradual depreciation of the Rupee year after year to Rs. 27 = \$ 1.00 at present; the new exchange rates were designed to provide better export incentives and to eliminate price distortions arising from an overvalued currency and stimulate domestic agricultural production ;
- (f) Relaxation of controls on imports and exchange payments and remittances allowing free imports without controls except in a few items on the basis of a revised and lower tariff structure ; trade liberalization was designed to revive domestic industry by free flows of machinery, spares and raw materials as well as to stimulate new areas of private business activity ;
- (g) Abolition of price controls on most items and other regulations on business activity so as to allow free market forces to operate ;
- (h) Mobilization of external assistance on a large scale to finance an ambitious development programme centred round the Mahaweli Development Project as well as to meet balance of payments strains resulting from open or free economy and liberalised imports ;
- (i) Shift of emphasis from import substitution industries to export oriented industries particularly in a Free Trade Zone or Export Promotion Zone and the establishment of the Export Development Board and Export Credit Insurance Corporation towards this end.



The new economic policies were launched on the basis that private enterprise oriented economies in Asia had achieved higher and more rapid economic progress than the others, and Sri Lanka's future lay in emulating these countries. Thus South Korea and South East Asian countries, particularly Singapore, were adopted as models of economic development in formulating the new economic policies of the government. The attraction of South Korea and ASEAN countries is understandable, for it is beyond dispute that the free market oriented countries had achieved higher rates of economic growth and higher per capita income than the controlled economies of Asia in recent years.

The average annual growth rate of real GDP in ASEAN countries in 1970 — 75 was 7.8 per cent, that of Indonesia, Malaysia and Singapore exceeding 8 per cent. Republic of Korea showed a growth rate of 9.8 per cent. In the South Asian countries where there is greater state control over economic activities, on the other hand, growth rates were much lower:— Bangladesh 3.6 percent, Burma 2.5 percent ; India 2.5 percent; Pakistan 4.5 percent and Sri Lanka 4.2 percent. Similarly per capita GDP in the free market oriented economies far exceeded that of the controlled economies. In 1978 per capita GDP exceeded US \$ 1,000 in Singapore, Malaysia, Republic of Korea and Hongkong but fell below US \$ 200 in all South Asian countries except Pakistan as shown in Table 1. Food production in ASEAN and South Korea in 1970 — 75 exceeded 4 per cent per annum while it was 2.9 per cent in Sri Lanka and was even lower in other South Asian countries except Afghanistan as shown in the table.

Growth was so impressive in the four free market oriented economies of the Republic of Korea, Hong Kong, Singapore and Taiwan that they have been called the "Four Little Tigers". The Republic of Korea with a growth rate of 8 per cent is now a world class economic power having raised its per capita income from \$ 100 in 1961 to around \$ 2,000 today. Nearly two-thirds of the Koreans consider themselves to be middle-class and the country has 95 % literacy. Singapore's per capita income of \$ 6,500 has doubled since 1978 ; it had a growth rate of 9 per cent and there are over 100 foreign banks operating in its territory. Hong-Kong is the leading financial centre after New York and London and it is the largest exporter of garments in the world. Taiwan is the world's 13th largest exporter and has an impressive growth rate of 11 per cent Thailand and Malaysia are two of the best examples of developing countries which have diversified their exports within a short period and achieved high growth rates. Malaysia reduced its dependance on rubber, tin and timber by developing and expanding exports of petroleum, vegetable oil and manufactures while Thailand added cassava, sugar, fish, vegetables, precious stones and manufactures to her traditional exports of rice, rubber and tin.



TABLE I

## Economic Performance of Selected Asian Countries 1970 — 75

Country	Per capita GDP 1978 US \$	Average annual growth rate of real GDP 1970 — 75	Average annual growth rate of food production 1970 — 75
Asean	480	7.8	—
Indonesia	350	8.5	4.2
Malaysia	1216	10.3	4.8
Philippines	508	6.2	4.9
Singapore	3,293	9.8	7.2
Thailand	513	6.4	6.7
<i>East Asia</i>			
Hongkong	3,128	7.7	9.7
Republic of Korea	1,298	9.8	4.7
<i>South Asia</i>			
Afghanistan	175	3.8	4.9
Bangladesh	115	3.6	2.0
Burma	128	2.1	1.1
India	180	2.5	1.7
Nepal	120	2.0	2.2
Pakistan	252	4.5	2.6
Sri Lanka	194	4.2	2.9

Source : UN Handbook of International Trade and Development Statistics 1981.

7. The government also appears to be influenced in adopting its new strategy of economic development by recent developments in developed market economies as well as in socialist countries. Privatization or the drive to denationalize industry and public service has been implemented or accepted in a number of West European countries where government ownership is extensive. Thus the UK has already disposed of all or part of 17 nationalized industries including British Petroleum and British Telecommunications ; the opposition political parties in France have threatened to denationalize government undertakings and the German government has sold about \$ 80 million worth of shares in 470 small companies. Privatization challenges one of the most fundamental tenets of the modern European Welfare State — the notion



that citizens are entitled to a certain level of economic security and services even if the state is losing money by providing them. The new approach away from the welfare state is best demonstrated by the following statement of the British Prime Minister, Margaret Thatcher.

“There are still too many people propagating the theme that it is the government’s job to find all the business and employment. It isn’t. We can only do the things that governments do and then it has to be over to the people.”

The Reagan administration in the USA has openly encouraged developing countries to follow free market policies and has responded more favourably to private enterprise oriented countries in granting aid. At the 18th annual meeting of the Asian Development Bank in Bangkok in May 1985, for instance, the US issued a stern warning that Asian countries must either adopt free-market policies or do without US funding. Mr. Joe O. Rogers, the US representative on the ADB Board said, “The United States completely rejects the idea that there is such a thing as development economics. The purpose we have is to move all the countries forward to a democratic-capitalist framework.” US is one of the two largest contributors to ADB and he warned that future funds from U.S. would be contingent on whether ADB changes its policies on free market lines.

One of the most significant developments in recent years has been the substitution of pragmatism to ideological purity in China and the consequent change from a policy of “self-reliance” to a more open and flexible policy to modernize production by importing western technology and equipment. Dismissing the Cultural Revolution as “radical leftist nonsense” which put the clock back, the new leadership plans to make China a modern industrial power by 2,000 AD by a massive infusion of foreign technology, capital and credit. Deng Xiaoping has emphasized “No country can now develop by closing its door” and clarified his pragmatic approach : “It doesn’t matter whether you climb Mount Everest by its north slope or its south slope, as long as you get to the top”. Apart from becoming a member of the International Monetary Fund and World Bank and inviting and concluding joint ventures with market economy countries on a large scale China has opened 14 coastal cities to foreign investment like the Export Processing Zone in Sri Lanka. Under a limited programme of privatization, China in 1979 returned about \$ 600 million in confiscated assets to former millionaires urging them to go back to manage large enterprises. Encouragement of self-employment has resulted in about a million peasants buying their own tractors and trucks and slowly freeing themselves from the land and setting up businesses of their own. A decade ago such persons would have been railed as “capitalist roaders.”

Another relevant factor which must have affected government’s thinking was the privatization or shift of emphasis to free market in some of the developing countries which had worked within state owned and controlled



economies. Thus the President of Tanzania has admitted recently that it was a "big mistake" to have nationalized the sisal plantations in 1967 and ordered that nationalized estates running at a loss be handed back to private ownership. He also expressed the view that too many enterprises were nationalized and that it was a mistake to have replaced the co-operatives with loss-making centralised state farms. He has also lifted the ban on people building houses for rent in force since 1971 when private property was nationalised. Zambia has also launched a programme to return some of its nationalized industries to the private sector. Mozambique has drafted an investment code to attract western capital and the Malagasy Republic appears to have adopted a more pragmatic development policy. Egypt is continuing the freemarket policies of Sadat, who reversed without hesitation, all the Socialist policies of Nasser.

## II. High Level of Investment and Rapid Economic Growth

The declared economic policy of the government was to force the pace of development by means of an ambitious investment programme far exceeding the country's internal resources. Figures show that investment in the period 1978 — 83 was at a much higher level than in the previous six years. Thus gross capital formation in 1978 — 83 formed 28.5 per cent of the G.D.P. (or 31.3 per cent of GNP) in contrast to 15.8 per cent of the GDP (or 17.3 per cent of GNP) in 1971 — 76. Figures further reveal that 19.6 per cent of the total resources (GDP + Imports) were utilised for investment in the latter period as compared to 13.1 per cent in the former period.

It was the government's intention to finance this substantial investment programme without reducing consumption. Domestic savings in 1978 — 83 formed 12.7 per cent of GDP which was only slightly higher than in the previous period when it was 11.2 per cent. In 1971 — 76 however investment being only 15.8 per cent of GDP, domestic savings financed about 71.5 per cent of the investment. In 1978 — 83 on the other hand, investment constituted 28.5 per cent of GDP and domestic savings, though slightly higher than in the previous period, financed only 44.5 per cent of total investment. Thus the greater part of investment i.e. 55.5 per cent. in 1978 — 83 was financed by external resources as compared to 28.5 per cent in 1971 — 76. External resources amounted to 15.8 per cent of GDP in 1978 — 83 as compared to 4.5 per cent in the previous period.

The higher level of investment and the greater reliance on external resources are illustrated clearly in government expenditure in recent years. Capital expenditure of government in 1979 — 83 was nearly eight times that in 1972 — 76. Capital expenditure in 1978 — 83 amounted to 14.9 per cent of GDP as compared to 7.9 per cent in 1971 — 76. About 57 per cent of the capital expenditure in this period was met out of foreign aid as compared to 31 per cent in 1971 — 76.



Import liberalization on the other hand resulted in an unprecedented increase in imports to the country. Import volume in 1971 — 76 was about 26 per cent less than in the previous six years 1965 — 70. In the six years 1978 — 83, import volume was 242 per cent of that in 1971 — 76 or nearly two and half times larger. This massive influx of imports, it must be admitted, put an end to shortages queues and consumer dissatisfaction in the earlier period, but it was financed, not by earnings, but by external aid. Exports financed only 58 per cent of the total imports in 1978 — 83 as compared to 81 per cent in 1971 — 76 indicating that the enlarged flow of imports was financed by substantial foreign aid and borrowings.

The overall result of the high level of investment, import liberalisation and other measures flowing from open market policies discussed earlier, was a high level of economic growth of 6 per cent per annum as compared to a lower rate of 2.7 per cent in 1971 — 76. Gross Domestic Product in real terms rose by 42 per cent between 1977 and 1983 whereas it increased by only 17 per cent between 1970 and 1976 as shown in Table II ; gross domestic product per capita in real terms which increased from Rs. 1054 to Rs. 1125 or by 7 per cent between 1970 and 1976 rose from Rs. 1153 to Rs. 1481 or by 28 per cent between 1977 and 1983. Substantial increase in production appears to have taken place in paddy, fishing, construction, trade, transport, electricity, gas and water, banking and insurance and public administration.

Paddy production, which had declined by about 8 per cent between the two periods 1968 — 70 and 1974 — 76, rose by a massive 71 per cent, between 1974 — 76 and 1981 — 83, making the country almost self-sufficient in rice. This was the result of the improved irrigation facilities brought about by the Mahaveli development scheme and the near doubling of fertiliser consumption supported by an almost 50 per cent increase in agricultural credit in this period. Total cereal imports (rice and wheat) declined by 37 per cent between 1974 — 76 and 1982 — 84. Fish production which had risen by only 6 per cent between 1970 and 1976 increased by 71 per cent between 1976 and 1983 to reach 218,500 tons. Construction shows a high growth rate until about 1980 on account of the accelerated investment programme of the Mahaweli project, other government construction such as the new Parliamentary Complex of Kotte and Urban Housing Schemes and private construction of hotels and large buildings. There was a marked expansion of electricity, gas and water services flowing from substantial public investment to extend electricity and water supplies to suburbs and smaller towns and even villages. The establishment of District Ministries and increase of Ministries from 27 in 1976 to 42 and the consequent expansion of administrative services led to an increase in Public Administration. The expansion of the tourist industry until 1982 contributed to the increase in other services.

Trade and Transport accounting for nearly 30 per cent of GDP show high growth rates 45 and 50 per cent respectively in 1977 — 83 reflecting the effects of liberalised imports. Trade sector as a whole increased by 50 per



TABLE II

## Economic Growth-Sectorwise 1970 — 1976 and 1977 — 83 ,

(GDP at constant 1970 factor cost prices — Rs. million)

Sector	1970	as % of G.D.P	1976	as % of G.D.P	Change %	1977	1983	as % of G.D.P	Change %
<b>GDP</b>	<b>13,187</b>	<b>100.0</b>	<b>15,431</b>	<b>100.0</b>	<b>17.0</b>	<b>16,078</b>	<b>22,824</b>	<b>100.0</b>	<b>42.0</b>
1. <i>Agriculture,</i>									
<i>Forestry &amp; Fishing</i>	<b>3,732</b>	<b>28.3</b>	<b>3,894</b>	<b>25.2</b>	<b>4.3</b>	<b>4,299</b>	<b>5,498</b>	<b>24.1</b>	<b>27.9</b>
1. Tea	423		392		— 7.3	416	357		— 14.2
2. Rubber	233		232		— 0.4	213	198		— 7.0
3. Coconut	535		455		— 15.0	423	528		24.8
4. Paddy	951		720		— 24.3	990	1,456		47.1
5. Other	1,250		1,772		41.8	1,935	2,455		26.9
6. Fishing	160		170		6.3	179	297		65.9
2. <i>Mining &amp;</i>									
<i>Quarrying</i>	<b>95</b>	<b>0.7</b>	<b>571</b>	<b>3.7</b>	<b>501.0</b>	<b>515</b>	<b>800</b>	<b>3.5</b>	<b>55.3</b>
3. <i>Manufacturing</i>	<b>2,197</b>	<b>16.7</b>	<b>2,371</b>	<b>15.4</b>	<b>7.9</b>	<b>2,357</b>	<b>2,978</b>	<b>13.0</b>	<b>26.3</b>
1. Export Processing	893		860		— 3.7	823	769		— 6.6
2. Factory Industry	1,085		1,214		11.9	1,227	1,720		40.2
3. Small Industry	109		185		69.7	189	290		53.4
4. Other	110		113		2.7	118	199		68.6
4. <i>Construction</i>	<b>744</b>	<b>5.6</b>	<b>685</b>	<b>4.4</b>	<b>— 7.9</b>	<b>619</b>	<b>1,023</b>	<b>4.5</b>	<b>65.3</b>
5. <i>Electricity, Gas &amp; Water</i>	<b>101</b>	<b>0.8</b>	<b>122</b>	<b>0.8</b>	<b>20.8</b>	<b>131</b>	<b>274</b>	<b>1.2</b>	<b>109.2</b>
6. <i>Transport, Storage &amp; Communication</i>	<b>1,258</b>	<b>9.5</b>	<b>1,425</b>	<b>9.2</b>	<b>13.2</b>	<b>1,498</b>	<b>2,172</b>	<b>9.5</b>	<b>45.0</b>
7. <i>Wholesale &amp; Retail Trade</i>	<b>2,533</b>	<b>19.2</b>	<b>2,928</b>	<b>19.0</b>	<b>11.6</b>	<b>2,999</b>	<b>4,502</b>	<b>19.7</b>	<b>50.1</b>
1. Imports	540		400		— 25.9	513	1,044		103.5
2. Exports	754		716		— 5.0	663	796		20.1
3. Domestic	1,239		1,812		46.2	1,823	2,662		46.0
8. <i>Banking, Insurance &amp; Real Estate</i>	<b>152</b>	<b>1.2</b>	<b>246</b>	<b>1.6</b>	<b>61.8</b>	<b>295</b>	<b>458</b>	<b>2.4</b>	<b>85.8</b>
9. <i>Ownership of Dwellings</i>	<b>399</b>	<b>3.0</b>	<b>467</b>	<b>3.0</b>	<b>17.0</b>	<b>475</b>	<b>625</b>	<b>2.7</b>	<b>31.6</b>
10. <i>Public Administration &amp; Defence</i>	<b>517</b>	<b>3.9</b>	<b>760</b>	<b>4.9</b>	<b>47.0</b>	<b>791</b>	<b>1,439</b>	<b>6.3</b>	<b>81.9</b>
11. <i>Services n.e.s.</i>	<b>1,459</b>	<b>11.1</b>	<b>1,962</b>	<b>12.7</b>	<b>34.5</b>	<b>2,099</b>	<b>2,965</b>	<b>13.0</b>	<b>41.3</b>



cent but import trade rose by 104 per cent and domestic trade rose by 46 per cent. This was inevitable with the marked increase in the volume of imports by about two and half times as shown earlier. Investment goods imported alone in 1978 — 83 was about four times the volume imported in 1971 — 76. The expansion of transport similarly resulted from the liberalised imports of buses, coaches lorries, trucks, vans, cars, motor bicycles and cycles which have flooded the market. The number of registered motor vehicles which rose by a mere 16 per cent between 1970 and 1976 increased substantially by 119 per cent or more than doubled between 1976 and 1983, private coaches alone increasing by nearly twelve times. The number of new registrations in the six years 1978 — 83 of all motor vehicles amounted to 234,431 or nearly eight and a half times the number of 27,697 registered in 1971 — 76.

The open door policy regarding foreign banks led to the establishment of 14 new foreign banks in the country. Foreign banks had not been allowed to open branches here before 1977. The new National Insurance Corporation was established in this period while liberalised imports contributed to an expansion of hire-purchase credit from finance companies.

One of the major schemes of economic development under the new policies is the encouragement of export oriented industries in the Investment Promotion Zones. By the end of 1984, about 74 of the 199 projects approved were in commercial production and of these 32 were engaged in the production of ready made garments. Total employment in the projects at the end of 1984 amounted to 29,251 of which the majority were in textile and garments industries (79 per cent in 1983). Gross export earnings from the Investment Promotion Zone industries in 1984 amounted to Rs. 3537 million or 9.5 per cent of the country's total exports. It is significant that 82 per cent of these export earnings originated in the textile and garments industries.

The free flow of imported raw materials, machinery and spare parts allowed some domestic manufacturing industries to expand their production, particularly those that were able to withstand competition from imports. Thus capacity utilisation of industry as a whole rose from an average of about 53 per cent in 1974 — 76 to around 75 per cent in 1981 — 83 and of textile, clothing and leather industries from 56 per cent in 1976 to 98 per cent in 1983. Industrial production increased by 26 per cent in 1977 — 83 as compared to 8 per cent in 1970 — 76. Although domestic industries were highly protected in 1970 — 76 they could not be supplied with sufficient raw materials, machinery and spares on account of the foreign exchange crisis. The new industries in the Investment Promotion Zone and the enhanced capacity utilisation of old industries pushed exports of textiles and garments from 1.5 per cent of total exports in 1976 to 18.9 per cent in 1983. This helped to increase the share of industrial exports of the country from 15.6 per cent of the total exports to 35.1 per cent in this period, thereby introducing greater diversification into the country's export structure.



The import boom, increased investment by government, the Investment Promotion Zone and the general expansion of business created new employment opportunities. Central Bank's Consumer Finances and Socio - Economic Surveys indicate that the country's unemployment rate has declined from 14.8 per cent in 1978 — 79 to 11.7 per cent in 1981/82, which is the lowest rate of unemployment recorded in recent decades. Although full and accurate figures on the whole country's employment situation are not available there is no doubt that there has been a marked increase in employment since 1977. Estimates of employment in public and private sectors by the Central Bank show a rise in employment by 291,744 between 1977 and 1982. The liberal import policy has also made a major contribution through creation of self-employment such as bus, van, lorry owners/drivers, tractor owners/drivers, trishaw owners/drivers, garage mechanics, radio TV mechanics, government contractors, petty traders, rice mill workers and pavement hawkers.

IMF's approval of a country's economic policies is essential not only to secure IMF's financial assistance but also to negotiate aid from bilateral donors. A certificate of "good behavior" by the IMF is virtually indispensable for a country to obtain external assistance. Sri Lanka's economic policies and performance appear to have pleased the IMF and IBRD as well as donor countries so far. The Central Bank Governor Dr. Rasaputram is reported to have said that Sri Lanka was held as a model developing country by the highest circles at the World Bank. The Minister of Finance Mr. Ronnie de Mel, after his return from the latest Aid Group meeting stated in Parliament, on July 11, 1985 :

"We are able to obtain all this aid despite the very unfavourable political situation in the country, entirely because the donor countries and international organizations were convinced beyond all doubt that we have managed our economy in a very sound and successful way,"

The endorsement of the country's economic policies by the aid giving donor countries is well illustrated by the speech of the British Prime Minister, Mrs. Margaret Thatcher at the opening ceremony of the Victoria Project on 12 April 1985 :—

"When we set our hand to the task of helping you with this development it was not only because the economists had told us the investment was justified, nor was it simply because we supported your decision to accelerate the Mahaweli Development Programme. It was because we , thought we could with confidence endorse the economic policies your government was committed to pursuing and to the success of which the Victoria dam would contribute. The nature of that confidence was the largest contribution we have made to a single aid project."



In her speech to Parliament on 13 April 1985, she further stated :

“I admire the bold policies to sustain an open economy which you are pursuing and which enjoy wide support..... we welcome your readiness to open your markets to productive investment. We respect the courage and resolve with which you have undertaken responsible policies of economic adjustment. In 1977 you took the difficult decision to float the rupee. You relaxed trade restrictions and you established the Greater Colombo Economic Commission to develop investment protection zones offering substantial attraction to foreign investors. Like you, we in Britain are seeking growth through relaxation of government controls, through the stimulation provided by market forces, by reducing the role of the state in the lives of individuals.”

### III. Unfavourable Effects and Unhealthy Features

High economic growth in recent years, however, was accompanied by a number of unhealthy features, some of which have been pointed out from time to time by the Central Bank Annual Reports and the news papers. The aim of this study is to attempt to highlight these disturbing aspects of the economy so that appropriate remedial action could be taken in time.

#### (a) *Fall in agricultural production and exports :*

The first disturbing feature of economic growth in recent years is that the two vital sectors - agriculture and industry - have shown relatively low growth as shown in Table II. The increase in production of agriculture and industry in 1977 — 83 was certainly much higher than in 1970 — 76, but it was lower than in other sectors. The relatively poor performance of agriculture was almost entirely due to the actual fall in tea, rubber and coconut production. Paddy and fish production on the other hand, as shown earlier, showed a substantial increase. In the industrial sector, expansion of production in factories, small industries and others was substantial but this was to some extent negated by the fall in export processing, which in turn resulted from the decline in tea rubber and coconut production. The shares of agriculture and manufacturing in GDP declined between 1976 and 1983 from 25.2 % to 24.1 % and from 15.4 % to 13.0 % respectively.

The second feature, which is closely linked with the first, is the poor performance of the country's exports. While the volume of imports rose dramatically, there was a virtual stagnation in the volume of exports. Between the two periods 1971 — 76 and 1978 — 83 import volume, as shown earlier, rose by 142 per cent but export volume rose by a mere 2.6 per cent. What is more alarming is that the volume of exports of all the major plantation crops declined between the two periods - tea by 9.0 per cent, rubber by 8.5 per cent and coconut kernel products by 38.9 per cent. It was the substantial increase



of 119.1 per cent in minor products which pushed up the all export volume index slightly. Total export volume in each of the four years 1978 — 81 was actually lower than in 1975 — 76 and it was only in 1982 — 83 that the volume exceeded the 1975 — 76 level.

*(b) Adverse effects of import liberalization :*

The adverse effects of import liberalisation on the production of subsidiary food crops and on small manufacturing industries is the third, unfavourable aspect. Nearly all subsidiary food crops, whose production increased under import restriction in the period 1971 — 76, appear to have declined in 1978, 1979 and in the case of some items, in 1980 as a result of free imports and building up of buffer stocks of imported potatoes, onions, chillies and chicken. Production however recovered after 1980 in the case of most subsidiary food crops except kurakkan, sweet potatoes and chillies whose production levels in 1983 were below those of 1977. Increase in production of manioc, maize, Bombay onions, gingelly, meneri, cowpea and black gram was however modest as compared to the marked rise in the production of red onions, groundnuts, soyabean and potatoes.

While those industries which could withstand competition from imports, as shown earlier, increased their production under liberalised imports, some of the small industries such as milk, flour milling, handloom textile weaving, textile printing, manufacture of local machinery, components, ancillaries and spares, manufacture of motor spares, hand made paper, chemical products, soap, paint, hardware, metal products and electrical appliances, were adversely affected by open market policies. A wide ranging survey by the Ministry of Industries in 1980 revealed that local industries were faced with severe competition from imports and the Minister of Industries, according to newspaper reports, had made a strong case before the government for greater protection for indigenous industries on the following grounds : —

“A large number of local industries have been adversely affected due to new fiscal and financial policies adopted consequently to liberalization. Some industries have already folded up, having had to face severe competition from imports and not obtaining financial and fiscal support from government institutions.”

The Chairman of the Ceylon National Chamber of Industries Mr. D. S. Madanayaka is reported to have stated at the Annual General Meeting of 1984 that, “the local industry had been swamped by the import of manufactured goods.”

A number of state owned industries too were adversely affected by liberalised imports. For example the Hardware Corporation which earned a profit in 1979 — 80 began to suffer losses from 1981. In spite of increasing



expenses it was unable to increase prices due to stiff competition from imported products. Similarly the Steel Corporation began to lose from 1982. The Hardware Corporation was operating at 37 per cent of its capacity in 1983 while the Steel Corporation was utilising only 25 per cent of its capacity. Sales of condensed and powdered milk of the National Milk Board had fallen between 1977 and 1983 while its sales of processed milk had stagnated in 1980 — 83. Sales of the National Textile Corporation's cloth and yarn, Leather Products Corporation's shoes and leather products, Ceramics Corporation's crockery, Steel Corporation's rolled and wire products and Hardware Corporation's products, all appear to have fallen in the period 1978 — 83 while sales of the Tyre Corporation and Paper Corporation seem to have virtually stagnated. Employment in the Milk Board and Textiles, Paper, Tyre, Rubber Manufacture and Hardware Corporations in 1983 was less than in 1978.

(c) *Slowing down of growth :*

The fourth unfavourable trend is that the rate of economic growth seems to have slowed down from about 6.5 per cent in the period 1978 — 81 to about 5 per cent in 1982 — 84. Economic growth was highest in 1978 — 79 when the pent up demand was met by liberalised imports. It is significant that the rate of growth declined from year to year after 1979 as follows :—

1977	4.2
1978	8.2
1979	6.3
1980	5.8
1981	5.8
1982	5.1
1983	4.9
1984	5.0

This slowing down of growth was caused mainly by the slowing down of the rate of growth of gross capital formation from over 60 per cent per annum in the three years 1978 — 80 to 5 % in 1981 28 % in 1982 19 % in 1983 and to 11 % in 1984. Slowing down of growth took place in both public and private sectors ; growth decelerated in all the sectors which had experienced high growth except Public administration and Defence.

Construction which experienced a meteoric growth in 1978 — 79 of over 20 % declined to 11 % in 1980 and showed a negative growth in both 1981 and 1982 ; growth in 1983 was a modest 1 per cent. Firstly government investment in housing and urban development was drastically reduced on account of financial constraints and secondly the new Parliamentary Complex was completed by the end of 1981. Thus government capital expenditure on housing which rose from Rs. 43 million in 1977 to Rs. 25 million in 1978 and to Rs. 575 million in 1979 declined to Rs. 73 million in 1980 and remained on a



low level until 1983. Thirdly, the rapid rise in construction costs and high cost of borrowing resulted in a deceleration in housing and construction activity by the private sector. Construction costs in 1982 for instance were 338 per cent higher than in 1976, the cost of cement alone being 496 per cent or about five times higher. Commercial bank interest rates on loans secured by immovable property in 1982 for example ranged from 13 to 28 per cent as compared to 8 1/2 to 14 per cent in 1976. (By 1983 they had risen further to 16 — 30 per cent). In addition, land prices particularly in Colombo and other towns and suburban areas skyrocketed - price of land in the better residential areas in Colombo being about ten times higher in 1983 than in 1976.

In the trade sector, import trade which rose by 28% in 1977, 37% in 1978 and 23% in 1979 declined to 14% in 1980 and further to 2% in 1981 and remained at that rate of expansion in both 1982 and 1983. Once the pent up demand was satisfied and the market was saturated, demand for imports levelled off. This explains the slowing down of growth in the trade sector. Transport and communications show a slight fall in growth rates after 1980, probably as a result of the withdrawal of the lump-sum depreciation facility for commercial vehicles in March 1981. Growth rate which had exceeded 6% per cent per year in 1978 — 82 however dropped to 4.5 per cent in 1983. This seems to reflect the return to normalcy after the pent up demand was satisfied. The sharp fall in growth from over 7% per year in 1979 — 82 in services n.e.s. reflects the decline in tourism — the fall of 17 per cent in the number of tourist arrivals. This was the first time since 1971 that the increasing growth trend in tourist traffic was reversed. Hotel occupancy rate declined from 47.8% in 1982 to 35.9% in 1983 (North and East coast 11%). Banking and insurance indicate a slower growth rate in 1982 and 1983. Increase in 1983 was 6% as compared to 12% in 1982 and 15% in 1980 and 1981.

The above survey reveals that the open economic policies allowing free import of investment, intermediate and consumer goods caused an expansion in these sectors whose growth had been inhibited by inadequate imported inputs, as for instance trade and transport. The decline in their growth rates from the peak in 1978 — 80 along with the fall in the rate of increase of banking in 1982 — 83 betokens a tapering off of the import - induced boom. The slowing down of growth in construction, electricity, gas and water services reflects the resource constraint facing the government.

The slower growth rate has also affected employment. Creation of new employment appears to have been levelling off in the last two or three years after the initial spurt as shown below :—

#### Increase in Employment in Public & Private Sectors

Year	% change
1978	9.5
1979	5.9
1980	4.5
1981	1.5
1982	—0.8
1983	—
1984	—



In 1982 employment in public and private sectors actually declined by 0.8 per cent. Figures are not available for 1983 and 1984 but in 1983 there was a marked drop of about 17 per cent in employment in the tourist sector followed however by a moderate recovery in 1984.

It is interesting to note that the high growth rates of ASEAN countries, Hongkong and Republic of Korea which were regarded as models by Sri Lanka also appear to have declined from 1981 — 82. Economic growth of Singapore of 9 per cent has fallen to a modest 2.7 per cent in the first half of 1985, the lowest in a decade and is expected to fall further in the second half. ASEAN's growth rate of around 8 per cent in 1970 — 80 declined to 3.2 per cent in 1981 — 82 and the Republic of Korea showed a growth of only 5.2 per cent in 1981 — 82. The main reason for this slow down is the drastic fall in their exports in the context of the world recession.

(d) *Neglect of infrastructure :*

36. The fifth feature is the excessive diversion of resources to agriculture and irrigation leaving little for other economic and social services comprising the infrastructure. Thus in 1979 — 83 about 44 per cent of the capital expenditure of government was on agriculture and irrigation (mainly Mahaweli Development Scheme) as compared to 27 per cent in 1972 — 76. The shares of capital expenditure on communications, manufacturing as well as of education, health and housing on the other hand were lower than in 1972 — 76 as shown in Table III below :—

TABLE III  
Capital Expenditure of Government — Sectorwise  
(as percentages of total capital expenditure)

	1972 — 76	1979 — 83
<i>Economic Services</i>	<b>64.7</b>	<b>60.7</b>
1. Agriculture & Irrigation	27.0	44.0
2. Fisheries	2.1	1.3
3. Manufacture & Mining	14.2	4.2
4. Trade	0.7	0.5
5. Communications	20.7	10.7
<i>Social Services</i>	<b>11.3</b>	<b>8.6</b>
6. Education	3.9	3.3
7. Health	3.7	3.2
8. Housing	2.3	1.5
9. Other	1.4	0.7
<i>Other</i>	<b>24.0</b>	<b>30.7</b>
10. Civil Administration	4.2	5.1
11. Local Government	1.3	0.9
12. Other	18.5	24.7
<b>Total :</b>	<b>100.0</b>	<b>100.0</b>



Capital expenditure was actually cut down in some years in manufacturing, communications, education, housing and local authorities. Insufficient allocation of funds for the infrastructure has contributed to damaged roads frequent power failures, voltage fluctuations, water cuts and over crowded and understaffed hospitals and schools.

(i) *Roads*

Although the number of motor vehicles on the roads have more than doubled between 1976 and 1983, there has been no corresponding investment in road construction and maintenance during this period as shown below :—

**Expenditure on Highways**

**(Capital and Recurrent Expenditure in Rs. Million)**

		Amount	% Change
1979	...	359	—
1980	...	530	+ 47.6
1981	...	350	— 44.0
1982	...	434	+ 24.0
1983	...	337	— 22.4
1984	...	402	+ 19.3

The country's roads, as a result are generally in a shocking state of disrepair ; it is reported that the SLCTB has in fact withdrawn bus services from certain minor routes as they are no longer motorable while the Upcountry District Transporters' Association has protested that "unless immediate action is taken to repair upcountry roads, transport of estate produce may come to a halt". According to the city Traffic Police, at least 50 important roads in the City of Colombo alone are in a state of major disrepair. It was estimated in 1983 that about 4500 kilometres of roads in the country required immediate rehabilitation costing over Rs. 1000 million.

(ii) *Telephones*

Telecommunication services too have failed to keep pace with the increasing demand on account of capacity constraints. Thus the number of applicants for inland telephones on the waiting list has risen from 20,759 to 28,227 between 1978 and 1982 while the waiting list for overseas telecommunication service has increased from 21 in 1979 to 49 in 1982. The unsatisfactory state of telecommunications has been highlighted by the newspapers from time to time. A report by British Cable and Wireless Company states, "In practical terms, as many as four out of five attempts to make a telephone call fail. At this failure rate the telephone becomes a hindrance, not an aid to efficiency."



A spokesman for the Chamber of Commerce has stated that some foreign entrepreneurs have even given up establishing projects here because of the bad telephone service.

### (iii) *Education*

Total government expenditure on general education appears to have fallen from around 8.3% of total government expenditure in 1974 — 76 to about 5.1% in 1981 — 83. Total current expenditure on general education similarly fell from about 2.2 per cent of GNP to 1.9 per cent of GNP between these two periods. Perhaps as a result, general educational facilities have not expanded adequately to meet the demand. Thus the teacher/pupil ratio which was 23.2 in 1976 and 21.7 in 1977 has risen gradually to 24.0 in 1980 and to 26.4 in 1983. The number of pupils per school has increased from 266 in 1976 to 357 in 1983.

### (iv) *Health :*

Total health expenditure has declined from about 5.7 per cent of total government expenditure in 1974 — 75 to about 3.8 per cent in 1981 — 83 and from around 1.6 per cent of GNP to 1.5 per cent. There have been few new hospitals opened and the number of persons per hospital rose from 29,848 in 1976 to 31,710 in 1982 and persons per bed from 334 to 350. As the number of central dispensaries was constant between 1976 and 1983 persons per dispensary rose from 39,117 to 43,671. The number of doctors actually declined from 2248 in 1976 to 1951 in 1983 and consequently persons per doctor rose from 6108 to 7902. Persons per asst. medical practitioners and persons per ayurvedic physician too rose in this period. The shortage of nurses in August 1985 was estimated at 4000. Generally there has been a deterioration in the country's medical facilities.

### (e) *Deficit financing*

The sixth feature is increase in budget deficits from about 36 per cent of total Government expenditure in 1971 — 76 to about 45 per cent in 1978 — 83 or from about 10.5 per cent of GDP to 18.9 per cent. The greater part of it — 49 per cent was met out of foreign funds, but a sizable proportion — 46 per cent — was met from domestic market borrowing. This was less than the 52 per cent in 1971 — 76 but is still too high as it is a major cause of domestic inflation. Market borrowing declined considerably for the first time in 1984 thanks to buoyant revenue from high tea prices but is expected to rise again in 1985 and 1986 on account of the projected budget deficits of Rs. 21 billion and Rs. 32 billion respectively arising from the increased defence expenditure.



It is also a matter for concern that revenue has not shown an increase commensurate with expenditure. Revenue which formed 22.5 per cent of GDP in 1971 — 76 appears to have fallen to 20.8 per cent in 1978 — 83. In fact revenue as a ratio of GDP was at its peak of 27.4% in 1978 but declined year after year thereafter until 1982 —

1978	—	27.4
1979	—	24.3
1980	—	21.1
1981	—	19.1
1982	—	17.8
1983	—	27.7
1984	—	24.9

It increased slightly in 1983, but it was below the 1980 ratio. The increase in tea prices however raised the revenue/GDP ratio in 1984 to about the same ratio as in 1979. The decline in tea prices however seems to indicate that the ratio would fall again.

Taxes appear to have declined in importance as a source of revenue in recent years. Income Taxes formed 16.4% of revenue in 1982 but fell to 13.4% in 1983 and 14.5% in 1984; taxes on production and expenditure which provided around 76% of total revenue in the four years 1978 — 81 formed only 69% in the period 1982 — 84. There has also been a decline in the relative importance of gross receipts from government trading enterprises from about 6.5% of revenue in 1981 — 82 to 5.2% in 1983 and 4.9% in 1984.

#### (f) *Inflation*

One major result of the economic policies in the period 1977 — 84 has been the marked rise in the price level. This is the seventh feature. In the seven year period 1977 — 84 the Colombo Consumer Price Index increased by 172 per cent or nearly trebled whereas it rose by only 45 per cent in the seven years from 1970 to 1976. The wholesale price index increased even more by 204 per cent in 1977 — 84. House construction costs have risen by over four times i.e. 335 per cent between 1977 and 1984. The rise in consumer prices was highest in 1980 — 26 per cent, and less thereafter 14 per cent in 1983 and 17 per cent in 1984. International Financial Statistics of the IMF reveal that the price increase in Sri Lanka between 1978 and 1984 was the second highest among Asian countries, after the Philippines. The price rise was 143 per cent — higher than in Bangladesh, India, Nepal, Pakistan, Burma, China, Indonesia, Malaysia, Singapore and Thailand. The corresponding price increase in India was 75%, Bangladesh 91% and Singapore 32%. Sri Lanka was among the countries with the lowest cost of living until 1977.

The increase in the general price level of the country was caused by a number of factors: increase in world prices of imports, devaluation and depreciation of the rupee, increase in world prices of Sri Lanka's exports, relaxa-



tion of price controls and inflationary pressure caused by expansionist economic policies particularly deficit financing met by bank borrowing. Money supply rose by 254 per cent or by about three and a half times between the end of 1976 and end of 1983. It has risen by only 112 per cent or slightly more than doubled between 1970 and 1976. The largest increase in prices was in imported commodities reflecting the rise in world prices of imports as well as devaluation and depreciation.

(g) *Fall in real income.*

The rising price level resulted in a general fall in real income of most income groups in the economy. This is the eighth feature. In the organised sector, where figures are available, it is true, nominal income increased after 1977 but their real income began to fall particularly with the higher rates of inflation after 1979. In the earlier period 1970 — 76 real wages of workers in Wages Boards Trades appear to have risen by 21 per cent while the real wages of all central government employees and government school teachers declined, the former by 5 per cent and the latter by about 11 per cent. In 1977 — 84 on the other hand, real wages of all groups workers in wages board trades, all central government employees and government school teachers rose in the first three years 1977, 1978 and 1979 but declined there after. Between 1979 and 1984 real wages of workers in wages boards trades fell by 14.2 per cent—of workers in agriculture by 6.9 per cent, of workers in services by 28.1 per cent and of workers in industry and commerce by 20.7 per cent. The real wage index of workers in Industry and Commerce in 1983 and 1984 was actually lower than in 1975 — 76. Real wages of all central government employees declined only slightly by 4.1 per cent between 1979 and 1984 but the real wages of government school teachers fell by 14.3 per cent.

(h) *Unequal distribution of income*

Nine, a concomitant of rapid growth through open market policies is the general worsening of income distribution in the country accompanying increase in income levels after 1977. Central Bank's Consumer Finance and Socio Economic Surveys indicate that income distribution became more equal between 1963 and 1973 ; the lowest forty per cent of income receivers increased their share of national income from 12.0 per cent to 15.1 per cent while the share of the highest ten per cent of income receivers was reduced from 39.2 per cent to 30.0 per cent. This reduction in the disparity of income was in great measure the result of egalitarian policies in that period. In fact the then President of the World Bank — Robert Mc Namara—in his annual address in 1973, spoke highly of Sri Lanka's policies which resulted in the redistribution of benefits of growth toward the lower income groups and argued strongly against adopting the growth rate of GNP alone as an index of economic development.



Central Bank's Consumer Finance Survey of 1978 reveals a substantial improvement in real income between 1973 and 1978, but the share of income of the lowest forty per cent of income receivers had been reduced from 15.1 per cent to 12.3 per cent while the share of the highest ten per cent of income receivers rose from 30.0 per cent to 39.0 per cent indicating greater inequality in the distribution of income in 1978 as compared to 1973. The widening of income disparities in 1978 appears to be largely the result of open economic policies introduced in 1977 — high profits to those sections benefiting from liberalisation such as import, wholesale and retail traders, transport agents, building contractors and other businessmen ; reduction of consumer food subsidies : relative increase of indirect taxation and over generous grant of direct tax reliefs. As these policies continued even after 1978 it is not unreasonable to assume that income disparities would be even wider now than in 1978. The widening gap between the rich and the poor has characterised several countries developing rapidly and prosperity has flowed most readily to large cities and to the largest business companies as in the Republic of Korea.

(i) *Increasing malnutrition*

Ten, Inflation and fall in real income seem to have adversely affected the low income levels of the country as demonstrated by the increased incidence of malnutrition. A survey by the Agrarian Research and Training Institute in 1984 indicated that the high price of rice had caused less consumption of rice and consequently reduced the intake of calories. A survey of the nutritional situation in Sri Lanka by the Ministry of Plan Implementation in 1985 shows that one in every 15 Sri Lankans is suffering from severe malnutrition. It states that over three million people struggle to survive taking minimum nutritional requirements. In 1980/82 for instance, about 37 per cent of the child population was chronically malnourished and a further 13 per cent were partially malnourished. The survey reveals that there has been a continuous deterioration in the nutritional status of ultra-poor households with the reduction of food subsidies, removal of ration books and the effects of open market policies. The Daily News in an editorial on 22 July 1985 refers to this survey and concludes : "The survey we have quoted is no more and no less than a damning indictment on our society,"...The UNICEF has recommended to the government a revision of the Food Stamp Scheme as a means of assisting increasing malnutrition. The Executive Director of UNICEF Mr. C. James P. Grant — a Sri Lanka watcher since the late fifties when he was head of USAID Mission in Sri Lanka-has stated in September 1984 as follows :—

"Despite the increase in national wealth that statistics show, malnutrition is substantially more than it was fifteen years ago, even five years ago. This is partially because the food subsidy scheme is obsolescent and rigid having been frozen in 1980. Clearly a new rationalization, a new adaptation of the Food Stamp Scheme is necessary,"



(j) *Unregulated business activities*

Eleven, open market policies while allowing free flow of imports and encouraging private enterprise, appear to have at the same time permitted excessive imports of some products and unchecked growth of certain business activities with perhaps harmful effects on the economy. One good example is private bus transport. The number of registered private buses and coaches rose from 1255 in 1976 to 17,999 in 1984 and the private bus fleet now exceeds the SLTB fleet strength of 16,425. There does not appear to have been much control over private bus transport with the result that a private service encouraged to supplement a public service is now threatening to oust its rival. Indiscriminate issue of state carriage permits has eaten into the revenues of the SLTB; for instance, news papers reported that on route 103 (Fort-Narahenpita) the private sector operates 84 buses as against the SLTB 13. It has been further reported that about 150 private buses were operating without permits in Ratnapura, Badulla and Amparai districts alone as late as February 1984.

The expansion of private bus transport has been to some extent, at the expense of public transport. Thus the total number of passenger kilometers of the SLTB declined from 22,224 million to 13,786 million between 1980 and 1984 or by 38 per cent while SLTB's losses increased by 32 per cent to Rs. 376 million in the period. Passenger kilometers of the government railway fell also by 38 percent in this period while its operating loss rose by 230 per cent to Rs. 582 million.

The substantial increase-more than doubling-of the number of motor vehicles on the road has caused a marked rise in the number of road accidents by 37 per cent between 1979 and 1983. An alarmingly increasing proportion of these accidents are caused by private coaches: while private coaches constituted only 5.6 per cent of the total number of motor vehicles in the country they formed 9.4 per cent of the total number of vehicles involved in road accidents 1983. Most of the private buses are second-hand vehicles imported from Japan and condemned CTB buses sold after a fixed period of service; according to police reports about 50 per cent of them are not road worthy and are a hazard to road users. These buses in addition are often over loaded and are driven by inexperienced and reckless drivers who violate all the rules of the road. It has been highlighted in some newspapers that as much as 30 per cent of private coaches are owned by senior police officers and the main reason for negligent driving, speeding and overloading with impunity is the protection the drivers have from the law enforcement officials. The Daily News editorial of August, 7, 1985 stated:

"Official figures show that private buses out-number the SLCTB fleet. That by itself is no worry. What is deplorable, or more than that outrageous is the reign of terror they appear to have imposed. Our private sector services are run with scant regard for public safety, public



convenience or the needs of the community. They are driven in a wild rush for profits. They claim several lives daily, maim the young and mangle the old. They overspeed at every turn. They add to the destruction of public property. Some of them are not insured. These drivers and conductors wear no identity mark. They make a mockery of the law over a wide area of daily life. Meanwhile our roads are running red under a reign of recklessness by private buses. Does anyone care ? Or is it true as some mudalalis say-that they pay the right men to concentrate on lesser things ?”.

How the private coach owners actually bribe the SLTB bus crews to sabotage the public transport system was revealed by the Sunday Observer of June 3 1984. It referred to a case of Rs. 400 being paid per day to some SLTB crews to see that their buses did not run on schedule.

53. Private hotel industry is another example. Absence of regulation of hotel charges resulted in the fleecing of tourists which in turn discouraged tourism. The Minister of Finance, in his address to the Tourist Hotels Association in July 1985 referred to this, in addition to the 1983 July communal disturbances and the world recession, as a factor responsible for the slump in tourism. Daily News of July 27 1985 reported :—

“Another was what I would describe as the short-sighted greed of the hoteliers of Sri Lanka. During the boom period from 1977 to 1982, when tourist bookings were at their height, many hoteliers in Sri Lanka jacked up hotel rates to unconscionable levels and this would eventually have led to a sharp drop in tourist arrivals in any case, ‘he said. ‘Tourist Board figures have indicated a fourfold increase in rates during this period since 1977, a rise well over that justified by inflation’. Moreover the Minister said. ‘Many hoteliers failed to invest sufficient funds to effect improvements to their hotels and failed to build up a prudent level of financial reserves. Instead they paid out unduly high dividends to their share holders in order to take advantage of the tax holiday they enjoyed.”

54. How sharp businessmen including foreigners have taken full advantage of the open economy and played out many investors has been revealed by Minoli de Soyza in the Island of 22 July 1984 :—,

“Over 100 investors with more than 10 million rupees worth of investment are going to be left in the lurch as yet another Hongkong based commodity trading company bites the dust. This is the fourth such company to wind up operations in Sri Lanka during the past three years. The first three companies dealt in commodities such as red beans, cocoa, pulses and rubber. The minimum investment required was Rs. 50,000 as well as additional commission of Rs. 800 on each unit traded which was taken by the company. The first company to be established —



Coribals started in early 1981. After collecting a conservative estimate (based on the minimum amount of Rs. 50,000) of Rs. 2.5 million rupees the company folded up. The second company was Commodities Consultant and Service Company which had about 100 investors and raised at least 5 million rupees. The third, Oriental Consultant Investment Trading Company collected another Rs. 2.5 million. All these companies had closed down by early 1983, after collecting a very minimum total of 10 million rupees from investors. The last Hongkong backed company, told a potential investor who rang up to inquire this week that they would be winding up operations for good. This company traded in gold and asked for a minimum investment of Rs. 100,000. It had over 100 clients. When companies fold up suddenly, there is little chance of recovering any money. The companies are winding up one by one after having made a fast buck at the expense of Sri Lankan investors. Part of the problem undoubtedly has been due to the unconcerned attitude shown by the authorities here. Even at this late stage no one will claim responsibility. The Trade Ministry says it is the Finance Ministry's responsibility — The Finance Ministry says "It's not us." Where does the buck stop ?"

The absence of adequate regulations and lax enforcement of whatever regulations that may exist have resulted in a marked increase in illicit exploitation of timber which is fast reducing the country's forest cover, poaching which threatens several species of wild life, indiscriminate mining of river sand, sea sand and coral which is causing coastal erosion, unsupervised sale of insecticides pesticides and other dangerous drugs and unlawful employment of child labour.

#### (k) *Corruption and business malpractices*

Twelve, open market policies, relaxation of controls, pumping of large amounts of money into the economy and expansion of opportunities to make money to the private sector by way of business operations or by performing services to government have also resulted in an increase in business malpractices, bribery and corruption. It is often stated that controls and regulations breed dishonesty and corruption but the experience in recent years seems to indicate that dishonesty and corruption are perhaps more in an open market economy.

It was Rev. Dr. W. L. A. Don Peter, Rector of Aquinas College who stated at the graduation ceremony in July 1981 ; "Dishonesty has assumed such proportions in our society that one would not be far wrong, I think in concluding that it is our greatest vice." The Daily News of July 22 1981 endorsing this remark in its editorial, further added "The whole environment as Fr. Don Peter seemed to suggest betrays signs of moral decay. But then morality itself, like religion — successful men of our times will urge — is outdated. For money, today is the measure of success : riches, the measure



by which a man's worth is tested..." The Daily News as well as other newspapers have not hesitated to draw public attention to bribery and corruption from time to time. The Weekend of January 27 1985 for instance reported after an investigation that "Bribing has taken root at all levels in society like a slow cancer, until even the most healthy people are in danger of falling prey to its tentacles. Ironically the conditioning has become so complete that few people can still distinguish between a bribe and a service charge or tip, a Weekend investigation found."

If open market policies have enabled traders to make money as never before, it has also witnessed widespread tax evasion and defrauding of government. The Daily News of June 6 1984 reported a speech of the Minister of Finance as follows :—

"Finance Minister Ronnie de Mel yesterday stressed the need to streamline tax collection and stamp out tax evasion and default which he said has become a 'fine art' in the country. Large scale tax evasion was common in textile, jewellery and garment industries ; among medical practitioners, lawyers, cycle and motorspares dealers and rice millers. Many of them had declared only one eighth of their income. A furniture dealer had declared his turnover as Rs. 226,000 when in fact it had been Rs. 6 million."

Malpractices in business and other dishonest dealings as smuggling are frequently reported in the daily newspapers. The Chairman of the Textile Manufacturers' Association Mr. A. Y. S. Gnanam, for instance, has recently openly accused some of the garment manufacturers of smuggling substantial quantities of imported textiles thereby defrauding government of tax revenue and at the same time crippling the local textile manufacturing industry. He has alleged that these garment manufacturers sell in the local market fabrics imported duty free ostensibly for manufacturing export garments and export instead garments made of cheaper locally produced material. Mr. Gnanam charged in February, 1985 that these defrauders were getting away 'scot free' as they were helped by influential people. He said, according to the Weekend of February 24 1985, that the government was not taking any counter action in spite of their repeated representations. The Weekend of June 23, 1985 reported that in the last two years at least one container of contraband has found its way to the local market every month despite customs surveillance and that several prominent businessmen are involved in this racket in smuggling goods such as sarees.

It is almost paradoxical that there exists a black market in foreign currency despite an open economy, liberalised exchange control and floating exchange rate. It is known that foreign currency is purchased particularly from those returning from West Asia at a premium and thereafter smuggled to foreign countries. The attempt to smuggle foreign currency to the value of



Rs. 28 million at the airport in August 1985 is an example of this organised smuggling. Foreign currency smuggled to India in this way are sold to Indians who travel to Sri Lanka to shop in the duty free complex. Foreign currency smuggled to some other foreign countries are used to finance imports carrying higher tariffs. It is reported that letters of credit are opened for about half the actual value of these imports (the other half being paid by smuggled foreign currency) and the import duty payable being on the c.i.f. value, is actually much less than what is paid under normal import. Fraudulent practices thrive even at the Duty Free Complex which the government set up with the good intention of earning foreign exchange. It is reported that instead of being as intended, a shop where foreigners and locals alike could buy only what they wanted for personal use, the complex at the time it was closed at the former site had become a thriving outlet for a wide range of domestic requisites that were being sold openly outside the complex for a small percentage higher than the duty free value.

Malpractices exist in the export trade too such as export without declaration to the authorities of high quality teas stolen from state owned estates in the guise of cheaper low quality teas, as well as shipment of sub-standard teas in the guise of high quality teas. The Chairman of the Colombo Tea Traders Association Mr. H. Wijeratne himself stated at the Annual General Meeting in June 1981 as follows :—

“It is not unusual today for some unscrupulous person to deal in unlawfully procured tea, price under-cutting and shipments of tea which do not match with agreed upon standards. Members may be aware of instances where stolen tea was found in buyer’s warehouses for which action is yet awaited.”

Smuggling of Sri Lanka’s gems has become a thriving business. The Chairman of the State Gem Corporation has estimated the value of precious stones smuggled out of Sri Lanka at Rs. 2 billion a year while S. A. Assen in the Sunday Observer Market Review of 16 September 1984, estimated the unofficial gem exports at Rs. 3 billion annually. The Minister of Finance Ronnie de Mel, in his address to the Sri Lanka Gem Traders’ Association in August, 1985, called upon the gem trade to help him restrict and curtail the vast amount of smuggling that was going on.

Among the other malpractices in private trade are import and sale of substandard goods such as electrical appliances which fall short of power ratings and functional capacities attributed to them and electrical bulbs which last only a few hours and sale of adulterated foods and damaged or defective articles. Daily News of July 4, 1984 reported, for instance, “Trade and Shipping Minister M. S. Amarasiri has directed the Commissioner of Internal Trade to bring to book errant traders who resort to unfair trade practices. The Minister’s order follows over 100 complaints reaching the Commissioner



that most of the articles they have bought from private traders were found damaged or defective upon delivery. Among the articles are television sets and rice cookers."

The moral degradation as a result of encouraging tourism under free market policies was highlighted by the Weekend of July 14 1985 :

"Colombo is fast gaining international notoriety as a city teeming with free sex, cheap drugs, high society gambling and loads of pornography—a paradise for underworld's brothel—crawlers, junkies and gays. Advertisements are appearing almost daily in the Western Europe's sleazy travel magazines offering "package" sex tours to Lanka. Investigating the depths of this degradation, the Weekend team found more than 1500 female prostitutes, 500 male homosexual prostitutes, hordes of transvestites (males dressed as females) and at least six high class 'casinos' operating each night in Fort, Pettah and Bambalapitiya.....A senior police official, who wished to remain anonymous, told Weekend that there was increasing evidence linking high incidence of drug abuse, rising petty crime and male prostitution. "We believe that there are syndicates which are operating at high levels, using homo-sexual prostitutes as drug peddlars and female prostitutes to support petty crime," he said."

The Weekend also reported that "each month over 2000 patients call at the venereal disease clinic of the Colombo General Hospital for treatment of sexually transmitted disease. Experts estimate that another 14,000 people seek treatment from other general practitioners in the Colombo District." In addition to prostitution there are countless parlours showing pornoographic or blue films and about 100 bookshops selling poronographic 'men only' literature.

The close link between the expanding tourist industry and increasing prostitution in the country has been highlighted by a study on "Tourism in Sri Lanka : the Social Impact" by Dr. Nandasena Ratnapala, Director, Sarvodaya Research Institute recently. It reveals how prostitution has eaten deep into the social fabric of society in the tourist areas and how it has gained a new respectability and acceptance which induce husbands to encourage their wives and parents to compel their daughters to take to prostitution. Daily News of August 22 1985 commenting on this study, added : "The truth is that whatever the future of tourism, our people will be left drained of all standards of all values and all loyalties. Will that not spell our ruin ? Even if we live in a country where men seek to conceal their wrongs and women to vindicate them ?"



(l) *Living beyond means*

Finally, everything points to the fact that the country is living beyond its means. Foreign earnings from exports of goods and services and transfers of migrant workers financed 63 per cent of the country's foreign payments in 1974 — 76 but only 55 per cent in 1981 — 83. One of the most significant developments in recent years has been the marked increase in inward remittances from the large number of Sri Lankan emigrant workers in the West Asian oil exporting countries. Their gross remittances have risen from Rs. 109 million in 1976 to Rs. 6,857 million in 1983. Such transfers financed 9 per cent of total external payments in 1981 — 83 as compared to one per cent in 1974 — 76. Exports of goods and services excluding private transfers met only 46 per cent of total foreign payments in 1981 — 83 in contrast to 62 per cent in the period 1974—76. The country was increasingly spending far more than her earnings.

The external resources gap widened between these two periods from 37 per cent out of total foreign payments to 46 per cent and it was filled increasingly by short term credits as shown in table IV.

TABLE IV  
External Resources Gap (Rs. Million)

	1974 — 76		1981 — 83	
	amount	as %	amount	as %
<i>External Payments</i>	<b>21,965</b>	<b>100.0</b>	<b>192,290</b>	<b>100.0</b>
External Resources Gap	8,069	36.7	87,517	45.5
<i>Financed by</i>				
1. Official grants	1,315	6.0	10,513	5.5
2. Long term loans	2,292	10.4	18,666	9.7
3. Short-term credits, suppliers' credits, commercial borrowing and bank borrowing	3,675	16.6	49,941	25.9
4. Direct capital investments	23	0.1	3,307	1.7
5. Others including external assets	764	3.6	5,090	2.7

Thus short term credits, suppliers' credits, commercial borrowing and bank borrowing together met 26 per cent of the total external payments in 1981 — 83 as compared to 17 per cent in 1974 — 76 ; they were equal to 41



per cent of the country's total merchandise imports in 1981 — 83 as compared to 24 per cent in 1974 — 76. As foreign exchange earnings supplemented by private remittances, private capital investments, grants and long-term loans were inadequate to sustain the high level of import consumption there has been increasing resort to short term credits. This is a disquieting feature partly because short-term credits which carry a higher interest than long-term credits are costly and partly because sustaining a high level of consumption by increasing resort to short-term credits creates an illusion of prosperity.

It is beyond dispute that any developing country needs to borrow from abroad for long-term capital development and to meet unforeseen payments difficulties. This is true irrespective of the political system of the country—capitalist, socialist or mixed. Perhaps the least burdensome way of helping a developing country would be to give it aid in the form of grants but the capacity of donors to extend grants is obviously limited. Grants and long term loans (which are normally to finance long-term development projects) and IMF drawings are legitimate forms of development and payments assistance. In 1974 — 76 for instance, they were equal to 21.0 per cent of total external payments. This ratio had fallen slightly to 19.1 per cent in 1981 — 83. It is not unusual for developing countries to borrow short-term for emergencies, but it would be perilous for a country to borrow short-term beyond reasonable limits and to borrow regularly as a matter of course. Short-term credits have been a regular feature in the country's external finances for some time now but they appear to have reached unhealthy proportions now. Short-term debts formed only 15 per cent of the total external debt in 1978 ; it had however increased to 33 per cent by 1983.

Large scale external borrowing for both investment and consumption has pushed the country's external debt from Rs. 6826 million in 1976 to Rs. 69,122 million in 1983 or in terms of SDRs from 666 million to 2651 million or by about four times. This has inevitably led to an increase in debt service payments — amortization and interest — from Rs. 1074 million in 1976 to Rs. 7094 million in 1983 or from SDR 110 million to SDR 285 million. Debt service payments as a ratio of export earnings from merchandise and services declined from 22.9 per cent in 1975 and 20.1 per cent in 1976 to 12.4 per cent in 1980 but rose thereafter year after year to reach 21.6 per cent in 1983. Thus the debt service ratio in 1983 is not very different to that in 1975/76 ; although the external debt is much higher, debt service payments have not yet reached correspondingly high levels on account of the grace period and low interest in the case of long-term loans. The Minister of Finance recently stated that "Sri Lanka in the last seven years has obtained the highest amount of concessional aid per capita for any country in the world."

The increase in the debt service payments with the end of the grace period of long-term loans, increasing resort to short-term credits and rise in interest rates will absorb an increasing share of export earnings in the years to come and the debt service ratio is likely to rise further. Debt service payments



are also likely to absorb an increasing share of new borrowings. It is important to note that in the case of some developing countries debt service payments exceed new borrowings. In the case of Sri Lanka however debt service payments were equal to 46 % of new borrowings in 1983 as compared to 26 percent in 1980.

The above analysis shows that the most striking change in recent years is the transformation of an economy living mainly on its export earnings to an open economy living far beyond its export earnings with a substantial share of imports of goods and services financed by remittances of emigrant workers and short-term borrowing. The major causes of this change are the unprecedented expansion of imports to keep consumers happy and the stagnation in exports, in fact, decline in the major exports. The Governor of the Central Bank, in a speech to the Institute of Marketing on June 8, 1984 was reported by the Daily News to have stated as follows :—

“At present we are living beyond our means and we are incurring heavy debts to meet our requirements. The debt servicing burden which is the amount of export earnings inclusive of private transfers set apart for the payment of capital and interest on foreign debt is in the region of 18 per cent. This will increase further if the balance of payments position deteriorates.”

The prospects for short-term credits as well as for concessional grants and long-term loans do not seem to be promising in the near future with the world recession continuing. Private bank loans to developing countries could dry up in the next decade if economic conditions remain poor and interest rates stay high, says a report by economists at New York's Bankers Trust Co. The report notes that outstanding loans of the nine largest US banks to developing countries in 1982 totalled 276 per cent of the bank's capital. The growing number of governments trying to reschedule their loans also threatens the ability of western banks to commit additional funds. The report urges the International Monetary Fund to tighten loan conditions to developing countries as long as worldwide economic stagnation holds down export growth, increasing the balance of payments deficits and the borrowing needs of many developing countries. “If banks have reason to believe that the efficiency of the use of resources they are lending is declining,” the report states, “recent experience shows that they will act to curtail lending and harden terms.”

Sri Lanka has no doubt received a substantial amount of foreign aid and on concessional terms too in recent years. This has enabled her to finance investment without reducing consumption and without tightening belts. This happy scenario however may not continue and this has been clearly emphasized by the Minister of Finance himself in his speech to Parliament on July 11, 1985 :—



“Although I have every reason to be happy with our achievements at this year’s Aid Group Meeting, I must once again draw the attention of the House to the fact that we surely cannot go on depending on such large flows of concessional development aid for ever. The aid-giving countries themselves are beginning to feel the strain of such concessional lending. They will very happily lend us money on commercial terms, but they are becoming more and more loth to give us money on concessional terms. Public opinion in these countries is turning more and more against concessional lending to third world countries, except in the case of severe unforeseen disasters like the present drought in Africa. Many of these countries are facing budgetary difficulties and other economic problems of their own-high unemployment and high inflation. When budget cuts are made in these countries it is natural that the aid programmes should be axed first. We cannot go on depending on aid for ever. It is absolutely essential that we must begin to rely more and more on our own domestic resources, on increasing production-our own production - on increasing exports - our own exports - on increasing our own revenues, on increasing the revenues of my Budget.”

#### IV. Corrective Measures and Long-term Policies

The above analysis indicates that while open market policies and massive investment have helped to achieve, on the one hand a high rate of economic growth and ensured an adequate supply of capital and consumer goods, they have, on the other, been accompanied by unfavourable side effects and unhealthy trends. Such unfavourable features as deficit financing, inflation, inequality in the distribution of income, overloaded infrastructure, high short-term debt and widespread corruption appear to be mainly the result of accelerated or telescoped development or pumping of too much money into the economy in a relatively short period of time combined with unprecedented expansion of consumption. The Minister of Finance has described this as “Trying to do too much too soon and over extending in the process,” while the Central Bank has described it as “Overheating” of the economy. It is essentially an expansion of aggregate demand over and above the available real resources. Such unhealthy trends on the supply side such as the slow growth in export agriculture and some import substitution industries and the slowing down of growth generally in all sectors in recent years reflect the inadequacy of existing open market policies.

The overheating of the economy can be reduced by lowering the volume and rate of growth of investment from the present high levels. Any adverse effects on growth of output can also be neutralized by redistribution of investment in favour of projects and programmes with high input-output ratios. The crucial problem however is that resources are unlikely to be adequate to sustain even a lower level and rate of investment if, as the Minister of Finance



fears, there is a diminution of external aid, which in recent years financed over half the country's investments. It will be unavoidable under these circumstances to increase domestic savings substantially by cutting down consumption.

Consumption needs to be cut down in any case in view of the increasing short-term debt which has now reached a high level. No one likes shortages, but the question is can the country afford to sustain a consumerist society allowing free choice to the consumer? If the country can afford it by increased foreign exchange earnings, there can be no objection to it. The high level of consumption in recent years, however, as shown earlier, has been sustained mainly by external borrowing which is a sign not of strength but of weakness. The crucial issue therefore is whether the country should continue to live beyond its means as at present or make a start to live within its means.

The increasing government expenditure on defence, the fall in tea prices and unfavourable prospects for increased foreign aid are likely to compel Sri Lanka to seek IMF assistance before long. The IMF is the lender of last resort virtually to all member countries but the price of its rescue operation is harsh. The borrower would be required to cut spending, eliminate consumer subsidies, raise charges for government services, reduce consumption and stimulate exports. Such measures would inevitably result in retrenchment, pruning welfare expenditure such as free educational and medical care, raising of prices of essential foods and fuel and adopting "austerity" in general.

The hostility to these austere measures has often erupted in violence. The increase in food prices in accordance with IMF's austerity programmes led to widespread riots in Morocco causing 29 deaths and in the Dominion Republic causing 60 deaths. Such riots also followed similar food price increase in Brazil, Tunis and Bolivia. In the Dominican Republic, Morocco and Tunis the price increases had in fact, to be cancelled. Finance Ministers and Central Bank governors have sometimes been the victims of popular discontent against IMF inspired policies. In Bolivia, the Finance Minister who negotiated the stand by agreement with the IMF was forced out by the President in March, 1984. When the President of the Argentina's Central Bank returned after the annual IMF — IBRD meeting in Washington in autumn 1983, he was arrested by a district judge for "betraying his country's sovereignty by agreeing to the austerity measures sought by the IMF and western banks." In Brazil the head of the country's Central Bank resigned rather than implement the IMF's conditions for future borrowing. The devaluation and slashing of food subsidies in response to the IMF's demand for severe belt tightening measures brought on the first round of rioting which ultimately led to the overthrow of President Nimieri in Sudan.

It is because of these austerity measures that the IMF has been the target of much criticism from developing countries. The President of Tanzania, Julius Nyerere has described the IMF as an instrument of destabilisation of



the Third World. Former Peruvian Premier Jorge Fernandez Maldonado has said that the IMF prescribed only "absurd and obsolete recipes and generate even more under development, hunger, poverty and death." The Cuban President Fidel Castro has recently accused the IMF of demanding unacceptable austerity conditions that threatened to fuel social unrest.

Whatever the criticism, there does not seem to be an alternative to the IMF for countries desperately in need of external assistance. In fact the very countries which had earlier resisted its austerity measures as a condition for assistance such as Argentina, Brazil and Mexico are now sheepishly implementing such policies. <sup>1</sup>Besides, even socialist countries such as China, Kampuchea, Laos, Vietnam, Hungary, Romania and Yugoslavia are members of IMF and Poland is expected to be a member soon as the U.S.A. has now dropped its veto on her application for membership. Yugoslavia has made recourse to 9 standbys from the IMF since 1953, Romania 3 and Hungary 2. (These three countries and China, Vietnam and Laos have also borrowed from the World Bank).

Whether the country seeks IMF's assistance or not, the need for urgent measures to reduce aggregate demand and to increase the supply of real resources internally and making the economy more self-reliant and growth more self-sustained remains valid. It is in this context that an appraisal of current economic policies and a discussion on possible modifications or changes in policies seem opportune.

A review of economic policies appears also to be necessary in order to ensure more effectively that benefits of economic growth are distributed equally. Attention was drawn to this aspect by the Prime Minister Mr. R. Premadasa in his address at the Annual General Meeting of the Ceylon Chamber of Commerce on July 30, 1985 :—

"We have also to think of the large group of under-privileged in our society. For them a free market means the freedom to consume for the affluent and the freedom to watch others consume for the poor. With such a significant portion of our population within the fold of poverty, the free market will only have meaning if it distributes effectively, in addition to its contribution to growth."

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1. Mexico, in July 1985, devalued the peso, restricted bank credit and undertook to slash as much as \$ 500 million from the \$ 50 billion plus 1985 budget including the elimination of 15 cabinet under-secretariats and at least 50 other government departments. Argentina had to agree to freeze wages, introduce a new currency and bring down inflation from 1010 per cent to 150 per cent by April 1986 in return for a IMF standby of \$ 1.4 billion.



This raises the important question whether open market policies can ensure the attainment of this goal. There are several important issues involved in formulating economic policies in the present situation and it would not be possible to analyse all of them in one paper. The attempt here is to raise and discuss only some of them so as to provoke further discussion.

(a) *Reducing aggregate demand*

How far is it feasible to reduce aggregate demand by cutting down investment and consumption ? Investment has increased rapidly and reached a high level on account of about fivefold increase in capital formation in building and construction, plant and machinery and transport equipment. About one-third of gross capital formation in 1978 — 1983 was in building and construction. Mahaweli Development Scheme alone accounted for half of it. About 27 per cent of the government's capital expenditure in 1978 — 83 was on the Mahaweli. One way of living within means would be to decelerate the rising investment in these sectors. In the Mahaweli, for instance, now that the major part of the construction is completed it should be possible to reduce the pace of investment in the remaining programme. The government may also consider going slow in providing electricity and water supplies to small towns and villages who may not be in a position to pay for these services in any case. In transport, now that the private bus fleet already exceeds the SLTB fleet and is threatening its very existence, restriction of further imports of buses and coaches would appear to be prudent. Restriction of hotel construction would also seem warranted under the foreseeable prospects for tourism. Reduction of imports alone is enough to cut down low priority import induced investments.

In the government's budgetary operations, a good part of the savings likely to result from a deceleration of growth in building and construction, particularly in the Mahaweli, would need to be diverted to improve the economic and social infrastructure — roads, telecommunications, schools and hospitals which, as shown earlier, had not been allocated sufficient funds in recent years. While the Mahaweli project is highly capital intensive, investment in infrastructural facilities are slow in increasing output and defence expenditure economically unproductive. In addition, defence expenditure which is expected to rise to unprecedented levels, will command substantial resources. This situation, therefore, warrants a change of emphasis from capital intensive projects to not only less capital intensive projects but also to quick yielding projects and programmes where the impact of input on output is immediate.

A good example of such programmes is the construction and improvement of minor irrigation schemes-village tanks-by use of voluntary or "Sramadana" labour as well as paid labour requiring minimal machinery and equipment. Increase in production of paddy is likely to be significant under such a programme in areas where rainfall is inadequate and large scale irrigation schemes are not practicable, as for instance, in the Kurunegala District. Two



other areas where output can be increased rapidly with less capital outlay are plantation and subsidiary crops. It is important to note that whereas gross capital formation increased in 1978 — 83 by 445 per cent in building and construction and 359 per cent in transport, it rose by only 153 per cent in planting, replanting and land development. As plantation and subsidiary crops need a detailed analysis, they will be discussed separately at a later stage.

Whether it is feasible or not to reduce capital expenditure, it would be necessary to increase revenue so that it could meet an increasing part of capital and defence expenditure. In the period 1978 — 83 as a whole current account surpluses of the budget have met less than one percent of the capital expenditure. Clearly such a situation cannot be allowed to continue. That steps need to be taken to raise revenue is also demonstrated by the fact that revenue as a ratio to GNP declined in this period as shown earlier. It is not the intention of this study to examine what taxes should be raised and what lowered. This needs to be done by taxation experts or a tax commission. What is stressed here is that revenue must be raised and taxation is the main source of revenue. The shares of income tax revenue and receipts from government trading enterprises in total government revenue, as shown earlier, have declined. Clearly the question of higher taxes will have to be considered in the near future not only to raise revenue but also to cut down consumption. The possibilities of increasing the contribution of government trading enterprises also needs to be thoroughly explored. Public corporations are so important in the economy that they merit detailed analysis in a separate section on the public sector, to follow later in this study.

Surplus budgeting needs to be supplemented by restrictive monetary policy to reduce aggregate demand. Restriction of commercial bank credit for consumption and low priority investment, selectively, combined with a higher interest rate structure may have to be given serious consideration. It will also be necessary to examine measures to control the operations of finance companies which together with banks have fueled the consumption boom. Some of the leading finance companies have doubled their assets and profits within a short period of two years, 1981/82 to 1983/84, and declared dividends are as high as 135 per cent for 1983/84.

Restraining investment and consumption would of course entail cutting down of imports. If import licensing is unacceptable as it smacks of control, imports can be reduced by higher import tariffs combined with restriction of bank credit. It should however be pointed out that import controls and licensing are not obstacles to high growth or to free enterprise and they are extensively used in the fast developing free market economies like the Republic of Korea. Apart from import control, it may become unavoidable to introduce other economic controls and to exercise greater vigilance to curb undesirable economic activities and corrupt practices. Such regulation is not incompatible with a private enterprise oriented economy, which should allow enterprise freedom within the overall economic policy of government but not licence.



## *(b) Increasing supplies*

### *Export crops :*

Increase in exports is the surest means of augmenting the country's resources. It has been shown earlier that the poor performance of the country's exports was due to the fall in production of the three major plantation crops — tea, rubber and coconut. The increase in industrial exports should not blind us to the fact that on account of their very low value added content, the country has still to rely on its agricultural exports. The three major crops still accounted for over 50 per cent of the total exports in 1983 (over 70% in 1976). Annual average production of all the three crops was lower in the period 1978 — 83 than in 1971 — 76 as shown in Table V. Tea production in 1983 was the lowest recorded since 1956. Another unfavourable aspect is the poor record of replanting : approximately 2067 hectares of tea have been replanted annually in 1978—83 which was below the annual target of 3035 hectares and about 5042 hectares of rubber have been replanted as against the target of 6000 — 7000 hectares. Replanting of the three crops which had increased annually to a peak in 1981 declined in both 1982 and 1983 despite enhanced subsidies. Further, yield in tea appears to have declined in recent years.

Export prices of all the three exports in the period 1978 — 83 were much higher than in 1971 — 76, about four times. Export prices of these products were rising year after year and in 1983 they were higher than in 1976 by about 374 per cent in the case of tea, 221 per cent for rubber and 400 per cent for coconut products. By contrast the guaranteed price of paddy rose by only 89 per cent in this period but production rose by 71 per cent. In addition to rising prices, fertilizer use was also increasing in both tea and rubber while it was more or less at the same level in coconut. Furthermore in the case of tea, the area under cultivation was higher in the latter period. It is puzzling in this favourable situation to find production declining. Adverse weather alone cannot explain this decline.

Decline in production of tea and coconut was not a thing that started in the eighties : it was there in the seventies as well. The table shows that between 1965 — 70 and 1971 — 76, tea production fell by 5 per cent and coconut by 5 per cent. Rubber production however rose slightly by 2 per cent between the periods.

While a comprehensive analysis of the factors that affected production has yet to be undertaken, it has been generally assumed that the fall in production of tea in particular, in the seventies, was caused mainly by neglect and



inadequate investment before and in anticipation of nationalization and after nationalization by poor management and political interference. The Central Bank Annual Report for 1979 for example highlights these issues as follows :—

“By improved management practices and through more effective decentralization of management and by elimination of outside interference in operations, it should be possible for these corporations not only to increase production but also to eliminate waste and losses and increase profitability.”

TABLE V  
Tea Rubber & Coconut Scenarios

	Annual Average 1965—1970	Annual Average 1971 — 76	Annual Average 1978 — 83
(a) <i>Tea</i>			
Production — M.Kg.	221	210	196
Total area — hectares	241.540	241.849	243.409
Fertilizer issue — 000 M. tons		102	109
Yield per hectares — Kgs.		951	
Replanting — hectares	2064	2052	2067
Price — Colombo net per Kg — Rs.		5.37	19.60
Cost of production per Kg — Rs.		5.18	18.50
Profit margin per Kg — Rs.		0.19	1.10
(b) <i>Rubber</i>			
Production — M. Kg.	142	145	138
Area under tapping — hectares		194,879	177,960
Fertilizer issues — 000 M. tons		15	20
Yield per hectares — kgs		754	773
Replanting — hectares	4688	3094	5043
Price — Colombo net per Kg — Rs.		2.62	10.14
Cost of production per Kg — Rs.		2.28	7.70
Profit margin per Kg — Rs.		0.34	2.44
(c) <i>Coconut</i>			
Production — million nuts	2507	2378	2286
Fertilizer issues — 000 M. tons		43	42
Price — Colombo per nut Rs.		0.34	1.50
Cost of production per nut Rs.		0.11	0.52
Profit margin per nut Rs.		0.23	0.98



Central Bank has also underlined deficient management of plantations as a major cause of falling production in the Annual Report of 1983 :—

“Previous Annual Reports have repeatedly drawn attention to the need to restructure management of the state sector plantation corporations... While the unprecedented drought undoubtedly depressed output, inadequacies in management in the state plantations sector continued to afflict tea and rubber industries. Little progress was evident in 1983 that efforts to tackle the problem was yielding tangible benefits”.

Poor management of the tea plantations is well illustrated by the organized pilfering of made tea from estates which are finally exported without payment of internal taxes. This pilferage was estimated by the tea trade at 10 to 15 percent of the production annually. The difference between figures of production and of export of tea in the seven years 1978 — 84 was 89 million kg. or an annual average of 12.7 million Kg. Domestic consumption on the basis of 1.52 Kg. of tea consumed per head per year at home, according to the Central Bank Consumer Finance Survey of 1973, amounts to 159 million Kg. in 1978 — 84 or 22.6 million Kg. per year. As tea export figures are more reliable than production figures, the logical inference is that tea production has been underestimated by about 69 million Kg. in this period or around an annual average of 10 million Kg or about 5 percent of production. If allowance is made for tea consumed outside households such as in hotels, canteens, tea boutiques etc. the proportion would certainly exceed 5 percent. It has been reported that thefts of tea are being carried out possibly with the connivance of superintendents of state-owned estates who are supposed to account for these shortages by showing a drop in yield in their records. Certain high yielding estates which during Agency House management were producing around 1500 lbs. of tea per acre, for instance, are now reported to be producing a much lesser quantity of around 700 lbs.

Thus the first step needed is to bring about better management of estates and elimination of pilferage of made tea. It will be interesting to find out to what extent the management of tea plantations has been politicized and whether this has contributed to reducing efficiency and increasing pilferage.

Secondly it is imperative to examine whether the present institutional set-up is conducive to the efficient functioning of plantation industries as the institutions entrusted with the management of the plantations appear to be incapable of even spending the investment funds provided by government annually. In the Six years 1978 — 83, under-expenditure of capital funds provided by Parliament was alarmingly high in the ministries in charge of plantation industries as shown below :—



## Under-expenditure of Capital Funds 1978 — 83

	<i>Under expenditure as % of total capital expenditure provisions 78 — 83</i>
1. Ministry of Plantation Industries	32.1
2. Ministry of Janatha Estate Development Board	44.2
3. Ministry of State Plantations Corporation	30.5
Average for the three	35.9
4. Ministry of Coconut Industries	46.0
Average for all four	38.7
5. Average for all ministries of total capital expenditure of government.	15.0

The four ministries in charge of plantation industries have thus spent only 61 per cent of the capital expenditure provided by government annually in the six years 1978 — 83. Their average underexpenditure was consequently about 39 per cent or much higher than the average of all ministries together which is 15 per cent. Under-expenditure was as high as 46 per cent in the Ministry of Coconut Industries and 44 per cent in the Janatha Estate Development Board. In fact in some years under-expenditure exceeded 50 per cent : Ministry of Janatha Estate Development Board — 78% in 1981 and 55% in 1983 ; Ministry of Plantation Industries — 58% in 1979 Ministry of Coconut Industries — 55% in 1980 and 62% in 1983. These exceptionally high under-expenditure ratios raise doubts whether these institutions are geared to undertake the tasks assigned to them and whether any useful purpose will be served by providing them with extra development funds in their present state.

Thirdly there are several authorities dealing with the tea industry resulting in confusion, delay and overlapping. There is neither an integrated policy nor a central guiding authority for the tea industry as a whole. Tea production is under the supervision of three ministries. State owned tea plantations which account for 80 per cent of the entire tea production are under the Ministry of State Plantations Corporation and the Ministry of Janatha Estate Development Board, both under the President. Private tea estates appear to be the province of the Ministry of Plantation Industries. Tea export trade and international conferences on tea are within the purview of the Ministry of Trade and Shipping. Taxation of the tea industry is determined mainly by



the Ministry of Finance while incentives for processed tea exports are decided on by the Export Development Board. The Tea Board looks after tea research, promotion and small holders.

The conversion of the two state corporations — the State Plantations Corporations and the Janatha Estate Development Board — into two separate Ministries and the appointment of their two chairmen as secretaries to the two ministries concurrently with enormous powers, has made the situation worse. There does not appear to be a mechanism to coordinate the operations of these two Ministries, monitor and supervise their activities and ensure liaison with other ministries and organisations dealing with tea. The two Ministries are in a privileged position and no other ministry or organisation would be tactless enough to point out their mistakes and take them to task.

The situation today is little different from that in 1968 as described by the Tea Commission headed by Sir Arthur Ranasingha :

“We are convinced that the diffusion of powers and functions among several ministries and departments of government, and the absence of coordination in respect of matters connected with the tea industry seriously hamper its efficiency as a contributor to the general economic well-being of the country. Wide range of problems seems to us to require the attention of a central organization to take a comprehensive view and seek solutions in accordance with the policies designed with care to promote the development of the industry as a whole. For this reason we welcome the suggestion which is implied in our terms of reference that there should be a single organization to deal with all matters connected with the Tea Industry”.

It was to centralise the diverse functions in one body that the Tea Board was set up to supervise and control the tea industry and it was to vest overall responsibility for the whole plantation industry in one ministry that the Ministry of Plantation Industries was created by the previous government. Both the Ministry of Plantation Industries and the Tea Board have now been castrated and rendered impotent. The authority and functions of the Tea Board are in abeyance and it is allowed to play such a restricted role that the government does not consider it necessary for it to have even a fulltime chairman. Thus the tea industry is drifting without clearly defined objectives, intergrated overall policy and absence of a central authority responsible for its development.



The Chairman of the Colombo Tea Traders Association, Mr. H. Wijeratne stated at the Annual General Meeting in June 1981 as follows :—

“The Tea Industry has been and continues to be the country’s foremost foreign exchange earner. It is therefore important that there should be a continuing dialogue between those who produce and those who market the teas, to the end that production would be geared to meet consumer demand. It would be in the best interests of all concerned if production and marketing of tea in Sri Lanka came under one ministry because then marketing needs could more easily be met by the producers”.

Fourthly, it will also be interesting to find out whether the establishment of a separate Ministry for Coconut has contributed to promote the best interests of the coconut industry, particularly as this ministry has been able to spend only about half the capital expenditure voted by Parliament in the last six years. It will be useful to reexamine the virtues of having one ministry in charge of all plantation industries — tea, rubber and coconut — as it was before 1977.

(ii) *Import-substitution.*

Side by side with the revival and expansion of exports of tea, rubber and coconuts, high priority should be given to promote import substitution in both food and industrial production. It was seen earlier that while subsidiary food production has increased in recent years, it has not increased as it should have done on account of the competition of imported food. It would be appropriate to examine whether the free import of food items, which can be grown locally, is in the long-term interests of the country, particularly in view of expected foreign exchange constraints. The lack of a coherent policy on subsidiary food production has been spotlighted by the Central Bank Annual Report for 1983 as follows :—

“The response of paddy agriculture to a carefully orchestrated policy and the lack of dynamism in production of subsidiary food crops seem to suggest that policy initiative in the latter area still lack coherence. Production has continued to be beset by inadequate expansion, marketing and storage facilities and seasonal price fluctuations. Inconsistencies in certain policies remained unresolved e.g. the competitive price of coconut products in the local market directed at consumers (fresh nuts and oil) and the dairy industry (poonac) have undermined producer incentives to produce substitutes like oilseeds, soyabean etc.”

Protection through a higher tariff on imports could go a long way to expand production of some subsidiary food crops such as potatoes, onions, chillies and pulses.



Two important areas where there is much scope for substitution are sugar and milk. Sugar production which increased by 75 per cent between 1970 and 1976 declined by 9 per cent between 1976 and 1983. Imports of sugar have risen from about 50,000 tons in 1974 — 76 to 315,000 tons in 1983 valued at Rs. 1,985 million. Milk production rose by 68 per cent between 1976 and 1983 but imports of milk food increased nearly fivefold in volume and flooded the market as never before. The value of imports of milk products in 1983 amounted to Rs. 978 million as compared to Rs. 81 million in 1976. Efforts are being made to expand production of both these products with the help of multi-national companies, but it may be necessary to supplement these efforts by restricting competition from cheap imports.

It appears that sufficient attention has not been paid to the fact that sugar and dairy products are heavily subsidized exports of some developed countries. The EEC for instance subsidises sugar production as well as sugar exports and it has been able to increase its share of the world market for sugar through subsidized exports ; dairy products which are sold by developed countries including the EEC at subsidized cheap prices have tended to discourage domestic dairy development in the developing countries generally. It would be relevant under these circumstances to review the policy of free imports which encourages subsidized imports and consider the question of protecting domestic production of sugar and milk.

While Sri Lanka has taken ASEAN and the Republic of Korea as models for her development policies, she has not seriously taken into account an important element in the development strategy of these countries — protection of local industries. These countries have achieved high growth rates by building up their industries through protection. The Republic of Korea for instance has been following a close-door policy on trade : import bans, high tariffs and harsh investment restrictions have kept foreigners out of the South Korean market and hundreds of goods are either banned or allowed with government approval. Similarly domestic industries in ASEAN countries are well protected and a major exercise in ASEAN is to reduce these trade barriers to allow greater specialisation on the basis of comparative advantage.

It was generally believed by policy makers in Sri Lanka, as mentioned earlier, that open market policies alone without special measures would be adequate to stimulate and sustain domestic industries until 1984 when a comprehensive revision of the tariff structure was carried out. This exercise has imposed higher tariffs on some products competing with local industry such as full cream milk powder, sanitary ware and sugar. To what extent these tariff changes are adequate to promote local industries yet remains to be seen.

Protection of domestic industries by high tariffs does not necessarily mean shutting the door to imports or foreign capital. The consumers could yet purchase imported goods but at a higher price than locally produced substi-



tutes. Foreign capital participation and tie-ups with foreign companies would continue as before so as to create additional capacity and improve technology of local industries.

Open market policies were vehemently opposed by the Ceylon National Chamber of Industries whose Chairman Mr. A. R. P. Wijesekara outlined the case against these policies in his address at the annual general meeting of the Chamber in 1981 in the following words :—

“The government wants as a matter of urgency to guide local industries away from import substitution into export industries. This is something easier thought than achieved in a short while..... Meanwhile we the local industrialists make the point and we would repeat this point time and again till it is accepted, that export industries can only be built up on the strong base of servicing the domestic market. We appeal to the government not to attempt to turn us into exporters while leaving the domestic market open for dumping of imported consumer products, from countries which heavily subsidized exports. We appeal to the government to give us a chance of competing for the local market with countries which price their exports at reasonable prices..... But please do not search the world for foreign capital to come in and make in Sri Lanka goods which we have made successfully over the last twenty years. Do not allow robber barons to come into this country to drive the local industrialists out of a market which is legitimately theirs.....If the government were to continue on the present road, then local industrialists may fall by the wayside and may be replaced by trans — nationals who have access to tied markets elsewhere in the world.....”

The case for protecting and encouraging import substitution industries is strengthened by the fact that their value added content appears to be generally higher than the export-oriented industries of the Investment Promotion Zone. It is interesting to note that the average proportion of value added (derived by subtracting the cost of raw materials and power and fuel from the ex-factory value of out put, in industry declined from about 42 per cent in the period 1974 — 76 to about 27 per cent in 1981 — 83. This was the result mainly of the expansion of the textile/garments industries in the IPZ and the chemical industries whose value added content is lower than that of others. Thus average value added in the textile/garments industries in 1981 — 83 was around 15 per cent while that of industries associated with food, wood, paper, non-metallic mineral products and fabricated metal products which operate outside the IPZ was over 40 per cent. The fact that the value added content of the textile/garments industry alone fell from 43 per cent in 1974 — 76, when there was no IPZ, to 15 per cent in 1981 — 83 indicates the impact of the new IPZ industries on reducing the average value added content.



Import-substitution industries are also exporters or potential exporters. In fact the greater part of the country's industrial exports are from these industries. In the three years 1981 — 83 industrial exports formed 36 per cent of the country's total exports of which IPZ exports amounted to only about 8 per cent. Thus around 28 per cent of the exports are accounted for by industries outside IPZ—mainly import substitution industries. The increase of their share of exports from 14 per cent in the period 1974 — 76 to 28 per cent in 1981 — 83 is an index of their increasing contribution to the country's export-effort. In fact it should be the future strategy of the government to ensure that domestic industries increase their share of exports further in order to maximise resources. The prosperity and high growth rates of the Republic of Korea and Singapore are mainly due to the high proportion of their manufactured exports. Thus manufactures accounted for 81 per cent of the total exports of the Republic of Korea (1981) and manufactures and petroleum products formed 76 per cent of the exports of Singapore (1983).

(c) *Reorganizing the public sector.*

An essential prerequisite to increasing internal resources for development is the adoption of appropriate measures to reduce waste, inefficiency fraud and losses in the public sector. The Minister of Finance in a public speech as reported by "Daily News" has stated as follows :—

"Minister of Finance Ronnie de Mel said yesterday that a lack of financial discipline was evident today not only in ministries, government departments and corporations but also in the private sector.....He said that it had been found that projects had been approved on very flimsy data while estimates were fictitious. Immense government expenditure provides fresh soil for mismanagement, waste, corruption and petty empire building he said. Because of this it was incumbent upon accountants to maintain rigorous control of financial discipline."

Daily News of August 2, 1985 reported that the Minister of Finance, addressing the Kalutara Development Council Meeting had described the government Highways Department as "a highway robbery department" and stated "I always cut your estimates by 50 per cent and the work is still done."

The newspapers, it must be pointed out, have frequently spotlighted waste inefficiency and corruption in the public sector. Daily News editorial of 13 July 1984 for instance, stated,

"Men and material that cost the country precious sums of money are kept idling. Equipment received from foreign services is often left to rot. Tender procedures seem to be manipulated to suit pre-selected tenderers often : just as advertisement for employment are sometimes tailored to fit a particular individual. Are these lapses and abuses to be screened from the public eye ? Departmental reports come out so



late that dust has settled on the wrong-even before it reaches the Auditor General's Office. The irregularities that are openly practised at official level naturally demoralise public servants of lesser levels. A cut back on a huge contract has become standard practice. Rs. 5 to a peon remains a bribe. This sort of ambivalence only leads to a spread of corruption."

Many are of the view that waste, inefficiency and corruption are greater in public enterprises or State owned Corporations. The Parliamentary Committee on Public Enterprises in its Seventh Report — January 24, 1985 — has clearly indicated that "none of the enterprises have rendered satisfactory accounts" and that "Control by the management over the public enterprises is far from satisfactory." The Committee has also drawn attention to some of the other shortcomings of public enterprises such as "uneconomic activities, fruitless expenditure, under utilisation of installed capacities, redundant or surplus assets, unsatisfactory price structures, non-rendition of draft annual reports to the Auditor-General, poor liquidity, inadequate rates of return on investments, poor financial performance and inefficient and ineffective use of resources and waste of resources." Reference has been made to "continued disregard for accounting and financial controls which appeared to the Committee to have assumed alarming proportions" and "weak systems and procedures". The report also showed that business enterprises partly owned by state corporations remain outside 'public control and this constitutes "an erosion of parliamentary control over public finances."

Minister of Finance Ronnie de Mel openly stated as reported in Daily News of August 31 1984 that, "some public sector corporations are hopelessly mismanaged, hopelessly over-manned and hopelessly over-extended financially speaking. They are classic examples of how things should not be run." He concluded that "They have become a plague on my life and a bane on our economy." The Minister in July 1985 also drew attention to the criticism by several donor countries of the performance of the public corporations in, the aid group meeting.

The plain fact however is that public corporations are in practice political corporations. Their main service has been to provide employment to political loyalists. The chairman and directors as well as all officers from the general manager to the lowest peon are appointed by the minister in charge or with his knowledge and approval. They are appointed less for their technical knowledge and competence and more for their political loyalties. Thus mismanagement, inefficiency and corruption are built-in in public enterprises by their very nature. Daily News of March 8, 1985 had the following editorial:

"Their original aim was to stimulate new lines of produce, trade and commerce - financed by the State, but not enslaved to bureaucratic ramifications. Today they have often become political appendages offering asylum for rejects at the polls or their callow offspring. Our



public sector enterprises all reveal a heavy overload — an impossible redundancy of staff..... We have arrived at the stage where we have more jobs than work-often in the name of generating employment. Who are the beneficiaries ? Government servants claiming kinship with one political high up or another. That most damaging aspect of it all is that, they come in on higher salaries than the older members in an establishment ; callow youth who know little grammar and betray less experience ; drop-outs from public schools, certified half wits and oldsters seeking to revive dying embers of a once flaming virility. Thus the loss in money to the country is grossly heavy and scandalous. Beyond that the damage to the morale of the nation's welfare could be something even more catastrophic.....Favouritism and nepotism, and the manipulation of appointments are all steps on the highroad to public corruption. It is a path we have travelled too far already. We have to change our course, not to sublimate wrongdoing."

Mr. A. R. P. Wijesekera in an article on "Private buses overtake CTB" in Daily News of May 8, 1985 states :—

"The CTB degenerated over the years into an organization in which each employee looked for an influential patron who protected him against management actions. Add to this the fact that the CTB ultimately carried a huge number of drones as passengers in its organization. The CTB was heavily overstaffed as a perennial source for political patronage. Even at this late stage there should be a serious attempt at divorcing the CTB from politics completely."

In addition to filling public corporations with political appointees, chairman and directors of corporations have been changed so frequently that it has been difficult to maintain continuous and stable policies. This has also allowed directors to get away with any malpractice ; by the time malpractices are detected by audit, those who were responsible for them would have been replaced by new directors. Furthermore, major policy decisions of public Corporations are in fact made by the minister in charge or the government and are rubber stamped by the Boards of Directors. Such decisions in many instances are not based on business but political considerations. For instance the Tobacco Industries Corporation which has no connection whatsoever with public transport, purchased 593 motorised trishaws from Hebtulabhoy & Co in 1980 and handed them over to the Self-employment Projects Ltd., (SEP) which was to pay up the capital. This project was so badly managed that the government took it over under the Business Acquisition Act in 1985. The Minister of Finance in a lengthy speech in Parliament on August, 8, 1985 presented an array of facts to prove that the SEP was grossly mismanaged and that it was guilty of misappropriating state funds. He further pointed out that fraudulent activities which were a hundred times worse than those in the Tobacco Industries Corporation and SEP had taken place in several other



corporations such as cement, ceramics, steel and hardware and called for a Presidential Commission to probe the extent to which the former Industries Minister Cyril Mathew had misused the corporations under his Ministry.

The Minister of State, Anandatissa de Alwis speaking to an assembly of corporation chairmen in Galadari Hotel, stated that he personally felt criticism of corporations was often unfair "because nobody realized that the boards of corporations are invariably helpless that they cannot make the decisions they would like to be free to make." He spoke of how political decisions often prevented the corporations from efficient functioning :

"Time and again political demands have been made about the prices of the articles you sell. Time and again some of us have dumped people on the corporations." (Daily News March 1, 1985).

Few will dispute that waste, inefficiency and corruption in the public sector can be cut down to a great extent by reducing politicization, by having an administration run by honest public servants and by operating public corporations on strictly commercial lines free from political control and interference. Few will also dispute the urgent need to strengthen the government machinery to fight waste and corruption. It should be noted nevertheless that however desirable it is to reorganize and reorient public corporations, it may not be easy to do so in actual practice. It is a fact that public corporations have been largely political corporations in effect and they are likely to remain so in Sri Lanka's political and social context. One way out is to transfer the management or to sell the entire enterprise to the private sector. A more prudent approach would be to give greater weightage for technical competence in recruitment, reduce political interference in business and disciplinary matters and permit at least the major business decisions to be taken on commercial considerations. Such an approach is of crucial importance in any programme of action to cut down losses and maximize surpluses of public corporations and thereby increase government revenues. Furthermore, if it is true that a healthy private sector is needed as a countervailing power against the public sector, it is equally true that a strong public sector is necessary to check the abuses of the private sector. It may be useful to recall that it was a colonial government, with no pretensions to socialism, which entrusted the import and distribution of essential foods to the public sector and built up the consumer co-operative movement during the war years, because it had little confidence that the private sector, left to itself, would look after consumer interests.



# REFLECTIONS ON INDUSTRIAL DEVELOPMENT IN THE POST-INDEPENDENCE ERA

E. M. WIJENAIKE

The development of industry has always been regarded by developing countries as of crucial importance for promoting economic growth and raising living standards. Sri Lanka has shared this view for the last 40 or 50 years.

If we look back briefly at economic development during the last 40 to 50 years it will be seen that the first stirrings in regard to the need for industrial development occurred even before the last war. During the war itself due to scarcities some impetus was given to local industry and a number of small industries were started under the patronage of the government to meet shortages in imports. After the war however many of them had to be closed down. With independence and growing population however the need for industrialisation assumed greater importance. However, if we examine the record over the last 40 years by and large despite the great urges that there have been for industrialisation, overall, our performance has been relatively poor and certainly very much below that of a number of other Asian countries such as Hongkong, Singapore, Republic of China, Malaysia etc., who started their programmes of development somewhat later. This is indeed sad as this country although not possessed of great natural resources had a highly educated middle class population and excellent technical skills at the level of the professional and sub-professional grade. It had also a very good general engineering infrastructure which had been developed to serve the plantation industries, over the last 100 years or more.

While industrialisation is certainly an important objective for a developing country, it is not something that will just happen in most developing countries. Government intervention and support is necessary and each country depending on its own socio-economic conditions, must fashion strategies and policies to



suit its own particular needs and its factor endowment. There is no uniform or common strategy of development suitable for all developing countries. It is also even more important that when strategies and policies are formulated they must be translated into a concrete programme of action which is pragmatic. It would appear that what has happened in Sri Lanka is that although the strategies and policies over the years have been generally sound successive governments have found it difficult to create the environment necessary to accelerate the tempo of industrialisation in terms of practical action programmes, except perhaps the present government which has certainly done better than all its predecessors. Admittedly this lack of success by previous governments may have been for reasons somewhat beyond their control to some extent like the external shocks of the sudden oil price hike in the 1970's. It would appear also that the direction of industrial development in Sri Lanka has been affected very much by the political ideology of the particular government in power and also sometimes by the impractical ideas of bureaucrats holding high positions but with little or no knowledge of industrial management.

Prior to 1960 industrialisation through the establishment of import substitution industries, was justified on the grounds that it would help to reduce the dependency of the country on the export of primary products by reducing the demand for imports and increasing local output. It was felt that growth of output alone by restructuring the economy would raise living standards and provide employment for surplus labour.

However, in this initial phase of industrialisation little progress was made except for the establishment of a few government enterprises despite some protection for infant industries. In the early 1960's the governments in power which had to face an acute foreign exchange shortage, continued these policies with great vigour. Quite a number of import substitution industries both manufacturing essential as well as non-essential items were started by private entrepreneurs. These import substitution industries were developed under the protection of high tariff barriers and generous tax benefits based on the "infant industry arguments". The foreign exchange crisis resulted in a very restricted licencing system where licences were required for all raw material and machinery imports. The exchange rate was grossly over-valued and interest rates kept low to protect the consumer with the result that entrepreneurs preferred to import capital intensive technology rather than use labour intensive technology for manufacturing. Considerable emphasis was also placed on the development of public sector industry. Most of the industries started at this stage did not use local raw materials. Protected industries earned enormous profits as there was no competition. Large capital intensive public sector projects such as steel, hardware etc. were also started.

When the government changed in 1965 somewhat more liberal procedures were introduced for starting industries which gave a greater fillip to industrial development and private enterprise. However, the policy of the previous government in regard to maintaining and strengthening public sector industry



continued. Under this government particularly one significant contribution towards industrial development was the establishment of the Industrial Development Board which was specifically created to promote industrial development. A two tier exchange rate was also introduced to help industrialists.

In 1970 with the next change of government the policies and strategies for industry were changed again in line with current economic thinking and the government's own political ideology. The basic needs — employment generation strategy for industrial development was adopted. It was also decided that greater emphasis should be placed on public sector industry which would be the main instrument for industrialisation. As far as the private sector was concerned assistance and incentives were given for the promotion of labour intensive small scale industries based on appropriate technology. The Industrial Development Board was vested with the special responsibility for the promotional work in this regard. In addition to the large expansion of the public sector by the Ministry of Industries, the Ministry of Planning itself through Divisional Development Councils got involved in active promotion and implementation of small industrial projects, based on appropriate technologies, in many cases with disastrous results as the officials concerned had unfortunately no knowledge of industrial management at all. By 1977, the situation in regard to industrial development had been reduced to an extremely sorry state, due to over regulation, exchange shortages, labour unrest, mismanagement in public sector industry and almost total lack of entrepreneurial interest in the private sector. Nearly all DDC projects were failures. The small certainly did not turn out to be beautiful as was the hope of the government. However, there were windfall profits for some private sector firms due to import shortages.

In 1977, there was another change in policy with the present government introducing policies and strategies to promote an open economy. Under the open economy, except for a few sectors, there is allowed the unrestricted import of machinery and raw material to entrepreneurs who are interested in starting new industry. On technology too the Government's position appears to be today an open one. Regulation of industrial development was reduced to a bare minimum. Protection however continues for certain import substitution industries. Some of these import substitution industries ran into difficulties because cheap imported goods were being dumped in Sri Lanka by certain developed countries. Quite a few large industrial concerns which prospered much during the previous regime, under conditions of virtual monopoly, have also got into serious difficulties partly due to management inefficiency and continue to be in difficulty. The apparent over-valuation of our exchange rate against certain currencies has also compounded problems of liquidity, resulting in many large industries having to operate at low capacity utilisation, with serious effects on their viability. However, overall there has been an impressive growth of new industrial enterprises and a considerable fillip given to existing ones. 1984 appears to have been a particularly good year recording the best performance of industrial exports in a decade.



The objectives, policies and strategies for industrialisation in developing countries have been the subject of much debate amongst economists over the years. To summarise what I have said at the risk of repetition, in the first phase of industrialisation in Sri Lanka the goal of industrialisation was to re-structure the economy so that it would be less dependent on the export of agricultural production and more self reliant in regard to imports by the establishment of import substitute industries. The so-called Mahalanobis model. This was only a very limited success.

In the second phase the objectives of industrialisation underwent a change and employment was considered as being the most important goal of industrial development and the basic needs - employment approach based on utilisation of appropriate technology, local raw materials and labour intensive techniques was given high priority. This was a very inward looking strategy based mainly on the economic theories such as those of Schumacher. The government also looked upon public sector industry as the main vehicle to promote industrial development. All large scale industry was to be state owned. Industrial development was closely controlled and more or less directed by government. This strategy was a failure. The large expansion of the public sector also did not help as performance was poor. The incentives for private entrepreneurs were totally insufficient to stimulate interest in industry.

In the third phase Sri Lanka once again changed its goals and strategies for industrial development by opting for what is termed an export led industrial development strategy. Here again the main objective was employment creation mainly through industrial exports. Unlike in the previous phases, however, much greater reliance is being placed on the private sector to promote industrial development. Market signals were to be more important than those of government decision makers. Expansion in the public sector was restricted and public sector industry was expected to ensure that revenues at least cover costs. No new public sector industry were to be started.

The arguments for export led industrial development represents in a sense the re-emergence of the free trade position and the classical theory of comparative advantage. Sri Lanka, as a labour surplus economy, by developing export oriented industries which utilise labour intensive technologies will make best use of its factor endowment on the assumption of course that there are no other factors of production such as natural resources which are equally or more underutilised. This strategy certainly appears to have been much more successful than the previous ones.

There is we know still another school of thought which rejects both the free trade arguments of the export led industrial strategy protagonists and also the basic needs employment approach protagonists on the grounds that such policies will perpetuate under development and also not solve the complex problems of developing countries. They advocate the adoption and acquisi-



tion of the most modern technology where the size of market permits and the country concerned is able to absorb such technology. Developing countries should endeavour to leap frog from the state of technology that presently exists in their countries and adopt the most modern. This view is gaining ground particularly with the rapid spread of computerization in some developing countries.

From our own experience however it would appear that at least at the present juncture the export led industrial growth approach is what is most appropriate for Sri Lanka.

A combination of export led industrial development and import substitute strategies is not entirely incompatible particularly where import substitution has good prospects for export orientation and provided also incentives for the latter are not more attractive than for the former.

As I have stated earlier there is no strategy or policy that can be regarded as the perfect instrument for promotion of industry in developing countries, particularly for countries like ours which are so susceptible to external forces. It is therefore necessary to continually monitor, reappraise, and change strategies as problems arise.

Most important, the institutional mechanisms to do this must be there. I make this point because I feel that there are a large number of problems within the framework of existing strategy that have arisen that need attention early, but the existing institutional mechanisms appear slow to respond

The Ministry of Industries in 1981 stated that the policies and strategies of the government in regard to industrialisation were to promote, equal, opportunity for private and public sector industry to develop and to encourage in particular :

The utilisation of local raw material in industry,

Labour intensive industry,

Foreign investment, in manufacturing industry,

Regional development,

Development of agro industry,

Rural industry.



Obviously for these policies to be meaningful in terms of a programme of action they have to be implemented in a concrete way which means that the following are essential :

The establishment of an appropriate institutional framework for financing extension services, research etc.

The establishment of a suitable infrastructure to provide basic amenities at reasonable cost,

Legislation where necessary for the provision of incentives to achieve the goals set out in the policies and strategies enumerated.

Machinery for continuous co-ordination, monitoring and review.

We know that a number of dynamic new institutions have been set up such as the Greater Colombo Economic Commission and the National Development Bank, to help implement government's industrial policies, apart from many others. Attractive incentives have also been provided for industries serving both the domestic and export markets. Older institutions such as the Development Finance Corporation and the Export Development Board have been revitalized. The World Bank, the Asian Development Bank and other external organisations are providing concessional finance. Despite all this there are problems that are causing a fair amount of concern which need the government's continuing and urgent attention :

The over-dependence of the country on textiles, garments and petroleum exports which are highly vulnerable to external forces. Nearly 50% of the manufacturing exports comprise these items and they have a low value added. Also over 50 per cent of all export garments is for the US market.

The grave difficulties a number of industrialists, particularly in the garments industry and the textile industry, are facing in regard to liquidity.

The failure rate in industry in general. No statistics however are available.

The apparent over-valuation of the exchange rate in relation to certain currencies which is causing difficulties for certain export oriented industries, particularly those using local raw materials.

The inadequacy of protection in the case of certain import substitute industries due to leakages into the domestic market of duty free goods, and also dumping.

The non-availability of land for industrial purposes at reasonable prices. The industrial estates programme has not been expanded, substantially.



The slow growth of agro-industries, and rural industrialisation. The slow development of industry, in particular agro industry, in areas under the Mahaweli project.

The optimum benefits of the Mahaweli Project can only be realised when this happens — particularly where employment generation is concerned.

The continuing concentration of industry in the Colombo district.

The low rate of capacity utilisation in many industrial units, particularly those using highly capital intensive technology.

High rates of interest for working capital.

Poor financial management at the level of the individual firms.

Poor performance of certain large public sector industries. The need to improve the considerably the existing industrial extension services.

Although government policies are those which reject controls on industrial development this does not mean complete non-intervention. If the open economy policies and strategies are to succeed in the industrial field considerable intervention at the appropriate moment is essential, so that the environment for industrial development continues to remain congenial particularly for the private entrepreneurs, who will be the principal change agent, To promote industrial development. The private entrepreneur identifies, formulates and makes decisions on project implementation. The government provides the rules of the game and the necessary environment.

This is how the system should work. Professor Lewis remarked many years ago that policies should be sensible and there should be good public administration for any strategy in industrialisation to succeed.

Having being involved for many years with industrial administration both in the public sector and the private sector, I must wholeheartedly agree with this view from my own experience.

Looking into the future and taking into consideration past performance and international trends I would say that we can realistically expect only modest progress in industrial development in the next few years because of the various inbuilt constraints that exist. The contribution of the manufacturing sector to GDP is presently only around 14 per cent. Processing of tea, rubber and coconut is included in this figure.



However, the need to press on with accelerating the pace of industrial development must continue in view of the valuable contribution it is making towards re-structuring the economy.

Manufacturing industry today consists of 29 public sector corporations, about 9000 registered private factories and over 20000 un-registered small and cottage industries. About 60% of the gross output comes from public sector corporations. The products of the Petroleum Corporation have a very large share in this out-put.

The report on public investment for 1985—1989 mapping out the economic development strategy for the period ahead states that present policies for industrial development will continue and government's role in industrial development is perceived as mainly providing the necessary economic climate and the basic infra-structure. The private sector will have to bear the major share of the burden of developing a viable industrial structure in Sri Lanka. There will be a further rationalisation of the 1977 reforms so that a selective incentive structure is provided to achieve a socially desirable rate of growth and structure of production.

In conclusion I would like to state that due to limitations of time. I have in discussing the economic policy issues relating to industrial development mainly focussed my attention on the growth of modern factory type industry. However, the contribution of the traditional unorganised, informal sector could be quite considerable provided it is possible to structure a scheme of assistance for them.

In this presentation I have drawn freely from a number of sources too numerous to acknowledge, particularly United Nation's publications which I found to be of great assistance.

As a postscript I would add that the time is now appropriate for the government to appoint a committee of experts to study industrial development policies and strategies that exist today with a view to making recommendations regarding changes that might be necessary in the light of present economic trends.



# AN EVALUATION OF AGRICULTURAL POLICY ON THE PADDY SECTOR IN SRI LANKA 1950 - 1985

N. L. SIRISENA

## Introduction

Agricultural policy in regard to the paddy (or rice) sector is probably the most successful of all production oriented policies in Sri Lanka. Successive governments have aimed at increasing the paddy output through expansion of the cultivated area and increasing average yields. The large mass of farmers seem to have positively responded to the state policies as shown by growth in paddy production.

Domestic paddy output has increased by 225 per cent between 1959 and 1984, showing a linear trend of  $678.11 + 87.2$ . Although there had been years<sup>1</sup> in which negative growth rates were recorded, it was during 1971—73 that there had been a continuous decline in output for three consecutive years. In other periods, negative growth rates were short-lived, often confined to a single cultivation season. In most of the years, output fluctuations in the paddy sector were primarily determined by weather conditions, although there is no doubt that policy factors too have been important. On the other hand, the performance of the paddy sector during 1971 — 73 seems to be predominantly influenced by policy factors (a negative response on the part of farmers<sup>2</sup>) in addition to adverse weather.

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1. Total paddy output declined in the following years : 1965 (28%), 1971 (13.6%), 1972 (6%), 1975 (28%), and 1982 (3.4%).
  2. See the discussion on the GPS at page 74.



The import of rice had declined very substantially during the post-independence period. Till about 1966 rice imports have been over 400,000 Mt. tons a year. Since 1967 rice imports had continuously declined, although in certain years, they had increased. Rice imports in the 1980's have been below 175,000 Mt. Tons and in 1984 they had been only 38,000 Mt. tons.

Per capita food availability had fluctuated around 100 Kgs. per year, however, it had declined to 88 in 1972, 92 in 1973, 93 in 1975 and 91 in 1976. Till 1965, the consumption level had been well above 100 Kgs. Since 1977, the consumption levels have been again above 100 Kgs. Rice being the basic food commodity, its per capita availability level had always influenced the prices of food commodities and the nutritional standard<sup>3</sup> of the people.

One objective of this paper is to examine the effectiveness of component policies that helped the growth of the paddy sector. Although, a host of policies have been followed ranging from investment in irrigation projects to market promotion through the Guaranteed Price Scheme, some policies have been more effective than others, while a few had hardly an impact. Secondly, we propose to examine the impact of paddy output growth on paddy producers' income and the food consumption pattern on one hand and the balance of payments on the other. Thirdly, we propose to examine the need for adopting new policy objectives for the paddy sector since Sri Lanka is now almost self-sufficient in rice.

### Conceptual Framework

The conceptual framework of this study is given in diagrams I and II. Diagram I demonstrates the causal relationships between policy variables and paddy output through a series of intermediate and proximate variables. The policy variables identified here as significant are :

- (a) Irrigation projects and land settlement policy ;
- (b) The Guaranteed Price Scheme ;
- (c) Institutional credit ; and
- (d) Research and extension.

The above policies have contributed towards the increased output of paddy by influencing the fixed and variable input use in that sector. However, the impacts of the Guaranteed Price Scheme and Credit Policy have not been consistent throughout. Diagram II demonstrates the impacts of the paddy sector expansion on producer income, consumer welfare and the balance of payments. In other words, this section is being used to evaluate the end result of paddy sector policies on producers, consumers and the economy.

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3. This of course depended on the government's food policy, particularly on the subsidy. See pages 80 - 81.



DIAGRAM 1: EFFECTIVE POLICY FRAMEWORK IN THE PADDY SECTOR

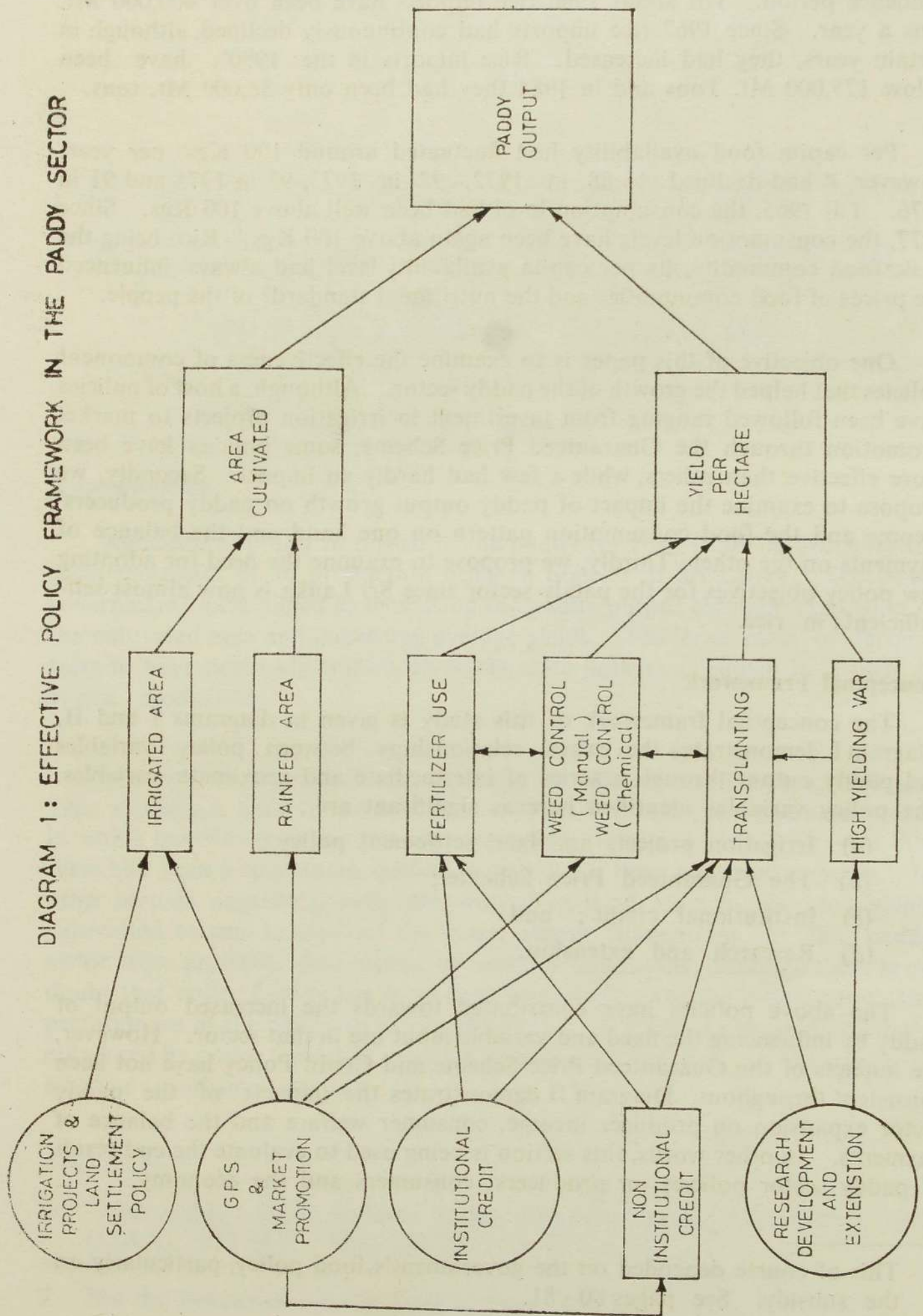
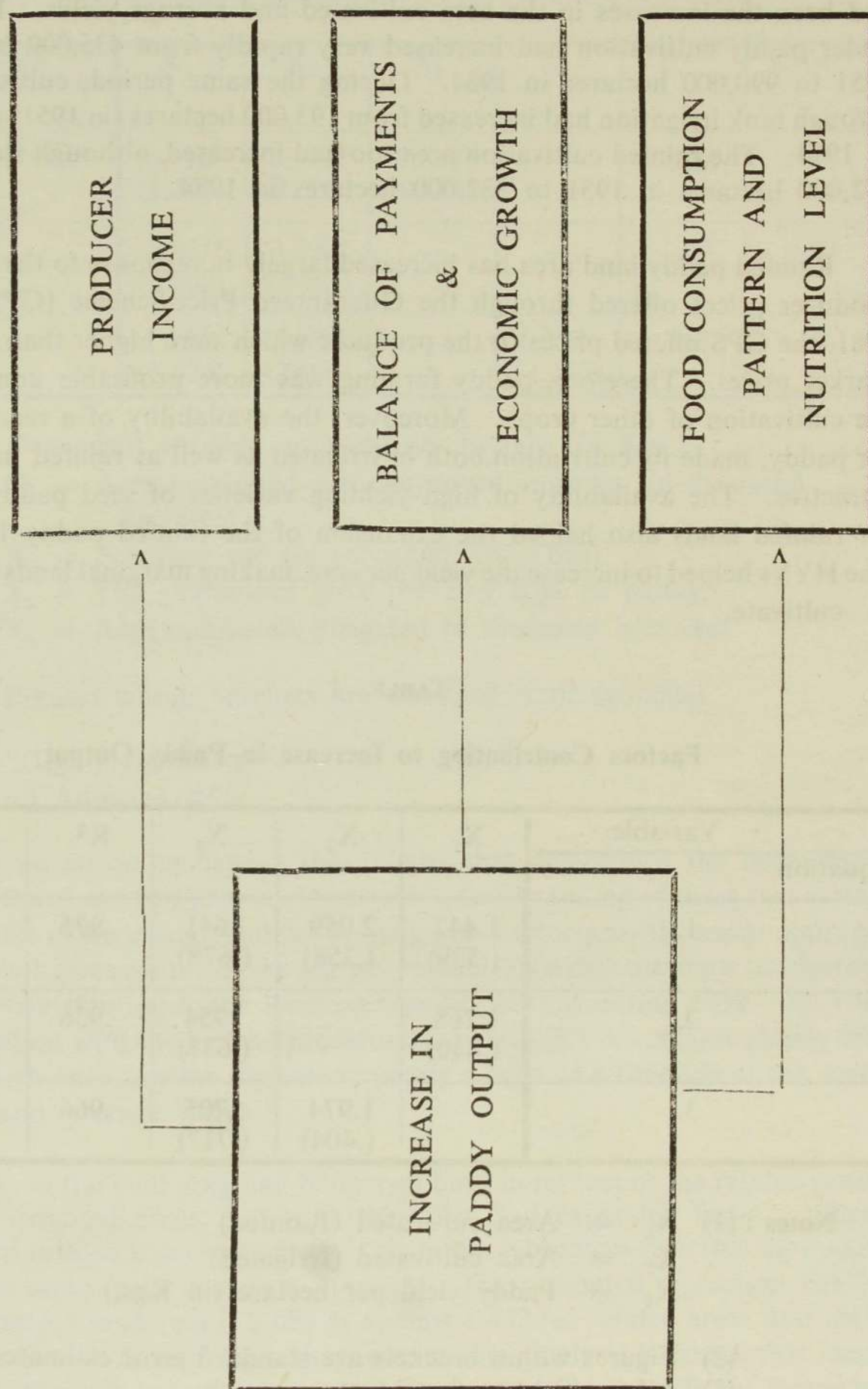




DIAGRAM II IMPACTS OF PADDY SECTOR GROWTH





## An Evaluation of Major Policy Instruments

The most proximate reasons for the increased paddy output in Sri Lanka had been the increases in the area cultivated and average yields. Land area under paddy cultivation had increased very rapidly from 435,000 hectares in 1951 to 990,000 hectares in 1984. During the same period, cultivated area through tank irrigation had increased from 193,000 hectares (in 1951) to 688,000 in 1984. The rainfed cultivation area too had increased, although slowly from 242,000 hectares in 1951 to 332,000 hectares in 1984.

Rainfed paddy land area has increased largely in response to the attractive producer prices offered through the Guaranteed Price Scheme (GPS). Before 1981, the GPS offered prices to the producer which were higher than the world market prices. Therefore, paddy farming was more profitable compared to the cultivation of other crops. Moreover, the availability of a ready market for paddy, made its cultivation, both in irrigated as well as rainfed lands more attractive. The availability of high yielding varieties of seed paddy suitable for rainfed lands also helped the expansion of the rainfed paddy land area. The HYVs helped to increase the yield per acre, making marginal lands profitable to cultivate.

TABLE 1

### Factors Contributing to Increase in Paddy Output

Variable	$X_1$	$X_2$	$X_3$	$R^2$	$R^2$ (a)
Equation					
1.	1.442 (.539)	2.059 (.358)	.641 (.678)	.975	.971
2.	1.168 (.840)		.954 (.633)	.936	.930
3.		1.974 (.404)	.705 (.717)	.966	.963

Notes : (1)  $X_1$  = Area cultivated (Rainfed)  
 $X_2$  = Area cultivated (Irrigated)  
 $X_3$  = Paddy yield per hectare (in Kgs.)

- (2) Figures within brackets are standard error estimates.  
(3) All coefficients significant.  
(a) Adjusted  $R^2$ .



TABLE 2

## Factors Contributing to Increase in Paddy Yields : 1970 — 1983

Variable Equation	X <sub>1</sub>	X <sub>2</sub>	X <sub>3</sub>	X <sub>4</sub>	R <sup>2</sup>	R <sup>2</sup> (a)
1.	0.196 (1.365)	3.745* (2.500)	7.867 (8.124)	—	.70	.60
2.	1.227* (0.852)	3.592* (2.487)	—	—	.67	.60
3.	1.166 (1.423)	3.567* (2.660)	—	0.124 (2.240)	.67	.56

Notes : 1. Dependent variable = Yield per hectare (In Kgs.)

X<sub>1</sub> = Area cultivated with improved varieties (in thousand hectares).

X<sub>2</sub> = Fertilizer use (in thousand Mt. Tons).

X<sub>3</sub> = The guaranteed price per 20.9 Kgs. of paddy.

X<sub>4</sub> = Area cultivated (irrigated in thousand hectares).

2. Figures within brackets are standard error estimates.

3. \*Highly significant

(a) Adjusted R<sup>2</sup>.

Before we go on to discuss the policies that determined the behavioral patterns of the above two proximate variables, some ranking of these two variables in respect of their contribution to the paddy sector growth, seems appropriate. Table 1 gives results of the regression analysis which attempts to identify the factors contributing to the increase in paddy output during 1959—83. The best fit equation with the highest prediction capacity ( $R^2 = .975$ ) is clearly the first one which estimates the increase in paddy output as a function of the area cultivated and average yields.

Increase in the land area had happened both in respect of the rainfed areas as well as irrigated areas, although the latter had expanded faster. When irrigated and rainfed areas are specified separately, it becomes clear that the major contribution came from irrigation schemes. The estimated regression coefficient for irrigated land area is 2.059 as against 1.442 for rainfed areas and .641 for yield increases. In ranking policy instruments, analysis indicates that land development through irrigation projects had been the most significant factor in paddy sector growth, followed by policies which helped to increase the rainfed



land area. In respect of the latter, the Guaranteed Price Scheme which provided price incentives emerges as one of the important policy instruments. This position become further clearer when the coefficients of equation 2 and 3 are examined.

Regression model 2 (Table 2) which analysed the causal factors of yield increase has come out with the finding that the spread of improved varieties of seeds (1.227) and fertilizer use (3.592) are the most significant factors that explain about 60 per cent of yield increase. The impact of the Guaranteed Price Scheme seems to have been subjected to a large margin of error. Although the effect is large (7.86), the error margin is still larger (8.12). We may note that during 1971 — 76, that GPS became a major constraint on the paddy sector due to rigid monopolistic behaviour of the Paddy Marketing Board. However, it is recognized that on the whole the GPS had been a major incentive for both intensive and extensive paddy cultivation.

### **Irrigation Projects and Land Settlement Policy**

At the initial stages the primary objective of land settlement policy in Sri Lanka had been to ease the population pressure in the Wet Zone districts. Food shortages during World War II had encouraged policy makers to recognise the value of irrigation schemes for food production. The desire to restore the ancient irrigation schemes, which had been the principal means of sustenance of Sri Lanka's ancient civilization, too would have encouraged settlement policy. The eradication of Malaria during 1944 — 1945 which had been a major obstacle to human settlement in the Dry Zone, provided a necessary pre-condition for agricultural development projects in the region.

The expenditure on major irrigation projects and land settlement schemes over the ten year period 1956/57 to 1966/67 amounted to about 66 per cent of the government capital budget.<sup>4</sup> The significance of irrigation projects in the capital budget continued, although its relative significance has declined. In 1981, the total expenditure on major irrigation projects amounted to more than one half of the government's capital budget. The multi-purpose Mahaweli Development Project alone absorbed Rs. 4.5 billion of the government capital budget in 1981.

By 1981, a total of about 90,000 families had been settled in major colonization schemes according to the Land Commissioner's Department. In addition to these settler families, who were selected officially, a large number of families have encroached into lands in major irrigation schemes. The number of families who have encroached is considered to be as much as the numbers that have been settled officially. The population in land settlement schemes is

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4. UNDP/FAO, Mahaweli Ganga Irrigation and Hydro-Power Survey, Ceylon, 3 Vols., Rome, 1969.



considered to be close to 1.5 million or about 10 per cent of the total population in Sri Lanka. By 1966, about 30 per cent of all paddy lands were in major irrigation schemes<sup>5</sup>. According to the Land Commissioner's Department, in 1978, a land area of 479,000 acres has been under major irrigation schemes representing 34 percent of all paddy lands. However since then, more lands have been developed under major irrigation schemes<sup>6</sup>. During 1979 — 84, over 175,000 hectares have been developed under the Mahaweli Development Programme. Of this land area, over 80 percent has been developed for paddy cultivation<sup>7</sup>.

The paddy output in the major irrigation schemes had been about 50 per cent of the total national paddy output in 1983 — 84. In the 1983/84 cultivation year the national average yield was, 59.9 bushels per acre, the average yield in minor irrigation schemes was 57.5 bushels, while the yield in rainfed area was 49.13 bushels. The average yield in major irrigation schemes during the same cultivation year has been 68.78 bushels per acre. This clearly shows that the highest productivity in paddy land could be seen in major irrigation schemes. Moreover, the largest expansion in paddy output has been in irrigation schemes. However, against this back-ground of major irrigation schemes having contributed the largest share to the paddy output in Sri Lanka, it is essential to emphasize that a close examination of the production potential of these schemes, as against the presently realized benefits, indicates the under-utilization of the potential due to the existence of a number of development constraints<sup>8</sup>.

The reliability of available data on yields is lower for the earlier years since the crop cutting survey method of estimating yields was introduced in the middle of the 1950s. Average paddy yields had increased by 34 per cent during 1959 to 1972, with the exception of 1966 and 1967. However, there had been a major deviation in this yield trend during 1972 — 1976. In addition to adverse weather conditions, lower applications of fertilizers resulting from limited supplies due to import restrictions seemed to have contributed to the lower yield levels during 1972 — 76. In 1972, per hectare yield declined to 2298 kgs. from 2417 kgs. in the previous year. In the following year there was a slight (2.3%) improvement but in 1974, again there was a yield decrease of 2.3 per cent. In fact, yield levels recovered to its previous trend only by 1977. Since

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5. Report of the Land Utilization Committee — 1968 (Sessional paper), Colombo, 1968.

6. Sirisena, N. L. Fertility Impact of Development in Sri Lanka, CDSS, 1984, pp 33 — 34.

7. Central Bank of Ceylon, Review of the Economy.

8. See pages 80 - 94 on Producer Income.



1977, per hectare yields have been continuously increasing. When the post-independence period is taken as a whole, substantial yield increases had taken place contributing to increased paddy output. In fact, the per hectare yield had more than doubled during the post-independence period.

### **The Guaranteed Price Scheme**

The Guaranteed Price Scheme (GPS) was started in the late 1940s and by 1964 about 59 per cent of the total paddy production had been sold to the GPS. The amount of paddy sold to the GPS varied, depending on factors such as the volume of the production, availability of other food commodities, the need to keep paddy for personal consumption, and the price offered by the scheme as against the prices offered by private traders. The number of farmers who benefitted from the Scheme has been estimated to be around 1.3 million. However, about 7.8 million people, including dependants of paddy farmers have directly benefitted from the Scheme. The GPS has been a voluntary purchasing scheme whose objective is to improve the open market price of paddy. The influence of the GPS has not been limited to those farmers who sold paddy directly to the Scheme. It contributed to improve the incomes of all paddy farmers who produced a market surplus (including those who sold to private traders) and thereby the producer prices in general.

The impact of the GPS in the Dry Zone areas has been much greater, as the largest share of its collections (about 78 percent) came from those districts<sup>9</sup>. This is understandable since the Dry Zone has been the major paddy producing region in Sri Lanka. Moreover, the average yield in the Dry Zone has been generally higher than in the Wet Zone. Further, land settlement schemes, which have a larger paddy surplus, have been located in the Dry Zone districts. In short, the largest impact of the GPS has been primarily on farmers in Dry Zone districts.

The GPS seems to have gone through 4 important stages during its 34 year old history. During the initial period (1948 to about 1956), the Scheme had difficulty in competing with private traders. Due to various market imperfections, such as the availability of credit from private traders and the backward social background of the farmers, the Scheme could collect only a small share of the market surplus. However, since the Scheme offered a price more attractive than the open market price, it managed to collect a substantial proportion of the paddy produced in the country, through purchases from private traders.

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9. Paddy Marketing Board, Annual Reports.



After a few years the Scheme improved its purchasing ability with the help of the co-operative movement. Moreover, the banking system offered to provide credit facilities for the GPS purchases under a special credit arrangement with the Central Bank, which re-financed the GPS loans to co-operatives at a concessionary interest rate of 3 per cent. The farmers too gradually realised the benefit of selling their produce to the Scheme, since the guaranteed price was higher than the open market price. The co-operatives began to sell fertilizer to farmers on credit in addition to purchasing paddy. Data show that a large volume of paddy had been purchased by the GPS promoting a high degree of competition in the paddy market. The period between 1956 — 1971 could be considered the most successful period of the Scheme.

A third stage of the GPS came when the Paddy Marketing Board (PMB) was created in 1972 to implement the Scheme. The Paddy Marketing Act No. 14 of 1971, gave wide powers to the PMB and these powers were enforced between 1972 — 77. The Law gave the PMB monopoly purchasing power over paddy. One reason for this basic change in the market promotion approach of the GPS, from one of promoting competition to one of restricting competition, was the financial difficulty of implementing the food policy of the government. In 1973 and 1974 the world market prices of rice increased rapidly. In 1972, the cost of imported rice (a bushel equivalent) to the Food Commissioner amounted to Rs. 7.77. The cost of the local rice purchased through the GPS was Rs. 16.51. However, by 1974 this situation reversed, the imported rice cost Rs. 38.36 while the local rice cost only Rs. 36.48 and it became more economical from the budgetary point of view, to make more local purchases and reduce imports. Therefore, the government decided to purchase as much paddy as possible under the GPS, for distribution under the rice ration scheme. Moreover, the government also decided to enforce the laws in the Paddy Marketing Act of 1971 which restricted paddy marketing to the private sector.

The guaranteed price which was Rs. 18/- per bushel upto 1973 was increased to Rs. 33/-. However, as the open market price had been higher than the guaranteed price, the PMB in 1974 could collect only 478,000 Mt. tons or 27.2 per cent of the total paddy output. The national price average of paddy in 1974 was Rs. 48.62 per bushel; however in some regions it had risen to Rs. 52.15. In spite of the monopoly purchasing powers, the purchases of the GPS further declined in 1975. The additional restrictive measures imposed on the market such as a complete ban on the private transport or marketing of paddy and rice did not seem to have been helpful to the PMB. After a while the ban on paddy/rice transport was slightly relaxed, allowing an individual to carry 2 lbs. of rice or 4 lbs. of paddy.

The ban on private marketing and transport of paddy and rice created a major distortion in the paddy economy. It created major differences in prices in different regions of the country. In districts producing a surplus, the prices



were lower while in deficit districts the prices were higher. In the Dry Zone regions (Zone 3, 4 and 6) which were the main paddy producing areas, (unofficial) market prices were lower. In the Wet Zone and Jaffna Peninsula (Zone 1, 2 and 5) paddy and rice prices were very high.

TABLE 3

**A Comparison of GPS and Open Market Prices of Paddy and Rice**

	Rice (Per Measure)	Paddy (Per Bushel)
	Rs.	Rs.
Guaranteed Price	2.20	33.00
1. Wet Zone (Low Country)	4.29	52.15
2. Wet Zone (Up Country)	4.44	45.50
3. Dry Zone (Low Country)	2.72	44.65
4. Dry Zone (Up Country)	2.82	50.50
5. Dry Zone (North)	7.27	—
6. Arid Zone	4.25	48.62

*Source :* Chief Investigators' Reports, Land & Labour Utilization Survey, 1974.

The attempt to use GPS as a means of getting rice for distribution under the government's food ration scheme had been a failure. On one hand, PMB collections declined. The PMB collections declined from 41.5 per cent in 1972 to 36 per cent in 1973, 27 per cent in 1974 and 22 per cent in 1975. It may be worth recollecting that over 50 per cent of the paddy procurement in previous years was through voluntary purchases. The basic objective of the government, i.e. the PMB to collect a large volume of paddy, was not realized, therefore the Food Commissioner had to import much more rice than was expected.

The most significant effect of this policy had been the decline in paddy output<sup>10</sup>. In 1971, paddy production declined by 13.6 per cent from the previous year ; in 1972 production further declined by 6 per cent. In 1973,

10. Dept. of Census & Statistics, Paddy Statistics.



production increased by 22 per cent, but in the following year it declined by 26 percent. In 1976, there was a small increase in paddy output. However, taking the 1971 — 76 period as a whole, the production level was lower showing a marked depression in the paddy production which had been continuously increasing before. In 1977, the restrictions on paddy marketing were removed. The paddy sector once again became dynamic, expanding by about 10 per-cent a year.

After the general elections of 1977, the PMB abandoned its monopoly purchasing role. In the 3 years following 1977, the purchases of the PMB had increased rapidly as production too increased. However, since 1980, the purchases of the PMB have begun to decline rapidly as private traders have begun to offer more attractive prices to the producers. The purchases of the PMB in 1981 had been only 10 per cent of the total production. Since 1981, the GPS has transformed itself into a floor price scheme. The PMB has adopted the role of a floor price operator intervening in the paddy market when prices are lower, particularly during the post-harvest periods. The PMB, along with the Food Commissioner has also assumed a new role as a partner of the food buffer-stock scheme. For the purpose of buffer-stock operations, the Board has started purchasing paddy under a tender scheme, since the collections through the GPS have been lower. In 1981, the PMB has purchased 29,000 Mt. tons of paddy under the tender scheme as against 99,000 Mt. tons under the GPS.

The major significance of the GPS is that it has created a major transformation in the paddy sector in Sri Lanka. The paddy sector which had been subsistence oriented in the 1950's and before, has become market oriented, largely as a result of the GPS. The use of inputs such as fertilizer, high yielding varieties, agro-chemicals and adoption of more productive cultural practices has been encouraged by market development. In short, the GPS has created a desirable transformation in the outlook of the paddy sector. This, by and large helped the growth of the paddy sector in the Sri Lanka economy.

Further the market promotion by the GPS had helped the supply of credit to the paddy sector. When co-operatives were actively participating in the GPS, the farmer received credit from the state banking system to make purchases. Moreover, a fertilizer credit scheme too was implemented by some co-operatives along with the paddy purchasing scheme.

The ready existence of a market for paddy, has encouraged even the private credit suppliers to be more receptive to credit requests by farmers. On the other hand, in the 1950's and before, paddy farmers had great difficulty in obtaining credit from private sources, and where credit has been given conditions have been very stringent, primarily due to the under-developed market that existed for paddy sector output. The market development which took place under the GPS, particularly before GPS was brought under the PMB, appears to have contributed to easing the credit supply to some extent.



## Credit to the Paddy Sector

The role that credit plays in promoting economic activities is not being doubted. In the paddy sector with increasing commercialization, mechanization and adoption of improved cultivation methods along with high yielding varieties, the credit needs have increased. Of the two credit sources in the paddy sector, non-institutional credit which is mainly coming from money lenders, merchants and relatives in the form of buyers' credit has increased faster than the institutional credit which is obtained mainly from commercial banks.

During 1978 — 1980, institutional credit had declined to a much lower level (Rs. 59.6M in 1978/79) following a large increase in 1977/1978. The result of this reduced supply of credit from institutional sources was the increasing dependence of the rural sector on non-institutional lending. The Consumer Finances Survey data show loans from non-institutional sources increased to 81 per cent in 1978/1979, compared to 78 per cent in 1973. When institutional lending started to improve since 1980, loans from non-institutional sources had declined to about 66 per cent in 1981/1982. It may be worth noting that even in 1981/1982, the largest share of loans had been obtained from non-institutional sources reflecting the high level of dependence of the paddy sector on private sources for their credit needs.

The major problem of non-institutional lenders is the high interest rate. Often they seem to charge interest rates as high as 100 per cent.<sup>11</sup> Even when it is said that no interest rate is charged, there is an implicit interest rate which is as high as the explicit interest rate of money and other lenders. The implicit interest is charged by paying a lower price for the paddy output compared with the GPS or the open market prices.

Institutional credit to the rural sector is both a welfare as well as a production related question. As we already noted, the cost of non-institutional credit is high. Therefore, when farmers obtained credit from non-institutional sources, the producer margin declines very substantially. Moreover, non-institutional sources supply only short-term credit and they hardly provide credit for the purchase of capital goods or land development.

A basic issue with regard to institutional credit to paddy farmers in Sri Lanka has continued to be the question of loan recovery. The poor recovery record could be considered more as a reflection of the conceptual and operational weaknesses of the rural lending programme rather than an inherent character

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11. Central Bank of Ceylon, Consumer Finances Survey, 1981/82.



of rural lending<sup>12</sup>. Agricultural production by its very nature is subject to greater risks compared with manufacturing or commerce. Crop failures due to inadequate irrigation as well as floods are common. Secondly rural farmers are small scale operators who have limited knowledge of financial management. There are times that the funds received at various stages, i.e. loans from banks as well as sale proceeds, are improperly spent. Therefore, an agreed pattern of loan repayment could not be achieved, unless lending institutions themselves follow the concept of supervised credit disbursement and seek recovery when sales are done. On the other hand, in instances such as crop failure, creditors would have to follow a pragmatic approach. In other words, the wilful loan defaulters have to be treated differently from farmers who default loan repayments due to unavoidable reasons.

The rural sector lending programmes of state owned banks are deficient in almost all the above aspects. In addition, a firm determination to improve the rural lending programme is lacking in the commercial banking sector. Therefore, the necessary conceptual adjustments in lending policy and institutional development by way of training adequate personnel to supervise rural lending have not yet taken place in the commercial banking sector.

“Even after 10 to 15 years of work in this area, both the People’s Bank and the Bank of Ceylon have failed to develop a cadre of personnel sufficient in numbers for the purpose and responsive to the needs of the sector. At present both banks are inadequately staffed at all levels to carry a programme of rural credit. The People’s Bank has one field level supervisor for every 12,000 — 15,000 borrowers, while the Bank of Ceylon has even less — one for every 12,000 — 20,000 borrowers. Many of these supervisors have not received any training in end use supervision of loans or recovery of loans. Commercial banking appears to be the main concern of the two banks with the result that most of the resources — men and materials — are applied to the benefit of industrial and commercial sectors.<sup>13</sup>”.

## Research and Extension

The factors that have contributed to per hectare yield increases are many and inter-related. However, the improved and high yielding varieties of seed paddy, which were introduced by the agricultural research centres in Sri Lanka, had been fundamental to a number of other developments that took place in the technology of paddy production in the country. The first hybrid variety of

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12. The Hatton National Bank which is engaged on a small scale in rural lending has a record of recovering almost all loans.

13. De Silva, G. M. P., Strategy for Recovery of Agricultural Loans, Staff Studies, Central Bank of Ceylon, Vol. 12, No. 2.



seed, H—4 was released to farmers in 1957. Later, other varieties such as H—7, H—9, H—10 and BG—11 have been introduced to the farms in the Dry and Intermediate Zones. Other hybrid varieties have been introduced to the low country wet zone farms in recent years.

New improved varieties had a high degree of yield stability as well as high yields. Farmers have adopted these improved seeds and by 1970, about 71 per cent of all cultivated lands were planted with improved varieties<sup>14</sup>. In 1982, about 88 per cent of paddy lands were planted with improved varieties of seeds. In the Wet Zone too, where small scale farmers are predominant, improved seeds have been adopted lately by the majority of farmers. Although a significant yield gap exists between the yields realized at experimental farm conditions and actual farm situations, primarily due to the reduced input used by the farmers, it is essential to recognize that the use of high yielding varieties of seeds along with improved cultivation practices, have greatly contributed to the per hectare yield increases.

Along with the spread of HYVs of seeds, fertilizer use, transplanting, manual and chemical weed control have taken place since new seed varieties have shown greater yield response to input applications. On the whole, the research and extension which led to the spread of HYVs of seeds which is commonly known as “the Green Revolution” has commercialized the paddy sector.

### **An Evaluation of Impacts of Paddy Sector Growth**

#### *Food Consumption and Nutrition*

As we have observed in previous sections the paddy sector had expanded during the post-independence period. The most immediate impact of this growth of the paddy output had been on the per capita food availability. In spite of a population increase, Sri Lanka had managed to increase the per capita rice availability while reducing imports to a minimum. Therefore, other things remaining unchanged, one can conclude that the paddy sector growth had led to an improvement in the food availability and nutrition in the country. This overall situation is confirmed by the rice consumption data collected by the Consumer Finances Surveys of 1973, 1978/79 and 1981/82. The per capita consumption of rice had increased continuously, 1978/79 rice consumption was 4.8 per cent higher than the 1973 level, while 1981/82 level was 11.3 per cent higher than 1978/79 level. Sector-wise data indicate that rural consumption has continuously increased, while the consumption in urban and estate sectors had declined in 1978/79 but increased in 1981/82. Table 4 shows that in 1981/82 rice consumption had declined in respect of the lowest 20 per cent of

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14. Department of Agriculture, Peradeniya.



spending units. However, the consumer behaviour could be better seen in Table 5 where it shows that the consumption of basic food commodities by lower income groups who receive less than Rs. 1000/- per month had significantly declined<sup>15</sup>. This trend of reduced food consumption could be more clearly seen in the daily calorie intake through the main food items of rice, flour, bread, sugar and coconut which had declined by about 10 per cent for the lower income groups. In the Rs. 101 — 200 income group, marginal increases in rice and sugar consumption are indicated ; however, flour and bread consumption had decreased by more than half. The largest reduction in food consumption is shown in respect of Rs. 401 — 600 income group, rice consumption has declined by 4.2 per cent, sugar by 5.5 per cent, flour and bread by about 40 per cent and coconut by 2.4 per cent. (See Table 5). On the other hand, the higher income groups have increased their rice consumption while reducing bread and flour. The per capita daily calorie intake through main food items had increased by 1.5 per cent.

One reason for the above rice consumption pattern had been the withdrawal of the rice ration. The Ration Scheme (RS) which was started during the World War II and continued till September 1979 ensured a minimum quantity of food to consumers. The Ration Scheme involved a subsidy of Rs. 2162.7 million or 20.6 per cent of government's budgetary expenditure in 1978 and Rs. 2325.9 m. in 1979. The lower income groups depended heavily on the rice ration for their cereal requirement. In 1978/79 certain lower income groups received more than 60 per cent of their rice requirements through the Ration Scheme<sup>16</sup>. The Food Stamp Scheme (FSS) which replaced the RS, provided income transfers to about 7.1 million people in 1984. On average, a family of five received about Rs. 90/- per month as an income supplement. The subsidy of the new scheme was much lower, in 1980 it was Rs. 304.6 million or 2.2 per cent of the budgetary expenses. Since 1982 it had been still smaller, less than Rs. 100 million a year. The monetary value of food stamps which were decided in 1979, remains unchanged upto now (Oct. 1985) although prices of food commodities have increased very substantially. The food sub-index in the Colombo Consumer Price Index (CCPI) had increased from 263.3 in 1979 to 598 in 1984, an increase of 127 per cent.

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15. In 1978/79, although the income share of lower income groups declined compared with 1973, the absolute level of income did increase. However, by 1981/82 both income share as well as the absolute level of income of lower income groups seems to have declined compared with 1978/79. See income data in Central Bank of Ceylon, Consumer Finances Survey 1973, 1978/79 and 1981/82.

16. Central Bank of Ceylon, CFS, 1978/79.



TABLE 4  
Per Capita Consumption of Cereal Food by Sectors and Spending Units

	Rice (Grams)			Wheat Flour (Grams)			Bread (Grams)		
	1973	1978/79	1981/82	1973	1978/79	1981/82	1973	1978/79	1981/82
All Island	7,237	7,582 (4.8)	8,438 (11.3)	1,453	1,389 (-4.4)	886 (-36.2)	1,435	1,998 (39.2)	1,519 (-24.0)
By Sectors									
Urban	6,701	6,438 (-3.9)	7,291 (13.2)	876	681 (-22.3)	496 (-27.2)	2,310	3,074 (33.1)	2,729 (-11.2)
Rural	7,346	7,999 (8.9)	8,719 (9.0)	1,058	854 (-19.3)	568 (-33.5)	1,330	1,816 (36.5)	1,287 (-29.1)
Estate	7,473	7,373 (-1.3)	8,599 (16.6)	5,484	7,514 (37.0)	5,592 (25.6)	508	572 (12.6)	609 (6.5)
By Spending Units									
Lowest 20%		6,927	6,868 (-0.9)		1,518	902 (-40.6)		2,004	1,154 (-42.4)
Second 20%		7,055	7,558 (7.1)		1,538	988 (-35.8)		1,863	1,283 (-31.1)
Third 20%		7,345	8,418 (14.6)		1,487	935 (-37.1)		1,883	1,414 (-24.9)
Fourth 20%		7,891	8,940 (13.3)		1,451	935 (-35.6)		1,977	1,563 (-20.9)
Highest 20%		8,245	9,570 (16.1)		1,071	707 (-34.0)		2,213	1,963 (-11.3)

Source : Consumer Finances Surveys 1973, 1978/79 and 1981/82.

Note : Figures in brackets give the percentage change.



TABLE 5

**Average Quantities of Rice, Sugar, Flour, Bread & Coconuts  
Consumed per Head for 1 Month by Income Groups — All Island**

Item Unit	Year	Rice (Grams)		Sugar (Grams)		Flour (Grams)		Bread (Grams)		Coconut (nuts)	
		78/79	81/82	78/79	81/82	78/79	81/82	78/79	81/82	78/79	81/82
*Income Group	Rs.										
0	—	6,858	5,196	658.3	509.0	887.9	1,396.0	1,738.4	2,224.1	7.37	6.2
101	—	6,660	6,691	677.3	680.9	1,321.4	494.6	2,163.4	895.0	7.97	9.5
201	—	6,885	6,830	613.2	587.9	1,561.8	831.0	1,986.8	1,109.8	7.47	7.7
401	—	6,993	6,702	610.4	577.1	1,534.3	868.1	1,853.2	1,113.2	7.07	6.9
601	—	7,362	7,272	671.6	621.2	1,469.9	1,036.7	1,891.2	1,280.1	7.27	6.8
801	—	7,839	7,792	723.5	697.7	1,529.8	948.4	1,985.4	1,285.6	7.86	7.2
1,001	—	8,118	8,562	851.6	788.9	1,198.6	935.9	2,013.7	1,444.3	8.20	7.4
1,501	—	8,298	9,211	956.5	945.4	918.8	937.6	2,423.9	1,648.3	8.52	8.1
2,001	—	8,136	9,622	1,043.6	1,063.1	991.4	808.3	2,450.0	1,819.8	8.95	8.5
2,501	—	8,874	9,576	1,031.1	1,237.3	1,390.3	594.9	1,881.3	2,147.8	6.65	9.2
3,001	—				1,341.7	726.3	486.0	2,589.5	2,183.2	10.29	8.9
5,001	—	7,713	9,633	1,166.6	1,361.7		353.0		2,573.9		9.0
Over	10,000		8,960								
Overall Average		7,515	8,437	731.4	839.5	1,388.3	887.3	1,995.8	1,518.6	7.68	7.7

Source : CFS 1978/79, 1981/82.

\* Income group of Spending Unit for 1 month in Rs.  
900 Grams = 1 Measure of Rice  
28.35 Grams = 1 Ounce.



TABLE 6  
Daily Calorie Intake in Sri Lanka — By Income Groups

Income Group (Rs./Month)	Rice		Flour		Bread		Sugar		Coconut		Total		% Change
	1978/ 79	1981/ 82	1978/ 79	1981/ 82	1978/ 79	1981/ 82	1978/ 79	1981/ 82	1978/ 79	1981/ 82	1978/ 79	1981/ 82	
0 — 100	791	599	103	162	142	182	88	68	371	312	1495	1323	—11.5
101 — 200	768	772	153	57	177	73	90	91	401	478	1589	1471	— 7.4
201 — 400	794	788	181	96	162	91	82	78	376	388	1595	1441	— 9.7
401 — 600	806	773	178	101	151	91	81	77	356	347	1572	1389	—11.6
601 — 800	849	839	170	120	154	104	89	83	366	342	1628	1488	— 8.6
801 — 1000	904	899	177	110	162	105	96	93	396	362	1735	1569	— 9.6
1001 — 1500	936	987	139	108	164	118	113	105	413	373	1765	1691	— 4.2
1501 — 2000	957	1062	106	109	198	135	127	126	429	408	1817	1840	1.3
2001 — 2500	938	1110	115	94	200	149	139	142	451	428	1843	1923	5.3
2501 — 3000	1023	1023	161	161	154	154	137	137	335	335	1810	1810	
3001 — 5000	—	1104	—	69	—	175	—	165	—	463	—	1976	5.3
5001 — 10000	889	1111	84	56	211	178	155	179	518	448	1857	1972	
Over — 10000	—	1033	—	41	—	210	—	181	—	453	—	1918	
Average	867	973	161	103	163	124	97	112	387	388	1675	1700	1.5

Source : Computed using data of CFS, 1978/79 and 1981/82.



TABLE 7

## Prices of Rice and Rice Substitutes

Item	Unit	1979	1980	1981	1982	1983	1984
Rice	Kg.	3.77 —	4.71 (24.9)	6.25 (32.7)	6.56 (5.0)	6.91 (5.3)	7.74 (12.0)
Bread	450 g.	1.09 —	1.94 (78.0)	2.41 (24.2)	2.66 (10.4)	2.75 (3.4)	3.03 (10.2)
Wheat Flour	Kg.	2.66 —	4.90 (84.2)	5.75 (17.3)	6.52 (13.4)	6.69 (2.6)	7.69 (14.9)
Manioc & Sweet Potatoes	Kg.	1.72 —	2.62 (52.3)	3.25 (24.0)	3.13 (—3.7)	3.37 (7.7)	4.27 (26.7)

Source : Island Wide Data Collection Programme, Central Bank of Ceylon.

Note : Figures in brackets give the annual price increase.



In the utilization of food stamps it has been found that about 177 per cent of food stamps are utilized to purchase rice while 12 per cent are used on sugar.<sup>17</sup> Only 4.74 per cent of food stamps are used to purchase milk food while only 1.4 per cent of stamps are used for bread and flour. Since food prices have increased the purchasing power of food stamps too has declined drastically, as reflected in the reduced rice issues under the FSS.<sup>18</sup> In 1978, 571,296 Mt. tons of rice were issued under the Ration Scheme as against 275,166 Mt. tons issued in 1980 through food stamps. By 1984, rice issues through food stamps had declined to 168,109 Mt. tons.

An implicit assumption of the withdrawal of the Ration Scheme was that consumers would make adequate purchases of food from the open market. This assumption in turn had been based on a further assumption that consumer incomes would increase through wage increases and employment expansion. However, in terms of actual performance, during 1979 — 84 the real wages of the organized sector had declined. The real wage rate index of workers in Wages Boards Trades had declined from 112.9 in 1979 to 96.9 in 1984. The real wage rate of government employees had declined from 111.2 to 106.6. In the unorganized sector, nominal wages of casual workers in paddy, tea and rubber increased by less than the increase in the food price index<sup>19</sup>. In the case of higher income groups, real incomes should have increased since during 1979 — 84, GNP increased by about 5 per cent annually. This is confirmed by the increase in consumption of rice as well as of sugar.

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17. Ministry of Plan Implementation, Report on the Survey of the Food Stamp Scheme, Colombo, 1981.

18. Central Bank of Ceylon, Monthly Bulletin, 1985 Jan.

19. Between 1979 — 84 Nominal Wage Rates increased as follows :

Paddy	— Male	126%
	— Female	132%
Coconut	— Male	134%
	— Female	142%
Rubber	— Male	117%
	— Female	100%
Tea	— Male	107%
	— Female	125%

*Source* : Central Bank of Ceylon, Country-Wide Data Collection Programme.



A third reason for the changes in the basic food consumption pattern had been the changes in relative prices which made rice the cheapest popular food item readily available to Sri Lankan consumers. As could be seen from data given in Table 7, during 1979—84 the price of rice had increased by 105 per cent, while bread prices had increased by 170 per cent, flour price had increased by 189 per cent and prices of manioc and sweet potatoes had increased by 148 per cent. Consequently, the substitution of rice for other food commodities, particularly for bread and flour, had taken place in all sectors and income groups. A more striking feature is the apparent change in the consumer preference of the estate sector where the consumption of flour had been very popular. By 1981/82, the rice consumption in the estate sector had increased by 16 per cent while flour consumption had declined by 25.6 per cent. (See Table 4).

In a way, the increased domestic rice production and the resultant slower increase in price of rice seems to have mitigated the adverse effects of withdrawing the Ration Scheme. In other words, in the absence of a major expansion in domestic rice production, Sri Lanka would have imported more rice which would have influenced the retail price of rice. In the absence of a price subsidy, consumers would have to pay international prices which were higher in most of the years (compared to the domestic retail prices which prevailed). In such a scenario, lower income groups would have suffered more.

### *Balance of Payments and Economic Growth*

In 1950, Sri Lanka imported 498,000 Mt. tons of rice at the cost of US \$ 58 million (Rs. 278 Mn.). Till about 1965, rice imports of the country had been high, annual imports had been over 463,000 Mt. tons while the annual average cost had been about US \$ 54 million. Between 1965 to 1977, rice imports had fluctuated around 350,000 Mt. tons per year, the average annual cost had been about US \$ 51 million. Since 1978 rice imports had drastically declined and the annual imports had been about 156,000 Mt. tons while the annual value of these had been about US \$ 40 million.

The import of rice had declined against a background of both increasing population<sup>20</sup> and increasing per capita consumption. In 1953, rice imports had accounted for 23.8 per cent of total imports; by 1964, this had declined to about 12 per cent. During 1974 — 1977 the relative share of rice imports in the balance of payments increased to about 15 per cent. However since 1978, the value of rice imports had declined to reach an annual level of about 2.6 per cent of total value of imports. The increasing availability of rice also had the impact of reducing the demand for wheat flour and bread. In other words, the paddy sector growth had resulted in a substitution effect on wheat flour and thereby a foreign exchange saving on the import of wheat flour.

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20. The total population in Sri Lanka in 1963 which had been 8.1 million, increased to 14.85 million by 1981. (Census of Population, Department of Census & Statistics). This represents a compound growth rate of 2.19% per annum.



TABLE 8

## Import of Rice

Year	Quantity in '000 MT	Value in Rs. Mn.	Value in US \$ Mn.	Value of Rice Imports as a % of	
				Food and Drinks Imports	Total Imports
1950	498	278	58	n.a.	23.82
51	402	236	50	n.a.	15.14
52	406	329	69	n.a.	19.33
53	410	324	68	40.70	20.15
54	402	273	57	41.11	19.54
55	385	222	47	35.52	15.21
56	491	264	55	37.55	16.21
57	523	258	54	35.05	14.30
58	482	238	50	33.29	13.86
59	583	283	59	35.38	14.11
1960	528	242	51	32.18	12.35
61	469	217	46	32.29	12.74
62	410	195	41	0.95	11.75
63	403	192	40	30.52	12.89
64	658	326	68	32.34	16.51
65	280	144	30	23.84	9.77
66	693	367	77	38.39	18.10
67	355	211	44	26.95	12.14
68	370	341	57	34.48	15.69
69	309	257	43	26.33	10.11
1970	480	318	53	29.75	13.75
71	295	195	33	21.24	9.82
72	299	161	25	16.75	7.80
73	340	270	40	20.50	9.77
74	298	720	108	33.49	15.09
75	465	1062	138	42.14	20.22
76	378	602	68	40.38	12.96
77	538	917	59	42.04	15.27
78	187	689	44	16.69	4.69
79	212	891	58	18.54	3.95
1980	168	882	49	14.38	2.60
81	168	992	48	20.29	2.71
82	174	925	43	25.98	2.21
83	147	765	31	14.23	1.68
84	38	197	7	3.95	0.41

Source : Customs — Sri Lanka, various years.



TABLE 9

## Value Added in the Paddy Sector\* At 1959 Prices

Year	Value Added (Rs. Mn.)	Annual Rate of Growth
1959	312.0	1.1
60	368.2	18.0
61	369.4	0.3
62	410.9	11.2
63	420.3	2.3
64	431.8	2.7
65	309.8	— 28.2
66	391.6	26.4
67	469.9	20.0
68	552.2	17.5
69	562.8	1.9
1970	656.8	16.7
71	569.1	— 13.4
72	537.6	— 5.5
73	537.6	0.0
74	656.4	22.1
75	472.7	— 28.0
76	513.2	8.6
77	687.3	33.9
78	774.4	12.7
79	785.3	1.4
1980	873.9	11.3
81	913.2	4.5
82	882.9	— 3.3
83	1,017.4	15.2
84	991.2	— 2.6

Note : \*Indirect value added contributions such as milling and trade and transport are not included.

The demand for imported inputs by the paddy sector had increased in the post-independence period. Particularly, the demand for chemical fertilizers, agro-chemicals and capital equipments such as tractors and sprayers had increased. The foreign exchange cost of these imports, computed annually for the paddy sector is difficult to obtain. However, it is unlikely, that the annual cost of inputs imported by the paddy sector would have exceeded its gross savings on import substitution.



The import structure change which had been observed in recent years, i.e. the reduced food imports and increasing import of intermediate goods, had been largely influenced by the growth in the paddy sector. Therefore, it could be concluded that the paddy sector growth, among other factors, (namely the transfer payments by the Sri Lankan workers abroad, foreign aid, and foreign capital) had helped Sri Lanka to face the adverse price trends in the international commodity markets, including food and fuel.

In addition to the balance of payments benefits of the expanded paddy output, the direct value added contribution to the economic growth of Sri Lanka had been very substantial. As shown in Table 9 value added in the paddy sector increased by more than three times in real terms during 1959 — 84. At 1959 prices, value added in the paddy sector increased from Rs. 312 million in 1959 to Rs. 656.8 million in 1970. During 1976 — 83 value added nearly doubled ; from Rs. 513.2 million in 1976 to Rs. 1017.4 million in 1983. In other words, in spite of the fact that agricultural production by its very nature is subject to wide fluctuations due to changes in weather, the paddy sector in Sri Lanka had an excellent record of rapid expansion. The periods 1959 — 64, 1966 — 70 and 1976 — 81 had seen continuous increase in paddy output. The major negative growth years had been only a few, 1971 and 1975.

### *Paddy Producer Income*

We have noted the increase in paddy output during the post independence era. Whether this increase has led to an equally significant growth in the income of paddy producers is a relevant policy question. There are two groups of paddy sector workers in Sri Lanka. The first group consists of agricultural operators and the family workers, while the second group is the casual workers who receive daily wages.

Very little statistical data are available on the costs of paddy production on a continuing basis. Therefore, it is difficult to make an analysis of income levels in the paddy sector, either of casual workers or producers. However, before 1979, the producers would have received a higher margin per unit of output since input prices did not increase much faster than paddy prices. Moreover, a few inputs such as fertilizer and seed paddy were given at subsidised prices, while the guaranteed price was higher than the world market prices in most of the years. More detailed statistical data are available on the paddy sector since 1979 from the Island Wide Data Collection Programme of the Central Bank. Taking 1979 — 84 period as a whole, the input prices of the paddy sector had increased faster than the paddy price itself. (See Table 10).

The wage rates of male casual workers had increased by 126 per cent during 1979 — 84 while the female wages had increased by 132 per cent. The largest wage increase had taken place between 1979 and 1980. The wages of a casual worker in the paddy sector increased by about 32 per cent between 1979 and



TABLE 10  
Price Trends in the Paddy Sector

	1979	1980	1981	1982	1983	1984	% Increase Between 1979/1984
1. <i>Producer Price</i> (Per Bushel)	41.83	51.92	69.26	72.65	74.77	78.53	87.73
2. <i>Casual Wages</i> Male	16.82	22.35	27.78	30.80	36.61	38.10	126.5
Female	11.72	15.49	19.82	22.15	26.94	27.20	132.08
3. <i>Seed Paddy</i> Improved Varieties	52.05	59.38	78.91	81.58	86.65	93.41	79.5
Traditional Varieties	50.71	57.60	74.06	77.42	83.35	87.83	73.2
4. <i>Fertilizer</i> Urea	71.55	51.55	119.14	145.79	155.43	152.25	112.8
C.P.D.	72.67	62.92	119.47	146.50	155.90	159.53	119.7
T.D.M. 1	71.34	53.33	118.70	146.07	157.28	153.93	115.8
T.D.M. 2	73.19	53.63	114.61	146.52	150.08	153.56	109.8
V 1	73.53	65.73	123.58	146.44	151.96	154.75	110.5
5. <i>Chemicals</i> Agrosan	19.96	23.26	30.04	31.56	32.69	35.38	77.3
Endrex 20	34.97	41.13	52.76	54.25	56.80	58.81	58.2
Baurs B.H.C.	7.85	9.39	9.69	10.44	13.79	18.11	130.7
Baurs 3 — 4	24.94	33.60	40.06	46.08	50.51	54.30	117.7
Hedonal M 60	30.51	31.96	46.62	41.70	55.09	56.58	85.4
Gramexon	41.32	36.01	36.08	39.48	42.79	43.96	6.4
Baurs M.P.C. A. 40	19.50	30.30	73.39	29.08	34.77	35.84	83.8
6. <i>Mammoties</i> Mammoties (Harcrop)	38.16	42.80	51.96	56.75	61.19	67.75	77.5
Mammoties (Crocodile)	48.15	53.85	70.36	81.06	86.15	89.58	86.0
7. <i>Others</i> Sickles (Medium size)	11.08	15.04	19.43	22.03	24.72	27.18	145.3
Gunnies (3 bushels)	7.59	8.67	11.53	15.02	14.52	14.79	94.9
8. <i>Tractor Hire</i> For ploughing	625.6	816.7	847.50	980.80	1113.02	1184.51	89.3
For threshing (Hectare)	295.1	404.1	757.50	406.42	466.90	468.69	58.9

Source : Central Bank of Ceylon , Country - wide Data Collection Programme.



TABLE 11

**Producer Margin in Land Settlements (Kalawewa in Mahaweli H Area)  
Per Acre in Rupees**

	Yala 1983	Maha 1983/1984*
Average Yield (Bushels)	76.68	62.44
Average Production Price (Rs./Bushel)	67.66	76.35**
Gross Return Per Acre	5188.17	4768.82
Less : Costs (Excluding Family Labour)	2170.38	2136.25
Net Return to Producer Family	3017.79	2632.57

*Source :* Department of Agriculture, Survey on Cost of Cultivation.

*Note :* Average farm size : 1.2 acres.

\*Provisional data

\*\*We substituted the national average since the provisional price data appear to be too low.



TABLE 12  
Trends in the Paddy Sector  
(Estimated Per Acre in SL Rs.)

Variable	1984			1983			1982	
	84 Yala	83/84 Maha	83 Yala	82/83 Maha	82 Yala	81/82 Maha		
1. Yield (in Bushels) Producer Price Rs./Bushels Gross Revenue	61.02 76.06 4641.2	58.79 76.35 4488.2	69.89 68.95 4818.9	70.55 73.96 5217.8	64.63 69.89 4503.4	61.10 69.64 4225.0		
2. Input Costs								
(a) Purchased from Outside								
Fertilizer	476.34	469.97	435.29	444.69	430.96	423.67		
Weedicides and Pesticides	380.80	358.54	352.39	318.77	257.18	215.89		
Transport	114.07	97.15	120.99	111.34	107.89	91.89		
Tractors	604.43	569.88	588.60	527.66	505.56	387.78		
Animals	421.97	417.87	355.00	351.34	278.94	277.01		
a. 1 Total (with tractors)	1575.64	1495.54	1497.27	1402.46	1301.59	1119.23		
a. 2 Total (with animals)	1393.18	1343.53	1263.67	1226.14	1074.97	1008.46		
(b) Purchased from within								
Casual Labour	484.47	414.0	444.3	452.7	414.3	369.6		
Seed Paddy	219.61	226.88	183.68	189.83	188.65	198.43		
Other Costs	278.06	244.57	265.38	247.46	237.38	224.49		
(c) Paid Costs								
(a. 1 + b) Tractors	2557.78	2380.99	2390.63	2292.45	2141.92	1911.75		
(a. 2 + b) Animals	2375.32	2228.98	2157.03	2116.13	1915.30	1800.98		
3. Net Revenue								
(a) Revenue to Producer Labour (Tractor users)	2083.42	2107.21	2428.27	2925.35	2361.48	2313.25		
(b) Revenue to Producer Labour (Animal users)	2265.88	2259.22	2661.87	3101.67	2588.10	2424.02		

Source : Estimated from Primary Data available from Department of Census & Statistics and Central Bank.



1980. The wage increase was most pronounced in the 1st quarter of 1980. The main reason for this wage increase was the withdrawal of the free rice ration which helped to keep the casual worker wages lower. As it is known in the theory of wage determination, subsistence cost is one factor which influences casual wages. When the ration scheme was replaced by the Food Stamp Scheme, the subsistence cost of casual workers increased very considerably, pushing wage rates upwards. Although money wages of casual workers have increased as noted earlier, the real wages have not increased as shown by price indices.

The prices of other inputs have increased less faster compared with the wages. The price of urea had increased by 112.8 per cent during 1979 — 84. Most of the chemical prices had increased by over 77 per cent. The price of a mammuty had increased from Rs. 48/- in 1979 to Rs. 90/- in 1984. The tractor hire charge had increased by 85 %. Against these price increases of inputs, the price of paddy increased only by 88 per cent.

As we have noted earlier, the expansion of the cultivated land area under paddy due to investment in irrigation projects has been the primary reason for increased paddy output. Various studies done on the socio-economic conditions of settlers in major irrigation schemes have shown that a substantial section of farmer families live in poverty. According to the findings of a survey<sup>21</sup> conducted in 1982, about 12 % farmer families in land settlements receive less than Rs. 500/- a month as total income while about 59 % of families receive incomes between Rs. 500 — 700. The mean income of a settler family in 1982 was Rs. 707/- per month.

The survey on farm costs conducted by the Department of Agriculture too indicates that farmer families have a very low income. According to Table 11 the producer income per acre is Rs. 5650 per year in 1983/84 in the Kalawewa Scheme, which works out to a monthly income of Rs. 470/- per acre or Rs. 565/- per farm of 1.2 acres which had been the average size of farms.

The objective of land settlements has been to improve the economic standard of settlers and with this objective irrigation projects have been implemented. However, data on income, employment and poverty show that land settlements are not major growth centres in Sri Lanka. The level of unemployment, particularly among the second and third generations suggests that very little additional employment has been available within these settlements.

The dominance of paddy cultivation, even in lands which are more suitable for other crops, is a major constraint to development. Since marketing facilities available for other crops have been limited, farmers produce non-paddy crops only to a limited extent. This has prevented the income improvemen

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21. Sirisena N. L., Ibid.



of farmers as a non-optimal cropping pattern is adopted due to lack of market incentives. This has been observed particularly in the Gal-Oya Scheme. In most of the land settlements, the non-availability of electricity has prevented the growth of agro-processing industries. The limited cultivation of vegetables and fruits too could be largely explained by this constraint.

The education and health facilities provided in most of the settlements are very limited and this seems to have had the effect of limiting social development in the community. The limited infrastructure facilities such as roads, transport and communication have prevented the growth of market centres and townships which are critically important for economic development.

An analysis of producer income on an island-wide basis (Table 12) indicates that a producer who cultivates one acre of paddy had received Rs. 5012/- in 1982, Rs. 5163 in 1983 and Rs. 4525/- in 1984. The producer income estimates raise two basic questions from a policy point of view. One is the economic viability of farms which are smaller. According to the Census of Agriculture 1982, 42.4% of all holdings representing 8.1% of area is less than one acre. It appears that farm amalgamation is essential for economically viable farm units. The second point is the poor economic condition of farmers who cultivate about one acre. The income seems to have stagnated in monetary terms. However, once the inflation rate is taken into account average farmer income had actually declined.

## CONCLUSIONS

The overall objective of agricultural policy in regard to the paddy sector has been import substitution. This objective has influenced the policy components in the paddy sector, particularly the research programme. However, at present (1985) Sri Lanka is producing almost all rice requirements of the domestic market. With the large scale investment in irrigation projects, particularly in the Mahaweli Development Programme, irrigated land area would increase much faster, and hence rice production in Sri Lanka would exceed the domestic requirement in the near future. Therefore, policy makers should urgently think of new policy directions.

The international demand for rice is increasing only slowly since most of the major rice consuming countries are having their own programmes to increase domestic production. Therefore, on the one hand, an examination of the world demand for rice seems essential. However, a more urgent policy directive is probably needed for the rice researchers to develop new HYVs of rice which could be marketed internationally. The HYVs of rice now in use are mainly demanded by Sri Lankan consumers. Grain characteristics, taste, nutritional standard and storage quality of local rice varieties have only a limited acceptance in the international market. Therefore, rice varieties which meet with the specifications of a larger foreign market need to be produced in Sri Lanka.



Another important question is production costs which need to be reduced since farmers are already facing eroded incomes. The authorities need to give priority to this question of producer income. One of the most effective ways of increasing farmer income is through improvement in productivity of land by adopting more productive technologies. Among policy options, greater concentration on research and development, particularly in developing new high yielding varieties of rice which could give greater yield per unit of land needs to be stressed. In other words, the heaviest responsibility for the future of the paddy sector lies with rice breeders and extension workers.

Moreover, new incentives have to be provided to the pioneer farmers who would produce rice for foreign markets. The most effective way of doing that is to declare a new guaranteed price for the new varieties of rice, considering the international price trends. Once the paddy sector starts producing a surplus for export, its contribution to the balance of payments would be direct as against the foreign exchange saving now being realized.

In the past, particularly in 1950's and 1960's, the Guaranteed Price Scheme had played a very significant role in promoting the market. Even today, the GPS is playing a useful role as a floor price operator since paddy prices are subject to wide fluctuations. In future, when the paddy output exceeds the local demand and prices are likely to fluctuate more, the GPS would have to take the responsibility of minimising price fluctuations.

The credit policy pursued in the past has been inadequate. When farmers borrow from non-institutional sources they pay high interest rates which are part of production cost. On the other hand, if credit is supplied from institutional sources the cost of production can be reduced substantially. In this respect a concerted effort to give more credit to farmers through the new Regional Rural Development Banks and the existing commercial and savings banking system is urgently needed. It is not only the credit requirements of the paddy sector, as such, which should be met more effectively, but the credit needs of the rural sector in general have to be met, to promote agricultural and other economic activities to absorb the unemployed labour in rural areas. The level of unemployment is quite high in land settlements and, therefore, the creation of off-farm employment should be a major objective of credit policy. That would also lead to increasing the income of farmer families.

The policies presently followed in respect of the Mahaweli Development Programme are far superior to what had been followed in the past. The present policies, particularly the infrastructure development, the supply of electricity, a net-work of roads and development of townships within the land settlements should be implemented in older settlements also. Poor infrastructure facilities, and lack of technical and marketing guidance had been one of the main reasons for the poor development in the older land settlement schemes.



In a less developed country, improvement in income level and food consumption are generally associated with an increase in the volume of production of a basic food commodity such as rice. Although the above hypothesis has been proved true at macro level by higher GDP growth rates and increased per capita food consumption, the recent experience of Sri Lanka is significantly different at the micro-level. In other words, against a background of a major increase in the paddy output, producer income on one hand and rice consumption by lower income groups on the other have declined. This obviously poses a challenging question to policy on the paddy sector. However, the country as a whole has benefitted by the expansion of the paddy output as shown by savings in foreign exchange and increasing availability of cereal food. Furthermore, the paddy sector has contributed in a significant measure to the economic growth (GDP), particularly in recent years.



# EMPLOYMENT TRENDS

R. B. M. KORALE

The interest on employment, population and other demographic conditions in Sri Lanka has arisen primarily because of the severe unemployment problem the country has been faced with for several decades. There have been many factors which have influenced and determined the unemployment condition in Sri Lanka. But two factors have had an over-powering influence. The first of them is the rapid growth of the workforce, which in turn was caused by the high rate of population growth. The dramatic decline in the death rates in the late 1940's without a corresponding decline in the birth rates led to an increase in the labour force at very high growth rates a decade and a half later. Thus by the early 1960's, the labour force was growing at a rate of 3% per annum. It was even higher than the population growth rate at its peak. The second important determining factor was the slow growth rate of the economy. The growth rates achieved were insufficient to absorb the increasing influx of job seekers, nor did the economy diversify adequately to create jobs in the formal sector to the increased number who joined the workforce with higher educational attainments. The growth rates averaged around 3% — 4% most of the time since the country gained independence while the population growth rates averaged around 2% — 3% during the same period. A brief overview of the trends and patterns of population and labour force growth would help to place the employment growth pattern in the economy in its proper setting. For this purpose, the sources of data that are available on these demographic and socio-economic characteristics are briefly outlined.

## Sources of Data

Statistical surveys and censuses of population are the main sources of data on the employed and unemployed population. The surveys in question have been undertaken for different socio-economic purposes and not necessarily to measure the labour force characteristics. Only 5 surveys have been initiated during the past 35 years with labour force measurement as an objective. The absence of a regular survey which produces data on this condition has made the data situation very weak, for the undertaking of any comprehensive analysis of employment and unemployment, and it thus becomes necessary to fall back on census of population data.



The data position is also weak, because of the absence of establishment records and administrative statistics such as that would be available from a good employment registration system. None of the sources such as that of the employees provident fund, job bank, wages boards etc. could be used for a statistical study of employment, in view of poor coverage, unupdated records and problems of classification.

### **Non-Comparability**

Concepts and definitions used in the censuses have been changed and as a consequence available statistics on employment and unemployment are not comparable. In the Census of Population 1946, the gainfully employed concept was used and persons who were employed excluding unpaid family workers and those who were previously employed excluding first time job seekers were enumerated. The Census 1971 definitions on employment and unemployment were wider and in the case of the unemployed even persons who were not actively seeking employment were enumerated as unemployed and they were treated as discouraged workers. In some of the surveys, the reference period used was one week whereas in other surveys the reference period was one month. If persons who worked only for one day in a month were enumerated as employed, it would lead to a higher estimate of the employed over an estimate where the reference period was one week. Yet it is necessary to depend on this data base inspite of these weaknesses for any analysis of employment and unemployment.

### **Population**

The Census 1981 enumerated the population at 14.85 m, it has grown from 6.65 m in 1946 by 120% over the 35 year period. As described this rapid growth was due to a sudden decline in the death rates in the 1940's without a fall in the birth rate till the beginning of the 1960's. The full impact of this rapid growth was felt in the mid 1960's when larger cohorts began to enter the workforce. The expansion of free education enabled larger cohorts to be retained in the education and training system for a few years thus delaying their eventual entry into the labour force.

The population of Sri Lanka was estimated at 16.0 m in 1985 and it is growing at a rate of 1.5% per annum with a crude birth rate of 25.0 per thousand and a crude death rate of 6.5 per thousand. The net migration rate has been increasing due to the outflow of adult workers for employment abroad, and due to the repatriation of Indian estate labour. The population is estimated to increase to 17.8 m by 1991 and 20 m by the end of the 20th century.



## Labour Force

The labour force more than doubled itself during the period 1946 — 1981 increasing from 2.611 m in 1946 to 5.75 m in 1981, by approximately 120%. Apart from this overall rapid increase in the numerical magnitude, the internal composition of the labour force also underwent a major transformation through the influx of persons with higher educational qualifications and attainments. Further the labour force participation rates of females have also significantly

TABLE 1.

### Labour Force Estimates

Title of Survey	Labour Force Participation 000'			Crude Participation Rate (%)		
	Total	Male	Female	Total	Male	Female
1. Census of Population — 1946	2,611	2,041	570	39.2	57.8	18.2
2. Census of Population — 1953	2,993	2,268	724	37.0	53.1	18.9
3. Census of Population — 1963	3,464	2,742	722	32.7	49.8	14.2
4. Labour Force Survey — 1968	4,150	3,156	984	34.6	50.7	17.2
5. Socio-Economic Survey — 1969/70	4,169	3,124	1,045	38.6	57.3	19.5
6. Census of Population — 1971	4,488	3,312	1,176	35.4	50.7	19.1
7. Survey of Labour Force Participation Rates — 1973.	4,560	3,267	1,293	34.4	48.5	20.2
8. Land and Labour Utilisation Survey 1975.	4,957	3,490	1,467	36.5	50.2	22.1
9. Consumer Finances and Socio-Economic Survey — 1978/79.	5,521	3,712	1,809	38.0	50.4	26.2
10. Socio-Economic Survey — 1980/81	5,715	4,109	1,606	37.3	53.1	21.2
11. Census of Population — 1981.	5,105	3,767	1,248	33.8	49.8	17.1
12. Consumer Finances and Socio-Economic Survey — 1981/82.	5,282	3,843	1,439	34.3	49.7	19.4



increased during the period admitting large numbers of females who have had 10 or more years of school education into the workforce. The existence of a large reservoir of discouraged workers who had been looking for non-manual work in shops and offices, which has remained scarce in relation to the numbers seeking these jobs has made it difficult to assess the magnitude and composition of the labour force variables. The estimates of the labour force ascertained in the different inquiries undertaken during the past 25 years is set out in Table 1. These surveys have disclosed the following annual rates of growth :

<i>Period</i>	<i>Rate of Growth</i>
1946 — 1953	2.0%
1953 — 1963	1.5%
1963 — 1971	3.3%
1971 — 1981	2.5%

These rates of growth are extremely high in relation to the corresponding rates of growth of the economy. The economy itself did not grow at a rate of more than 3% in many years during this period. As a consequence in some sectors employment was stagnant and in some years in fact it declined. Employment opportunities had not expanded to absorb the workforce which grew in this way and a part of the annual additions to the workforce was added to the backlog of the unemployed. The labour force growth rate has not declined below 2.5% and it is unlikely to go down below 2% for more than 2 decades. For at least the next 1 1/2 decades entrants to the labour force are already amongst us and no significant changes except for some increases in labour force participation is likely to occur.

## Growth Trends

During the period 1946 — 1981 the total volume of employment has grown from 2.612 m to a maximum of 4.851 m jobs in 1981. The latter is the highest figure of employment disclosed in the surveys. The trends in the growth of employment is broadly visible from the employment estimate given in Table 2. The Censuses of Population 1946 and 1953 indicate that 380,000 jobs have arisen in the economy and that employment has grown at 2% per annum. In the decennial period 1953 — 1963, only 200,000 additional jobs have been created at the exceedingly slow growth rate of 0.6% per annum. According to the census of population data between 1963 and 1971 employment has increased by about 450,000 jobs or at the rate of 1.7% per annum. These rates of growth are significantly lower than the rate of growth of the labour force.



TABLE 2  
Employment Estimates  
(In thousands)

Title of Survey	Estimated Employment		
	Total	Male	Female
1. Census of Population 1946	2,612	2,042	570
2. Census of Population 1953	2,993	2,269	724
3. Census of Population 1963	3,200	2,543	657
4. Labour Force Survey 1968	3,674	2,835	839
5. Socio-Economic Survey 1969/70	3,610	2,775	835
6. Census of Population 1971	3,649	2,838	811
7. The Determinants of Labour Force Participation Rates in Sri Lanka 1973	3,767	2,820	947
8. Land and Labour Utilisation Survey 1975	3,973	2,990	983
9. Consumer Finances and Socio-Economic Survey 1978/79	4,764	3,387	1,377
10. Labour Force and Socio-Economic Survey 1980/81.	4,851	3,623	1,228
11. Census of Population 1981.	4,119	3,268	881
12. Consumer Finances and Socio-Economic Survey 1981/82.	4,678	3,545	1,133

There are 4 estimates of employment for the period 1978 — 1982, but there are wide variations between these estimates, and the census of population 1981 estimate is an outlier. Three estimates derived from the Consumer Finance and Socio-Economic Survey 1978 — 1979, Labour Force and Socio-Economic Survey 1980 — 1981 and the Consumer Finance and Labour Force Survey 1981 — 1984 are comparatively closer yet variations between the highest and lowest amounts to about 250,000 jobs. For the lack of a better method if one were to use an average of these three estimates for 1981/ the rate of, employment creation between 1971 and 1981 amounts to 2.7% per year. According to available data around 700,000 of these, one million jobs had been



created between 1977 and 1981. It was during this period that the deterioration of the unemployment situation was prevented by the addition of a part of the annual entrants to the work force to the backlog of the unemployed, for the first time in the recent past. The slow employment growth rates when compared with the population and labour force growth for the same period, shows the origin and deterioration of the employment problem of Sri Lanka.

### Industrial Distribution

These censuses and surveys have also provided data on the industrial and occupational distribution of the workforce for the relevant survey periods. These data make it possible to broadly study the growth of employment in the different economic sectors including numerical magnitudes and percentage shares as well as inter-sectoral shifts within and between sectors. In the case of some surveys, however, the samples were not large enough to disaggregate the data below major industrial division level. Therefore, the census of population data has to be relied on to study the employment growth and trends in the different sub-sectors at minor division and unit industry levels.

The data provided in Table 3 show the distribution of employed by different industrial sectors ascertained from the more comprehensive inquiries. The classifications used in the Census 1946 prevented it being brought in line with the classifications now in use and therefore it has been left out. The sheer size of the agricultural sector in total employment is immediately apparent from the data, as this sector includes animal husbandry, forestry (2,311) and fishing (75,135) as well. Employment in this sector has grown from 1.58 m in 1953 to around 2.3 m in 1981 — 1982 over a period of nearly 3 decades. This amounts to an average rate of growth of 1.3 % per year. It should be noted that during the same period population expanded by 83.4 % and the labour force grew by 91.0 %. So in relation to these variables the employment growth rate has been very low. This explains the problem of unemployment as well. To absorb the increases in the labour force, this sector because of its pre-eminent position as having a sector share of 50 % of all employment, should have grown at about twice the rate.

Within the agricultural sector some sub-sectors such as paddy cultivation expanded providing employment to approximately 700,000 persons. On the other hand, employment in plantation industry has declined within the same period. According to available data it has decreased from 800,000 — 900,000 to 600,000 — 700,000 jobs. It was the modest gains in the paddy cultivation sub-sector and the fisheries sub-sector which has contributed to increasing the employment opportunities recorded for the period by about 700,000 jobs. It might be mentioned that considerable public outlays were directed to the development of irrigation facilities and land settlement programme and it has been this sub-sector which has received the greatest concentration of public resources.



TABLE 3.  
Distribution of Employed Population by Industry Sector  
(In Thousands)

Sector	Census 1953	Census 1963	Census 1971	SES 1981/81	Census 1981	Consumer Finance 1981/82
	No. (%)	No. (%)	No. (%)	No. (%)	No. (%)	No. (%)
1. Agriculture, Forestry and Fishing	1584.1 (52.9)	1681.9 (52.6)	1828.9 (50.1)	2293.3 (47.3)	1863.8 (45.2)	2360.7 (51.2)
2. Mining and Quarrying	...	...	...	...	...	...
3. Manufacturing	...	...	...	...	...	...
4. Electricity, Gas and Water	...	...	...	...	...	...
5. Construction	...	...	...	...	...	...
6. Wholesale and Retail Trade	...	...	...	...	...	...
7. Transport, Storage and Communication	...	...	...	...	...	...
8. Finance, Insurance, Real Estate and Business Services	...	...	...	...	...	...
9. Community, Social and Personal Services	...	...	...	...	...	...
10. Activities not Described	...	...	...	...	...	...
11. All Economic Activities	...	...	...	...	...	...



The Table also shows that the mining and quarrying sector has provided about 60,000 new jobs during the period. This sector has also increased its relative share from a very small proportion of 0.3% in 1953 to 1.7% in 1981. The enumerated figure of 13.8 thousand for 1953 could be an over estimate.

The manufacturing sector had expanded moderately by the establishment of basic industries in the public sector, and private sector import substitution industries of the early 1960's and through efforts to attract foreign investment more recently. If one were to use the estimate of the Consumer Finance and Socio-Economic Survey 1981 — 82, the total increase in manufacturing employment between 1953 and 1982 amounts to about 285,000 jobs which is nearly a 100% increase in employment in this sector. During the three decades although state policy throughout recognized the need to develop this sector with the objectives of increasing export earnings, import substitution, employment creation and improving living standards, this sector has not been growing anywhere near the projected growth rates. If it had been possible to achieve a growth rate around 8% per annum and if it was maintained, it could have then been possible to add a further 250,000 — 300,000 jobs to this sector. Employment in this sector is specially important as the labour force entrants have better educational attainment and they have been looking for wage employment in the formal sector jobs. It is ultimately the slow expansion of this sector that has led to the supply and demand imbalance with the number of educated youths exceeding the available opportunities. Studies undertaken sometime ago have disclosed that these persons were really looking for remunerative jobs outside the small family farms and the often quoted preference for clerical desk-type employment by educated youths was not confirmed by these surveys.

The electricity, gas and water sector has continued to remain small around 0.4%, although capital investments have been high, with a number of hydro electric projects coming on stream during the period. The construction sector was relatively small being less than 1.9% at the beginning of the 1950's. In spite of the priority accorded to the construction of irrigation facilities and peasant settlement projects, it has continued to remain small being around 3% — 5% of all employment (3.3% of output till the end of 1970's). It was viewed as a possible source of employment by policy makers but a shortage of capital equipment and the absence of an adequately skilled workforce has prevented it from being a potential source of employment creation. The wide fluctuation in capital inputs overtime has prevented stability and growth in this sector. The recent spurt in development activity has provided around 100,000 jobs between 1978 — 1982 in this sector. Thereafter again the present indication is that it has remained static and even started to decline.

The share of the wholesale and retail sector has continued to remain around 10% to 11% during the whole period, the total additional employment generated during the entire period being around 200,000 job opportunities. Available



figures show that between 1963 and 1971 this sector had remained static for all practical purposes. By 1980 — 1981, the total employment in the sector had increased to around 500,000 jobs. the total volume of additional jobs for 1971 — 1981 was 150,000 and most of these jobs accrued after the adoption of liberalized trade policies.

In the case of the transport storage and communication sector the relative share has remained practically the same between 1963 and 1981. Between 1953 and 1982 this sector had added about 85,000 jobs, the slow growth of the economy allround did not make heavy demands on this sector till recently. In the case of the community, social and personal services sector total employment has increased from 396,000 in 1953 to around 600,000 in 1981. The growth of this sector had been primarily due to the expansion of state services. The current public service strength is estimated at around 465,000. Thus the social and personal services activities that have arisen outside the state sector is relatively small. With exonomic development, it is this sector which expands creating additional opportunities. Ultimately the size of this sector would depend on the disposable incomes and consumer expenditure and therefore its rate of growth is also an indicator of living standards. The expansion of the tourist industry during the past decade or so has contributed to add several thousand job opportunities, but this sector has encountered problems with the onset of the ethnic and terrorist issues.

### Occupational Distribution

The occupational distribution of the employed population is available only from a limited number of data sources and they are the Censuses of Population 1963, 1971 and 1981. The sample surveys conducted during the recent past have also provided data on the occupational distribution at major group level. Detailed information on this variable is available only from the Censuses of Population 1971 and 1981.

In the case of professional, technical and related workers' major group, the numerical magnitudes had increased from 113,000 in 1953 to 269,000 by 1981, the share of the sector rising from 3.8% to 5.7%. In the case of the administrative and managerial major group, the numerical magnitude had remained static around 25,000. It is suspected that the 1953 and 1963 census estimates are over-estimates. The clerical and related workers group had increased from 103,000 in 1953 to 274,000 in 1981 by 170,000 additional opportunities during the three decades. This rate of increase was quite inadequate to absorb the job aspirants to these occupations. The bulk of these opportunities arose in the government service and public corporation sub-sectors where considerable over staffing in these occupations has occurred as a result of the pressures from unemployed job seekers'



TABLE 4.

## Occupational Distribution of the Employed Population — 1953 — 1981

Major Occupational Groups	Census 1953	Census 1963	Census 1971	LF + SES 1980/81	
	No. %	No. %	No. %	No.	%
Professional, Technical and Related Workers	113.6	142.7	178.5	269.2	5.5
Administrative and Managerial Workers	28.8	32.9	14.0	25.4	0.5
Clerical and Related Workers	103.3	118.4	186.1	274.1	5.6
Sales Workers	221.2	212.2	272.4	396.0	8.2
Service Workers	439.5	259.6	198.0	265.4	5.5
Agricultural Animal Husbandry & Forestry Workers, Fishermen and Hunters	1536.1	1653.6	1782.1	2191.2	45.2
Production & Related Workers, Transport Equipment Operators and Labourers	488.3	739.7	926.4	1415.4	29.2
Workers not Classified	62.5	40.6	91.5	14.8	0.3
TOTAL :	2993.3	3799.7	3649.0	4851.4	100.0

The estimate of service workers in the different censuses are not comparable, the definitions and other problems have made the data suspect. The total number engaged in agricultural pursuits has increased from 1.54 m in 1953 to 2.2 m in 1981. As expected the share of agricultural occupations in total employment had declined from 51.7% in 1963 to 43.7% by 1980. The production and related workers, and transport equipment operators and labourers group had increased from 488,000 in 1953 to 1,415,000 by 1981, and thus it had increased its share from 23.1% in 1963 to 30% by 1980. The decline in the share of the agricultural sector had been absorbed mainly by this major group.



TABLE 5  
(Employed Population classified by Employment Status and Sex — (1953 — 1980))

	Paid Employee		Employer		Worker on Own Account		Unpaid Family Worker		Unspecified		Total Total	
	Number	%	Number	%	Number	%	Number	%	Number	%	Number	%
Census of Population 1953	T	1832295	61.2	93843	3.1	898156	30.0	169055	5.7	—	2993349	100.0
	M	1347550	59.4	84643	3.7	761414	33.6	75133	3.3	—	2268740	100.0
	F	484745	66.9	9200	1.3	136742	18.9	93922	12.9	—	724609	100.0
Census of Population 1963	T	2081060	65.0	77190	2.4	853130	26.7	164090	5.1	24260	3199730	100.0
	M	1541160	60.6	73430	2.9	794860	31.3	120370	4.7	113100	2542920	100.0
	F	539900	82.2	3760	0.6	58270	8.9	43720	6.6	1160	656810	100.0
Labour Force Survey 1968	T	—	61.7	—	—	—	—	—	6.4	—	—	100.0
	M	—	56.5	—	—	—	30.3	—	5.8	—	—	100.0
	F	—	76.6	—	—	—	35.9	—	12.6	—	—	100.0
Socio-Economic Survey 1969/70	T	2371700	65.7	82100	2.3	970200	26.8	186100	5.2	—	3610100	100.0
	M	—	—	—	—	—	—	—	—	—	—	—
	F	—	—	—	—	—	—	—	—	—	—	—
Census of Population 1971	T	2429957	66.6	113846	3.1	913750	25.0	191322	5.3	—	3885	100.0
	M	1806949	63.7	107539	3.8	8231222	3.8	100794	3.5	—	84074	100.0
	F	623008	76.9	6327	0.8	90628	11.2	90528	11.1	—	471	100.0
Consumer Finance Survey 1973	T	—	60.8	—	—	—	31.0	—	6.7	—	—	100.0
	M	—	57.2	—	—	—	36.1	—	5.0	—	—	100.0
	F	—	72.4	—	—	—	14.9	—	11.9	—	—	100.0
Socio-Economic Survey 1980/81	T	3057893	63.0	86880	1.8	1250848	25.8	455836	9.4	—	451457	100.0
	M	2225190	61.4	82240	2.3	1067707	29.5	248232	6.8	—	3823369	100.0
	F	832703	67.8	4640	0.4	183141	14.9	207604	16.9	—	680881	100.0
											122	100.0



## Employment Status Structure

In a discussion on employment trends, it is necessary to examine the employment status of the population through time. The employment status reflects the pattern of manpower utilization and distribution and availability of additional workers for paid employment when the demand for employment increase. The numerical magnitude of employers and its relative share in total employment indicates the number of entrepreneurs functioning in particular economic sectors and geographic localities. The proportion of unpaid family workers is an indicator of the degree of the work and income sharing.

The employed population is divided into 4 employment status groups namely, paid employees, employers, workers on own account and unpaid family workers. The Census of Population 1946 excluded the unpaid family workers group from the definition of the employed. The employed population classified by employment status for selected censuses and surveys is provided in Table I. The increase in the numerical magnitude and relative share of paid employees is a significant feature apparent from the data in Table 5. The number of paid employees had increased from 1.8 m in 1983 to 3 m in 1980. The share of self-employment had declined from 30% in 1953 to 20.8% in 1980. The numerical increase in self-employment had been largely caused by the settlement of paddy cultivators on newly developed settlement schemes. The employer group had fluctuated between 1953 and 1981 declining in the mid 1960's and then increasing and declining again. This pattern could be due to small businesses and trade enterprises being absorbed into larger units and the absorption of small craftsmen in somewhat larger facilities. That the unpaid family worker group continued to be an important social and economic entity is evident from the data in Table 5, where 9% of the total employed population falls within this group. The growth of unemployment and increased educational attainment had caused the share of this group to increase from around 5% in the 1960's to the current level.

## Concluding Remarks

The foregoing analysis makes it possible to make the following comments and observations on employment and unemployment trends and prospects in Sri Lanka. It is evident from the discussion that it is necessary to evolve nationally accepted definitions for the measurement of the labour force, employment and unemployment. The need for yardsticks of measurement were highlighted as far back as 1959 in the Survey of Employment, Unemployment and Under-employment sponsored by the ILO and conducted by the Department of Census and Statistics. This issue was also discussed in the report on the Determinants of Labour Force Participation Rates in Sri Lanka, 1973. It is important to adhere to concepts and definitions as it is the changes in the definitions that have reduced the comparability of data over time and made it difficult to observe the changes and study the trends of these parameters.



TABLE 6.

## Unemployment Estimates

Title of Survey	Sample	Males	Estimated Females	Estimated Unemployed Both Sexes Number	Unemployment Rate
1. Survey of Employment, Unemployment and Under-employment in 1959—60 ILO	10,000 households	259,000	90,000	340,000	10.5
2. Census of Population 1963	total enumeration	199,490	65,480	264,970	7.7
3. Survey of Consumer Finance, 1963.	4,984	n.a	n.a	457,700	13.8
4. Labour Force Survey 1968	13,000 households	312,000	152,800	464,200	13.4
5. Socio-Economic Survey 1969—70	9,694	349,000	209,600	558,600	14.3
6. Census of Population 1971	total enumeration	474,065	365,199	939,264	18.7
Adjusted		474,065	197,917	671,982	15.6
7. The Determinants of Labour Force Participation Rates in Sri Lanka, July, 1973.	2,500 households	446,929	346,071	793,000	18.3
8. The Survey of Sri Lanka Consumer Finance 1973.	5,000 households	n.a	n.a	1,073,000	24.0
9. Land and Labour Utilization Survey 1975.	5,000 households	499,500	484,800	884,300	19.7
10. Labour Force and Socio-Economic Survey 1980—81	10,000 households	503,207	353,961	857,168	15.3
11. Census of Population 1981.	10% sample	498,726	396,417	895,143	17.9
12. Consumer Finances and Socio-Economic Survey 1981—82.	8,000 households	298,038	306,602	604,640	11.9



The prevailing estimates of employment and unemployment cannot be used as a consistent set for a detailed analysis. For instance, the estimates disclosed in the last four surveys differ substantially, and they have to be interpreted with caution. The Labour Force and Consumer Finance Survey 1981/82 has under-estimated both employment and unemployment and therefore does not adequately reflect the magnitude of the labour force nor that of the volume of employment generated during the period immediately preceding the survey.

The absence of a set of detailed labour force projections compounds this issue. The construction of labour force estimates and their regular review is a prerequisite to study the changes in levels and trends of employment and unemployment. These estimates make it possible to combine information from small surveys and case studies and evaluate the directions of change in these variables. One way to over-come these difficulties would be to incorporate a labour force module in the sample surveys on a regular basis without modifying the accepted definitions. The Department of Census and Statistics proposes to include such a module in the National Household Survey Capability Programme on a regular basis. The labour force magnitudes have been estimated in the labour force and socio-economic surveys of 1980/81 and 1985/86. The next labour force and socio-economic survey is planned for 1989/90. This series would substantially improve data and information on the socioeconomic condition of the economically active population.

The relative stagnation of employment while the population and labour force grew rapidly contributed to a growth of the unemployment problem, and this has been documented. The decline in the labour absorption capability of the plantation sector in the 1950's sixties and seventies was one of the main contributory causes for unemployment. Employment in the plantation industry sub-sector peaked in the 1950's. Until then employment in this sector continued to expand which not only made it possible to absorb labour migration from South India, but provided regular and part time opportunities to a growing labour force and prevented open unemployment in the Wet Zone. It is in this region that more than 70% of open unemployment had been concentrated and where an increase in labour utilization in this sector could have had a significant impact. The decline in the extent under cultivation in the tree crop sector means that a further increase in labour utilization could arise from improved cultural practices, in filling operations and through consequent output increases. According to some estimates, an additional 100,000 employment opportunities would not be too optimistic in terms of current acreages and optimum production levels.

The paddy cultivation sector can no longer be expected to expand at rates achieved during the past three decades. It is the growth of this sub-sector, which enabled the absorption of increments to the labour force and had reduced



labour force under-utilization in the districts and regions where paddy cultivation is the major economic activity. The additional acreage that will be required for this crop will be to provide food for the increment to the population only. The yield increases that could be attained through improved cultural practices and productivity improvements will not make this sector attractive from an employment generation point of view. This short fall in new employment from this sub-sector will have to be made up from increased labour absorption in other agricultural and animal husbandry sub-sectors. Until now the government has concentrated its research and extension activities mainly on paddy cultivation and due to employment and other considerations it will be necessary to accord a higher priority for other food crops and export crops.

Employment in the state sector cannot expand further merely to provide the type and level of service so far undertaken. There is overstaffing at clerical and office employee levels both in government departments and public corporations. The rapid growth of unemployment in the 1960's and 1970's brought pressure for recruitment to clerical, manual and operative grades in the state sector. In the short term, therefore, it is not possible to expect the state sector to absorb significant numbers with the exception of the professional, scientific and sub-professional manpower categories required for the development and maintenance of economic infrastructure.

Because of these considerations one must conclude that performance of the industry and manufacturing sectors will be the key determinants of employment in the medium and long term. Employment utilization in this sector had grown from 289,000 in 1953 to 573,000 in 1981 at an average rate of 2.5% per annum. This sector will have to expand at much higher levels of growth, than that achieved in the recent past to have a significant impact on unemployment. For reasons stated earlier, this sector will have to share a bigger burden in the provision of additional employment and it will ultimately determine the employment structure and trends in the country. A reappraisal of policies directed to this sector and adoption of appropriate strategies for accelerating growth of both output and employment therefore are priorities.

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# FISCAL AND MONETARY POLICY IN SRI LANKA WITH SPECIAL REFERENCE TO THE PERIOD AFTER 1977

H. N. S. KARUNATILAKE

## Fiscal Policy

A common element in the fiscal operations of Sri Lanka throughout the period since independence has been the deficits in the government budgets. The magnitude of these deficits have risen progressively with the lapse of time. After 1977 these deficits have increased several fold and government has not been able to match its expenditure commitments by the mobilisation of adequate revenue. Before 1948, when budget making was in the hands of British administrators, a surplus budget or a balanced budget was the rule rather than the exception. Budget making was relatively easy at that time because government did not have substantial expenditure commitments for social welfare or for economic development. Budget making was not confronted with a growing inflation problem and the nature of budgetary management helped to keep inflation at bay.

## Magnitude of Deficits

From 1950 onwards there have been overall deficits in the budget without a break, with exceptions occurring in just one or two years in the fifties. In terms of size, the budget deficits in the sixties show a remarkable stability. For instance the overall deficit from 1961 to 1965 never exceeded Rs. 610 million. In 1961/62, the deficit was Rs. 50 million and in 1965/66 Rs. 682 million. Similarly, in the next five years from 1967 — 1971 there was a slight increase, but even so the deficits were contained within Rs. 1100 million. Thus upto 1973/74, the yearly overall deficits did not exceed Rs. 1600 million.



A significant change in the magnitude of the deficits emerged in 1976 when the average annual deficit started rising well above Rs. 3500 million. The major phase of deficit financing started in 1977, when for the first time the overall budget deficit doubled very rapidly. In 1978 the deficit was Rs. 7165 million and in two years, the deficit had more than doubled to reach Rs. 16274 million in 1980. Thereafter, in two years it reached Rs. 20 billion in 1982. In 1983 the deficit was Rs. 21 billion and in 1985 once again reached Rs. 21 billion. These figures, as shown in Table 1, reflect the significant changes in the size of the deficits in the budgets and in the main categories, income and expenditure.

Budget deficits have been necessary throughout in order to meet high levels of both current and capital expenditure. In the sixties and seventies, large amounts of budgetary resources were devoted to social welfare, particularly on food, education and health. The commitments in regard to these expenditures could not have been met out of the resources that could be mobilised from domestic sources. During the fifties and sixties the deficits were less influenced by the magnitudes of capital expenditure involved. In contrast budget making experience after 1977 was different because the size of the budget deficits was influenced by the high level of capital expenditure mainly, on very large projects.

### Factors Behind the Deficits

There were several reasons for the sharp increase in the budgetary magnitudes in the period after 1977. The first of these was the readjustment of the exchange rate, with a continuing sharp devaluation of the rupee from 1977 onwards. The effect of these downwards exchange rate adjustments was to inflate or sharply increase all rupee monetary values in the economy and in the budget. The entire cost structure in the country rose sharply within a very short period and this was because all costs were largely determined by the cost of imports of goods and services. Furthermore, the open economy policy made the economy more dependent on imports than before. Both the government and the private sector had always spent considerable sums of money on imports and after 1977 with the open economy policy these outlays increased much further.

The second reason for the large deficits after 1977 was the major investments which the government undertook on very large projects under its lead projects programme. Capital expenditure rose from Rs. 6614 million in 1978 to Rs. 29534 million in 1985. This was the first time in the history of country that projects of this size had been undertaken. Between 1977 and 1985, total capital expenditure was Rs. 133.9 billion, of which the estimated outlay on the lead projects would be about Rs. 50 billion. Quite apart from the size of the outlays, the costs of these projects tended to get inflated because most of them were undertaken by foreign contractors ; and costs after 1977 were expressed



in terms of a devalued rupee which tended to magnify real costs. To some extent these factors contributed to the very high level of expenditure which in turn has imposed considerable strain on the budgets, even though these projects were to a large extent financed by foreign aid. Since most of these projects had to be completed within a short period the government was not always able to exercise adequate controls over cost and waste.

The budgets presented in Parliament even in recent years were planned to produce a current account surplus. But it has been very difficult for the government to cut down current expenditure, especially with the large number of supplementary estimates that have been presented at various times. In the period before 1977, often supplementary estimates were presented to meet current expenditure associated with the social welfare programme, but after 1977 supplementaries had become necessary on account of additional commitments both in respect of current and capital expenditure. Although on most occasions government has budgeted for a current account surplus, the introduction of supplementary estimates has contributed to turn these programmed surpluses into substantial deficits.

After 1977 the government has found it increasingly difficult to effectively reduce the budget deficits, and as a result, the size of the deficits have been considerably higher than in the preceding decades. An equally important feature is the substantial curtailment of welfare expenditure after 1977 and this is seen in Table 2. More budgetary resources were diverted to major capital investments, while the principal channel of welfare expenditure was the food stamps which replaced the earlier subsidies. However, this expenditure on food stamps in real terms is small, and as a percentage of recurrent expenditure and total expenditure, the sum spent on food stamps has progressively fallen. In 1977 food subsidies took up 18.9 per cent of current expenditure, whereas in 1985 the share of food stamps in total current expenditure was only 5.1 per cent.

Upto the mid seventies government had a very comprehensive social welfare programme and in relation to total expenditure the size of outlays on social services was substantial. However in relation to the magnitudes of expenditure in the post 1977 period the amount spent on subsidies and welfare and on education and health has fallen and this is seen in the distribution of current expenditure on social services in Table 2. In 1963/64 the net expenditure on the food subsidy was Rs. 454 million, in 1956/66 it was Rs. 478 million and in 1969/70 Rs. 599 million. What is significant is that this low level of expenditure on welfare in the sixties has had a tremendous social impact. However, today, because essential food items are very costly and because welfare expenditure is made more selectively to a relatively smaller segment of the population, the current higher level of expenditure has a smaller impact. It is difficult to work out per capita figures to see how much has to be spent today to give the same basket of goods to the smaller population that is now entitled to food



TABLE 1.

## Government Fiscal Operations

	(Rs Million)								
	1961/62	1962/63	1963/64	1964/65	1965/65	1966/67	1967/68	1968/69	1969/70
Revenue	1620	1593	1759	1816	1833	1954	2156	2497	2736
Recurrent Expenditure	2076	1985	2220	2259	1860	1895	2186	2384	2658
Capital Expenditure	1580	1596	1834	1893	1976	2012	2321	2544	2873
Current Account Surplus or Deficit	— 456	— 389	— 461	— 443	— 27	61	— 30	113	78
Budget Deficit	510	439	519	550	682	723	850	947	4150
Financing the Deficit Domestic	479	406	366	384	610	490	640	40	457
Foreign	63	100	106	117	154	256	247	426	502
Expansionary Impact of Fiscal Operations	—	162	162	40	122	56	267	179	428
Gross Food Subsidy	—	—	454	463	478	—	578	630	599

Source: Central Bank of Ceylon.



Table 1 (Cont.)

## Government Fiscal Operations

	1969/70	1970/71	1971/72	1973	1974	1975	1976	1977
Revenue	2736	2815	3282	4054	4787	5084	5739	6686
Recurrent Expenditure	2659	2981	4647	3727	4500	5199	5664	6148
Capital Expenditure	1076	1054	1207	1334	1841	2536	3448	3182
Current Account Surplus or Deficit	77	— 166	—1365	327	287	— 115	75	538
Budget Deficit	936	1053	2195	981	1599	2699	3576	3074
Financing the Deficit Domestic	591	683	736	440	900	1610	2264	1766
Foreign	345	370	559	541	690	1059	1326	1326
Expansionary Impact of Fiscal Operations	424	218	111	— 54	24	184	605	— 715
Gross Food Subsidy	573	612	656	679	925	1230	973	1427

Source : Central Bank of Ceylon.



Table 1 (Cont.)

	Government Fiscal Operations							(Rs. Million)		
	1978	1979	1980	1981	1982	1983	1984	1985		
Revenue	11688	12730	14068	16228	17809	25210	37731	38041		
Recurrent Expenditure	10408	11502	13249	16005	37980	46860	53592	59498		
Capital Expenditure	6614	8991	13145	13737	18669	21733	21570	29534		
Current Account Surplus or Deficit	1288	1228	819	223	-20171	-21650	-15861	-21457		
Budget Deficit	7165	8791	16274	14866	20091	21606	15361	21457		
Financing the Deficit Domestic	2653	4592	9610	6696	11612	12250	3944	9100		
Foreign	1779	4237	6715	8208	8794	10950	11251	14071		
Expansionary Impact of										
Fiscal Operations	175	634	7029	3847	3675	474	-2095	-114		
Gross Food Subsidy	2162					1492				

Source : Central Bank of Ceylon.



stamps. In relation to the magnitude of total current expenditure the sum spent on food subsidies today is fairly small as seen in Table 2. In 1984 only Rs. 1492 million or 1.9 per cent of total expenditure was spent on food stamps.

### **Rise in Capital Expenditure**

The impact of the changes in the cost structure on budgetary operations in the seventies and eighties needs to be compared with those of the earlier decades. The budgetary operations of the seventies and eighties show a very large increase in the magnitudes in the budget, with the main items of income and expenditure running into billions. For instance the total capital expenditure in 1952 was only Rs. 379 million. This amount of money today is insufficient to complete a small project in the state sector. In that year the total current and capital expenditure barely exceeded Rs. 1 billion. But each of the lead projects under the present government have cost over Rs. 2 billion. Even in 1961/62 capital expenditure was Rs. 1580 million and recurrent expenditure Rs. 2076 million. Ten years later in 1972, the related figures were capital expenditure Rs. 1207 million and recurrent expenditure Rs. 4647 million.

The major problem in financial management after 1977 has been the progressive rise in capital expenditure. In 1977 total capital expenditure was only Rs. 3.1 billion and in 1985 it had reached the highest level of Rs. 29.5 billion. From 1979 a large portion of this deficit was financed through foreign aid. Government has found it difficult to mobilise adequate resources from local sources. In view of this it has depended heavily on foreign aid on both loans and grants, even though the share of the latter in total aid has been small.

### **Expansionary Impact of Budgets**

Table 1 gives an indication of the size of the deficits over a period of time and the expansionary impacts each year. Government very often has had to borrow from the Central Bank or issue Treasury bills to the Central Bank and in this process new money has been created resulting in the exertion of pressure on prices. The expansionary impact of the budget emerges when government borrows from the banking system or when there is a decline in cash balances and in aid counterpart funds. In 1962/63, the expansionary impact of the budget was Rs. 162 million, in 1965/66 it was less at Rs. 122 million. In 1967/68 it was Rs. 267 million and in 1970/71 Rs. 218 million. However, after 1977 the expansionary impact of the budget has risen several fold. In 1977 there was a negative impact and the budget was contractionary to the tune of Rs. 715 million. But by 1980 the expansionary impact had reached Rs. 7029 million and in 1982 it was Rs. 3.6 billion. However in 1983 and 1984 budgetary operations were less expansionary, because government was able to obtain more revenue from exports due to the boom in tea prices. In 1984 fiscal operations were contractionary to the extent of Rs. 2 billion and in 1985 Rs. 1.7 billion.



TABLE 2

## Summary of Budgetary Operations (Percentage of GDP)

<i>REVENUE</i>	1977	1978	1979	1980	1981	1982	1983	1984	1985
Revenue Tax	0.8	0.9	0.7	0.6	0.8	0.7	0.7	0.7	0.7
Crop Tax	1.8	1.7	1.9	2.6	1.7	2.1	2.0	2.5	2.4
Export Taxes	3.3	11.3	9.1	5.8	3.5	2.6	2.8	4.2	3.2
Import Duties	1.5	3.4	4.3	4.4	3.2	2.7	3.3	3.4	2.9
BTT	1.8	2.5	2.3	2.5	2.3	4.0	5.1	5.4	6.1
Excise Tax	2.3	3.1	2.5	2.5	2.2	2.1	1.9	1.8	1.8
Other Taxes	3.4	1.4	0.5	0.4	0.5	0.5	0.5	0.3	0.3
Other Non Tax Revenue	1.8	1.8	1.7	1.1	1.3	1.3	1.4	2.4	2.3
<i>CURRENT EXPENDITURE</i>									
Wages & Salaries	5.0	4.5	5.3	4.8	4.3	4.4	4.1	3.7	3.9
Goods & Services	2.1	2.7	2.8	2.8	2.5	2.4	2.4	2.1	3.6
Pensions	1.1	1.1	1.1	1.1	1.1	1.4	1.5	1.4	1.3
Transfers to Public Corporations	0.4	2.5	1.8	2.4	1.6	1.7	1.6	1.9	1.6
Subsidies to Households, Others	5.2	8.5	6.3	4.6	3.8	3.3	2.7	2.7	2.0
Interest Domestic	2.3	2.5	2.6	2.8	3.7	4.2	4.4	4.1	4.1
Interest Foreign	0.5	0.7	0.7	0.6	0.8	0.9	1.0	1.1	1.2
Overall Deficit	--5.8	--13.7	--13.8	--23.1	--15.5	--17.3	--13.4	--10.2	--8.7
<i>FOREIGN FINANCE</i>									
Loans	2.9	7.5	4.5	5.3	5.7	4.7	6.5	5.7	4.9
Grants		1.5	2.6	3.9	3.2	3.4	2.9	2.8	2.1
Commercial Credits				1.4	2.0	1.2	1.1		0.3



TABLE 2 (Cont.)  
Summary of Budgetary Operations (Percentage of GDP)

CURRENT EXPENDITURE (Percentage)	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Defence	3.7	3.2	3.6	3.1	3.4	3.0	3.0	2.4	4.1	4.6	9.0
Education	12.4	14.4	13.9	9.1	9.8	10.3	9.9	10.0	9.8	9.5	10.1
Health	6.2	6.9	7.4	4.8	5.4	5.4	5.3	4.8	5.3	5.6	6.2
Food Subsidy	25.9	19.5	18.9	26.5	20.1	2.2	1.9	0.5	0.3	0.3	0.3
Interest on Public Debt	13.3	15.0	16.4	13.3	14.6	16.8	23.9	25.5	27.9	28.2	26.3
<b>HOUSEHOLDS</b>											
Food Stamps (House holds) only half of total.	2.1	5.0	3.2	8.7	6.2	17.6	15.9	13.1	10.9	1.1	10.7
NSB, Social Service Dept. } Free Text Books.							(7.4)	(6.5)	(5.4)	(5.5)	(5.5)

Source : Central Bank of Ceylon.



This shows that success of budgetary operations in Sri Lanka and the ability to raise more revenue depends on the trends in commodity markets. In 1983/84, when tea prices went up, the budgetary resource problem was to a large extent overcome with additional revenue accruing to government. Government was able to increase its cash balance and repay its loans to the banking system. When commodity prices are low export taxes and other sources of revenue tend to fall and as a result problems emerge in finding adequate resources to balance the budget.

### **Inadequacy of Domestic Resources**

Sri Lanka has not been able to raise adequate revenue from domestic sources to meet its recurrent and capital expenditure. This has been the major problem of budget making. One reason for this is that the pattern of growth and the range of new economic activities that would contribute to generate additional revenue has been limited. Even where such new activities have emerged they have been given tax reliefs and liberal concessions. Large areas of economic activity have been given tax exemption and reliefs and this has aggravated the problem of trying to find additional resources to meet budgeted expenditure. These reliefs have been given at a time when the need to mobilise more resources had been far greater than before. With the result that those new activities have not contributed to revenue for at least the first five years, when their commercial performance has been possibly at its best. Far reaching changes have not been made in the tax base to generate more revenue. Even the changes that have been made upto now have been inadequate.

The tax base has been considerably widened from about 1970 onwards with a greater emphasis on indirect taxes such as the sales tax, business turnover taxes and others that fall into this category. Although this has contributed to widen the tax base and provide more revenue, yet this has been insufficient in terms of government's increasing expenditure commitments. The government has had a problem in extending these taxes because they have had an impact on the cost of living and social welfare. It will be relatively easy to get more tax revenue from basic and essential items that enter into everyday consumption, but there are limitations. Sales taxes could not be further extended because they effect the items of basic consumption and an increase in these taxes comes into conflict with the cost of living and income stabilisation policies.

The government has found it increasingly difficult to find new areas with bigger surpluses and profits which could be tapped for more revenue. However tax evasion has been increasing along with the increase in the volume of activities that do not easily come within the tax net. It would appear therefore, that there are clear upper limits to the imposition of particular taxes especially on essential consumer goods. The tax mobilisation effort today has been more



successful than in the earlier years. But these advantages have dwindled in the recent past because government expenditure within a vastly increased cost structure has gone up sharply in relation to revenue mobilisation.

Today there are many new activities which are difficult to effectively monitor for tax purposes. These incomes have arisen from areas such as smuggling, illicit trade in gems, drug trafficking, tender deals, hidden commissions and pay offs, bribery and corrupt practices,. The quantum of money involved in these transactions is very large and much of it is in the form of black money which now exceeds Rs. 40 billion. The latter sum is adequate to finance the entire Mahaweli Development programme consisting of the major projects that have been completed so far.

With regard to the gem trade, which has been rapidly declining since 1977, the quantum of funds that does not come within the tax net is enormous. Although official records do not show an increase in gem production, the illicit export trade in gems is as vibrant as it was in the early seventies and before. The annual production of gems is estimated to be about Rs. 6 billion, but the foreign exchange earnings from gem exports in 1984 was less than 400 million. Earnings of the gem mining and marketing trade is practically free of tax and the foreign exchange that accrues from exports that flows into the official coffers has been relatively small.

### **Foreign Aid and the Deficits**

A feature of fiscal operations before 1977 was that foreign finance and foreign aid was much less significant in financing budget deficits than today. This provided greater flexibility in budget making and in economic policy formulation. The low level of dependence on foreign finance meant that the country has had a greater measure of control over key variables, such as the exchange rate, the cost of living and welfare expenditure and that it could formulate policies independently. With the continuing dependence on foreign finance after 1977, Sri Lanka has been compelled, to some extent, to adjust its policies to the various criteria that have been laid down by donors and international funding agencies. The adjustments in policy that have to be made to conform to criteria laid down by international agencies has had a major impact on welfare expenditure, on the cost of living and other socially important variables. This may be characterised as an unfavourable secondary spin off of the present budgetary policies.

A large portion of the budget deficit has been financed from foreign sources, This feature was not there in the fifties and even sixties. In the 1965/66 budget, the overall deficit was financed to the tune of Rs. 384 million through domestic resources and Rs. 174 million through foreign resources. In 1971/72, which was not a good year, domestic resources provided Rs. 736 million and foreign resources Rs. 559 million to finance the deficit. In contrast the relevant magnitudes in recent years are very much larger. In 1980 the total budget deficit was



Rs. 16.2 billion, of which domestic rupee funds amounting to Rs. 9.6 billion and foreign funds of Rs. 6.4 billion were used to finance the deficit. After 1981 the quantum of foreign financing in budget deficits have been very much larger. In 1983 the total amount of foreign resources used to finance the budget deficit was Rs. 10.9 billion and local Rs. 12.2 billion. In 1985 foreign financing to the tune of Rs. 14 billion and local finance of Rs. 9.1 billion was used to finance the deficit.

The country therefore has been increasingly dependent since the early eighties on foreign finance to bridge budget deficits. The question is whether this is a prudent course of action. It is all well and good for the years concerned and when the debt service ratios are low, but thereafter, serious problems have emerged. The increasing dependence on foreign finance means that economic policy will be subject to greater conditionality. External agencies will continue to impose less favourable conditions as the economic situation worsens. The dependence on foreign finance has increased by leaps and bounds and this feature has taken a dominant place since 1984.

TABLE 3.  
Public Debt

	Foreign	%	Domestic	%	(Rs. Billion) Total
1973	2.7	23.1	7.5	76.9	11.3
1974	20.8	22.7	8.1	77.3	12.3
1975	3.7	25.5	9.2	74.5	14.5
1976	4.9	27.8	10.6	72.2	17.6
1977	10.5	42.1	11.8	57.9	24.9
1978	14.5	46.9	13.1	53.1	30.9
1979	15.8	44.6	19.6	55.4	35.4
1980	22.2	43.0	24.5	57.0	51.6
1981	29.1	44.8	29.4	55.2	64.9
1982	34.5	40.1	36.6	59.9	85.9
1983	46.0	53.4	40.3	46.6	86.3
1984	53.6	51.0	42.0	49.0	105.9
1985	64.3	56.1	50.1	43.9	114.5

Source : Central Bank of Ceylon.



From 1984 onwards for the first time in the history of Sri Lanka the foreign debt has exceeded the size of the rupee debt. For the year 1984 the total foreign debt was Rs. 53.6 billion while the local debt was Rs. 52.2 billion. From 1986 onwards the country will be facing a very serious debt service problem, where increasing amounts of current foreign exchange earnings will have to be set apart for the repayment of debt. In the eighties government followed the easy course of bridging budget deficits by resorting to foreign finance, the present economic problems have confirmed that this is not a prudent course of action.

### **Monetary Policy**

The new open economy policy of the government tended to increasingly depend on monetary controls and indirect means of regulating the economy. Direct action was minimised and the forces of supply and demand were allowed to come into play. Accordingly from the outset, monetary measures began to play a major role in economic management and from the last quarter of 1977 an active interest rate policy came into operation with a view to mobilising more resources and selectively influencing the volume, direction and of flow of credit. Changes in interest rates became a major weapon of monetary control. The introduction of these methods of economic management were largely influenced by the strategies advocated by the International Monetary Fund and the World Bank.

In 1977 the money supply rose very sharply by Rs. 1200 million. This was an increase of 29 per cent, as against an increase of 35 per cent in 1976, 5 per cent in 1975 and 6 per cent in 1974. Between 1973 and 1977, therefore, the money supply almost trebled with the bulk of the increase taking place in 1976/77. The main reason for the sharp increase in the money supply in 1977 was the substantial increase in external banking assets which rose by Rs. 1943 million during that year. In the previous year external banking assets had risen by Rs. 470 million. The increase in time and savings deposits, to some extent, tended to offset the expansionary impact of the increase in external assets. However, the increase in time and savings deposits took place mainly in the last quarter of 1977 following the increase in interest rates.

### **Reliance on Interest Rates**

The monetary measures which were introduced after 1977 had not been used in earlier years in the way they were then deployed. The various instruments used were a part of a package of economic measures which were designed to stimulate rapid growth and mobilise more resources internally, mainly through deposits in the financial system. In 1977 significant changes were effected in interest rate policy with the movement towards a system of appreciably higher interest rates. The focus of the new interest rate policy in 1977 was directed at the short end of the market and the upward revision in Bank rate was designed to raise the entire interest rate structure. The first revision in Bank rate was



made on 26th January 1977 when it was raised from 6.5 per cent to 8.5 per cent and that was before the package of new economic measures were put into operation. It was further raised by 1.5 per cent to 10 per cent on 31st August 1977 as a part of the new economic policy. The latter revision was associated with restrictions on Central Bank lending to commercial banks..

Following the new higher rates the National Savings Bank raised its deposit rates. The rate on fixed deposits was raised sharply in September 1977 from 7.5 per cent to 12 per cent on six months deposits and to 15 per cent on 12 month deposits. This upward revision in short term interest rates quickly led to an increase in the lending rates of commercial banks. This was also followed by an upward movement in the rate on inter-bank call loans. There was a sharp increase in the lending rates, and the minimum and maximum discount rates on commercial bills rose from 8.5 per cent and 13 per cent to 11 per cent and 21 per cent respectively. Finance companies also raised their rates on deposits to much higher levels even though their rates had been customarily appreciably above the rates of the commercial banks and the National Savings Bank. The rise in the long term rates was reflected in the minimum lending rates of the Development Finance Corporation which rose from 12.5 per cent to 15 per cent and that of the State Mortgage Bank from 12 per cent to 16 per cent. The minimum and maximum rates of the Agricultural and Industrial Credit Corporation moved up from 9 per cent and 12 per cent to 12 and 15 per cent respectively.

For the first time interest rates which had hitherto failed to reflect market conditions were permitted to move up in sympathy with the general economic trends in the country. It was taken as a major step towards containing widespread monetary expansion arising from the activation of the economy. In the last quarter of 1977, mainly as a consequence of higher deposit rates, there was a significant increase in total time and savings deposits in commercial banks. From an average monthly rate of accumulation of time and savings deposits with commercial banks of Rs. 77 million before 1977, in the period after the interest reform it rose to Rs. 146 million.

### **Restriction of Commercial Bank Access to the Central Bank**

Along with the higher interest rates commercial bank borrowing from the Central Bank at Bank rate was restricted to 7 per cent of selected items of assets as at 30th June 1977. Central Bank accommodation was subject to a penal rate of 15 per cent for 30 days and an additional 1 percentage point for each period of 30 days beyond the initial 30 days period. On November 16th 1977 Central Bank accommodation at Bank rate was reduced to 4 per cent of selected items as at 30th September 1977. This limit was revised upward from 23rd December 1977 by Rs. 100 million for export financing. The proportion of reserve requirements which commercial banks were permitted to hold as till cash, imposed in October 1976, was completely withdrawn on December



2nd 1977. Banks were informed not to increase their advances for non essential purposes and to non bank financial institutions engaged in lending money and on hire purchase activities.

Despite these monetary measures the rate of the monetary expansion in 1977 was not significantly lower than that of 1976. Even though it is claimed that these measures have had a positive effect on the monetary expansion. However since the major underlying factor behind the monetary expansion in 1977 was the growth in external banking assets, monetary policy alone could not have had an impact in controlling the increase in these assets. The policy of the Central Bank in restricting credit helped to further increase external assets by restraining the flow of imports.

### **High Interest Rates and Deposit Mobilisation**

In 1978 the rate of monetary expansion fell substantially and the money supply increased by Rs. 570 million or by 11 per cent during the year. This must be compared with the annual increase in the money supply of 35 per cent and 29 per cent in 1976 and 1977 respectively. The annual rate of monetary expansion in 1978 declined progressively from 35 per cent in January to 14 per cent in June, however in December 1978 there was a noticeable decrease when it reached 11 per cent. The main reason for this reduced monetary expansion was the contraction resulting from fiscal operations of the government sector and the sharp increase in time and savings deposits of the non bank private sector of a little over Rs. 3000 million during the year. But owing to the heavy build up of time and savings deposits the net result of the increase in credit to the private sector was an expansion of only Rs. 88 million. A favourable result of the high interest rate policy was the rapid mobilisation of fixed and savings deposits. Much of the higher earnings from new economic activity and the proceeds of remittances from overseas earnings went into these deposit accounts.

The year 1978, witnessed a significant growth in the resources of commercial banks which increased by Rs. 3585 million or 35 per cent. The growth in deposits provided the main thrust to the resources build up in 1978 and thereafter and the increase in time and savings deposits contributed the major share. During the year external banking assets rose by Rs. 1523 million as against Rs. 1943 million in 1977. This sharp increase in external banking assets was mainly due to grants and credits that the government received from abroad. Although the capital account of the balance of payments showed a substantial increase, the current account showed a deficit.

### **Ceiling on Credit**

In 1978 there was no noticeable change in the level and structure of interest rates. Bank rate remained at 10 per cent and the Treasury bill rate at 9 per cent. The Central Bank felt that high interest rates alone were not effective in



restraining credit adequately. On March 27th, 1978 the restrictions on commercial bank credit to non bank companies engaged in the business of lending money or hire purchase activity, excluding credit granted for financing capital equipment and new commercial vehicles, were intensified. From June 1978 an attempt was made to restrict commercial bank credit to the government corporations and statutory boards by means of an overall ceiling on such credit as at the level outstanding on 28th June 1978. This however gave rise to certain difficulties and the ceiling had to be modified with regard to the credit requirements of government institutions. This ceiling was raised by 5 per cent with effect from 15th July and by 12 per cent with effect from 7th August, 1978. Thus increasing the level of commercial bank accommodation to government corporations and statutory boards by 17 per cent over the level of such advances as on 20th June 1978.

The tight monetary policy pursued during the year through high interest rates and credit ceilings helped to moderate the rate of monetary expansion. This was so despite the fact that there was a deceleration in the monetary expansion due to the government financial operations and the substantial build up of time and savings deposits by the non bank private sector. The time and savings deposits of the non bank private sector with commercial banks rose by Rs. 1605 million during the year. This enabled the commercial banks to accommodate the sharply increased credit requirements of the private sector, which had been a major cause of inflationary pressures. Furthermore, the withdrawal of the till cash concession enabled the Central Bank to immobilise a substantial volume of funds from the commercial banks which would otherwise have formed the basis for credit expansion. The operation of the penal rate discouraged commercial banks from resorting to Central Bank credit.

### **Monetary Expansion Accelerates**

In 1979 the Colombo Consumers Price Index rose by 11 per cent, as against an increase of 12 per cent in 1978 and 1 per cent in both 1976 and 1977. On a point to point basis the increase in the index was much higher at 15 per cent. The money supply rose by Rs. 1933 or by 29 per cent. A substantial increase in external banking assets was the main reason for the acceleration of the rate of monetary expansion in 1979. The operations of the government sector had an expansionary impact on the money supply of Rs. 477 million. This was due to the fact the government had increasingly borrowed from the banking system. The operations of the private sector however resulted in a contraction of Rs. 222 million. Commercial bank credit to the private sector rose by nearly Rs. 2600 million which was largely offset by the considerable build up of time and savings deposits to the tune of Rs. 2500 million. The one factor that helped to contain the monetary expansion was the continuing flow of time and savings deposits to financial institutions. It also helped the banking system to meet the growing needs of credit in the private sector.



Despite a sharply worsening current account in the balance of payments the increase in external assets was mainly due to the additional resources which were available through foreign aid from overseas which was recorded in the capital account. There were no fundamental changes in the level and structure of interest rates during 1979. Although Bank rate remained at 10 per cent however with effect from 4th September, 1979 a progressively increasing graduated scale of penal rates ranging between 15 and 25 per cent were introduced in order to discourage commercial banks from resorting to excessive Central Bank accommodation. The fairly high penal rates did not directly affect the deposit and lending rates of commercial banks, but it pushed up the inter-bank call loan rate from the previous level of 7 and 9 per cent to a level between 10 to 30 per cent.

### Further Increase in Penal Rates

The second half of 1979 witnessed increased monetary pressures which called for the adoption of further steps to restrict the increase in the money supply. Attention was therefore directed towards rationalizing the existing monetary measures with a view to making them more effective and the preference was for cost restrictions than for quantitative restrictions. Accordingly, further restrictions were imposed on Central Bank accommodation to the commercial banks with a view to limiting their credit creating capacity. Experience had shown that the penal rate of 15 per cent did not act as a sufficient deterrent to discourage commercial banks from resorting to substantial borrowings from the Central Bank. This was because of the heavy demand for credit even at the high rates that were prevailing. With the effect from 4th December 1979 the volume of accommodation available at Bank rate was raised from Rs. 402 million to Rs. 613 million, consisting of Rs. 403 million in general accommodation which was 4 per cent of the selected assets of commercial banks outstanding as on 30th June 1979 and Rs. 210 million in export credit refinance, distributed among banks on the basis of outstanding export credit as at December 31st 1978. Any excess borrowings above these limits were subject to the graduated scale of penal rates of 15 per cent on the first 10 per cent of eligibility 16 per cent on the second 10 per cent, 18 per cent on the third 10 per cent, 20 per cent on the fourth 10 per cent and 25 per cent thereafter. The introduction of the graduated scale of penal rates discouraged most of the banks from borrowing from the Central Bank at penal rates and this helped to appreciably reduce their credit creating capacity.

The experience in the first half of 1979 had shown that there was increasing pressure from government corporations and the state sector for commercial bank credit and the banks felt themselves obliged to provide accommodation in excess of the ceiling. Therefore the ceiling on credit to government corporations was withdrawn on 4th September 1979. As a result of these measures the average monthly increase in bank credit to the private sector, which amounted of Rs. 262 million during the eight month period ending August 1979, dropped to Rs. 78 million in the period September — December 1979.



## Sharp Increase in Prices

In 1980 the Colombo Consumer Price Index rose by 26 per cent as compared to 11 per cent in 1979. On a point to point basis the increase in 1980 was 25 per cent over the 12 month period. This was a reflection of the progressively increasing inflationary pressures which had emerged in the economy as an aftermath of the 1977 economic policy. The background to this inflationary trend was the sharp expansion in domestic credit and the devaluation of the rupee. External banking assets, on the other hand fell substantially and figured as a deflationary factor. External banking assets declined by Rs. 4096 or by 85 per cent during the year. This development was a complete reversal of the trend that had been observed since 1976 when external banking assets showed continuing growth thereby adding to the expansion. The domestic credit expansion in 1980 was Rs. 1774 million, an increase of over 80 per cent. There was an increase in credit both to the private sector of Rs. 5123 million and to the government sector of Rs. 6415 million. The credit expansion of this magnitude was unparalleled. The money supply rose by Rs. 1759 million or 23 per cent and this increase was more or less equal to that which occurred in the preceding year.

The government made heavy demands on bank financing on account of the sharp increase in government expenditure on the large capital projects it had commenced. The budget deficit in 1980 was Rs. 15270 million as compared to Rs. 8791 million in 1979. Credit to public corporations rose by Rs. 776 million or by 23 per cent. The external sector however had a contractionary impact on the monetary situation. In 1980 there was a significant deterioration in the balance of payments position resulting from a sharp increase in the import bill. The trade deficit in 1980 was Rs. 16140 million as compared with the deficit of Rs. 7288 million in the previous year. This deficit was financed by capital resources available from the IMF and market borrowing, which still left a large deficit which had to be financed by running down accumulated reserves.

## Further Intensification of Measures

The monetary policy measures adopted since 1977 were intensified in 1980 with a view to improving their effectiveness. The graduated scale of penal rates was designed to make the commercial banks more cost conscious and this was particularly applicable to the two state banks. By the end of the first quarter, commercial bank borrowing from the Central Bank at the Bank rate and at the penal rates, rose sharply to Rs. 394 million and Rs. 927 million respectively. Much of these borrowings were to finance imports. In the context of the very high rate of inflation in the fourth successive year there were signs of a setback to the deposit mobilization effort since August-September 1977. There was a need then to further restrict the credit creating capacity of the commercial banks and to provide a more positive return to savers.



TABLE 4.  
Key Monetary and Economic Variables.

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Money Supply (Rs. M)	3088	4165	5365	5936	7669	9428	10024	11750	14747	15546	16823
Demand Deposits	1882	2751	3351	3820	4834	6687	6511	7271	9067	10339	9865
Fixed & Savings Deposits (Rs. M)	3384	4177	5938	8115	11732	15519	20280	27913	34292	38392	46584
(a) Commercial Banks	2244	2756	4627	6965	10427	13779	19124	23641	28828	31468	37071
(b) National Savings Bank	1656	1958	2544	3019	4222	4909	5396	7631	9423	11538	12419
External Banking Assets (Rs. M)	— 361	108	3705	5589	6807	3630	2940	2371	3186	8964	10555
Total Credit (Rs. M)	6212	7252	8774	10674	14971	25803	33966	42397	48681	49926	55784
(a) Government	2809	3267	2989	1863	2929	8972	12789	17150	17533	1455	19133
(b) Private Sector	3535	4250	6345	8827	11947	17000	21152	25361	31415	35102	46652
Commercial Bank Excess Reserves (Rs. M)			47	55	40	42	151	171	169	232	98
Colombo Consumers Price Index	198.3	200.7	203.2	227.8	252.3	318.2	375.4	416.1	474.2	553.1	582.2
Wholesale Price Index	—	—	135.3	156.7	171.6	229.5	268.5	283.3	254.1	444.7	353.8
Bank rate	6½	6½	10	10	10	12	14	14	13	13	13

Source: Central Bank of Ceylon.



At the same time the commercial banks continued to make numerous requests to the Central Bank for the enhancement of the export credit refinance facility. As a result of these requests, effective April 1980, the export credit refinance facility was raised by 15 per cent to Rs. 30 million with a view to providing further relief to the commercial banks. Total export credit facilities available at Bank rate moved up to Rs. 230 million. Effective 21st April 1980 Bank rate was raised from 10 to 12 per cent. In order to further discourage commercial bank borrowing from the Central Bank the penal rate structure was raised from 15 — 25 per cent to a range 20 — 30 per cent. Following this move the Treasury bill rate moved up to 13 per cent. As a result the lending rates of commercial banks and other medium and long term credit institutions were raised.

As a consequence of the intensification of the monetary measures the annual growth rate of the narrow money supply dropped by 25 per cent between April and September 1980 and commercial bank borrowings from the Central Bank declined from Rs. 1487 million in April to Rs. 736 million as at the end of September. The reduced use of Central Bank accommodation caused increased pressure in the inter-bank call money market, pushing up call rates to the unprecedented high level of 25 per cent towards the end of the year. In 1980, despite the progressive and rapid decline in international reserves, domestic credit expansion and the growth of monetary aggregates continued at fairly high levels bringing renewed pressure on the price level. However by the end of the year there were disturbing developments in the monetary situation with sharp increases both in the narrow and the broad money supply.

#### **A Slightly Lower Rate of Monetary Expansion**

During 1981 there was some moderation in the monetary expansion. Domestic credit which expanded at the unprecedented rate of 81 per cent in 1980 registered a much lower increase of 33 per cent. During the year external banking assets declined at a lower rate of 19 per cent as compared to a decline of 47 per cent in 1980. The narrow money increased by Rs. 596 million or by 6 per cent while broad money rose by Rs. 4587 million or by 23 per cent as compared to an increase of 38 per cent and 32 per cent in 1979 and 1980 respectively. The moderation in monetary expansion was due to a satisfactory fiscal performance and results produced by monetary measures. The rate of monetary expansion slowed down appreciably in the second half of the year and the rate of inflation in 1981 appears to have somewhat moderated due to effective demand management policies. The Colombo Consumers Price Index registered an increase of 18 per cent in 1981 as against a rise of 26 per cent in the previous year. The annual average increase in the Central Bank Wholesale Price Index in 1981 was 17 per cent as compared to 34 per cent in 1980.

In 1981 monetary policy was conducted against a background of an increase in credit and a continuing increase in the price level, particularly in the first quarter of the year. The policy measures introduced in the previous year were



continued and were further intensified during 1981. In 1981, the Central Bank enhanced the export credit refinance facility with a view to providing further relief to the commercial banks and to promote exports. The refinance facility was raised to Rs. 230 million and the general accommodation facility granted to commercial banks at Bank rate was reduced from Rs. 473 million to Rs. 462 million. The accelerated demand for credit experienced during the first quarter of 1981 was partly due to the higher demand for credit in connection with the lump sum depreciation concessions provided on machinery and equipment which was expected to be valid only upto 31st March 1981.

### **Direct Credit Restraints and Use of Reserve Ratios**

The continued expansion in credit aggravated inflationary pressures, particularly in the first quarter of the year and spelt out the need for the further intensification of monetary measures with a view to restraining the rate of growth of monetary aggregates. In this context the use of traditional monetary policy measures would have taken a longer time to bring about the desired results. Hence the Central Bank was compelled to resort to direct credit restraints on commercial bank advances to the private sector and government corporations. With effect from 11th March 1981 commercial banks were requested (a) to ensure that the total amount of advances to the private sector during the period beginning 25th May 1981 does not exceed the total amount of such advances granted and outstanding as on 11th May 1981. (b) the total amount of advances granted to the private sector and outstanding on and after 26th May 1981 did not exceed the total amount of such advances granted and outstanding as on 31st March 1981. During the two week period when these credit restraints were in operation they were instrumental in bringing down credit to the desired levels. Consequently the restrictions were withdrawn with effect from 1st June 1981.

With effect from 15th June 1981 the Central Bank accommodation to commercial banks at Bank rate was further reduced from Rs. 467 million to Rs. 108 million, subject to minimum of Rs. 10 million for each bank. Effective June 1981, the statutory reserve ratios with respect to time and savings deposits were raised with a view to tightening excess liquidity in commercial banks resulting from the continuous increase in deposits. Accordingly the reserve ratios on demand deposits were raised from 12 to 14 per cent and on time and savings deposits from 5 — 6 per cent. This was the first occasion after 1977 when the reserve ratio instrument was used to control bank liquidity.

In addition to this general quantitative measure there was a need to further increase the cost of credit to commercial banks and to make reserves more expensive. Therefore with effect from 17th August 1981 Bank rate was raised from 12 to 14 per cent and the penal rates on Central Bank accommodation to commercial banks were raised from a range of 20 — 30 per cent to a range of 21 — 30 per cent. However the interest rate on export credit refinance



continued to remain unchanged at 12 per cent. The increase in Bank rate and in the general rate structure, reflected a more restrictive accommodation policy approach and was intended to further tighten money market conditions and the cost of funds.

A notable feature of interest rate policy in 1981 was that unlike in previous years the increase in Bank rate did not result in a general upward movement in deposit rates. The National Savings Bank did not raise its interest rates on deposits. Effective mid 1981, some commercial banks however raised their lending rates ; particularly advances granted for the construction of houses were raised from 13 — 25 per cent to 14 — 16 per cent and the rates on credit for other construction moved up from 14 — 27 per cent to 16 — 30 per cent.

### **Open Market Operations**

The year 1981 was important with respect to monetary policy in view of the introduction of open market operations in the policy package. For the first time since the sixties the Central Bank had used interest rates, open market operations and the variation of reserve ratios, the three major quantitative monetary instruments in the same year with a view to controlling monetary aggregates. With the introduction of the secondary Treasury bill market on 21st April 1981 the Central Bank engaged in open market operations in a more effective way. The Central Bank initiated the sales of Treasury bills at discount rates between the range of 15 to 16 per cent per annum. During the earlier stages of this operation the market was not very active, because of low short term rates prevailing in the call money market, which was 11 — 14 per cent. However, due to the short term liquidity problems experienced by commercial banks in response to monetary policy measures, the call money market rate rose to a peak of 19 — 23 per cent by mid year. Although there was a lull in activity in the secondary Treasury bill market by mid year, with the improvement in liquidity management of commercial banks in the last two quarters of 1981 the secondary Treasury bill market became active once again.

### **Reduced Inflationary Pressures**

The notable feature of the economic situation in 1982 was the reduction in the rate of inflation. After three successive years of high increases in the price level, the rate of increase in the general level of prices dipped to a single digit figure. The average rate of increase in the Colombo Consumers Price Index in 1982 was 10.8 per cent,<sup>1</sup> while the increase registered by the Wholesale Price Index was 5.5 per cent. The comparable increase in 1981 was 18 per cent. The lower rate of inflation was due to the government pursuing the policy of

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1. The Colombo Consumers Price Index has always been defective and independent estimates show that the rise in prices was much higher.



controlling the size of the budget deficits. The Central Bank continued its tight monetary policy thus achieving some success in demand management. Stability in prices of some of the imported goods due to lower prices in the world markets contributed in a substantial way to support the fiscal and monetary measures.

In 1982 the broad money supply rose by Rs. 6063 million or 25 per cent, compared to an increase of Rs. 4587 million or 23 per cent in 1981. During the year the narrow money rose to Rs. 1735 million or 17 per cent. However the rate of growth of time and savings deposits was markedly low, quite in contrast to the trends in earlier years. This was partly associated with the general down-ward trend in deposits. In 1982 domestic credit expansion ran at a slightly lower rate. The expansionary impact of these factors was partly offset by a drop in external banking assets by Rs. 568 million or 19 per cent. Government borrowing from the Central Bank rose by Rs. 3896 million or 28 per cent, as against an increase of Rs. 3139 million or 29 per cent in the preceding year. The banking system remained highly liquid during the most part of the year.

Expansion in the major monetary variables experienced in 1982 did not call for any major policy changes during the year. However the policy measures introduced in the previous years were continued. The high interest rate policy introduced in 1977 and intensified thereafter was continued notwithstanding the lower rate of inflation. During 1982 certain changes were introduced to the existing policy package in the field of supply promotion activities. The export sector was recognized as a vital sector in the economy and the provision of adequate medium and long term credit to the export sector became a major factor ; and the Central Bank increased the quantum of refinance to that sector. With effect from 3rd February 1982 commercial banks were allowed to resume loans and advances to non banking companies and bodies engaged in the business of lending monies to the public or engaged in hire purchase activities in excess of their total loans and advances outstanding on 30th June 1976. There were no major changes in the interest rate structure in 1982, because the banking system was very liquid. Accordingly the commercial banks reduced interest rates on all classes of fixed deposits in an attempt to lower the cost of funds. Interest rates on fixed deposits were reduced by a margin of 2 to 5 per cent.

In 1983 the narrow money supply rose by Rs. 2988 million or 25 per cent, when compared to an increase of Rs. 1735 million or 17 per cent in 1982. Meanwhile the broad money supply rose by Rs. 3759 million or 20 per cent as against an increase of Rs. 4328 million or 30 per cent in 1983. The decline in the growth of broad money was partly due to the outflow of deposits from commercial banks and other financial institutions after the downward adjustment of interest rates. The fall in the rate of monetary growth in 1983 was partly



due to a reduction in the rate of increase of domestic credit. Compared to an increase of Rs. 8431 million or 16 per cent in 1982, the increase in domestic credit in 1983 amounted Rs. 6895 million or 25 per cent. The volume of credit given by the Central Bank to government was also lower. The government used Central Bank profits amounting to Rs. 1.5 billion in March 1983 to reduce government indebtedness to the banking system. The government was also able to increase its revenue collections due to high import duties, turn over taxes and increased receipts from taxes on tea.

### **Renewed Increase in Prices**

The main feature of price trends in 1983 was the reversal of the downward trend in prices experienced in the two preceding years. The annual average increase of the Colombo Consumers Price Index in 1983 over the preceding year was 14 per cent, compared to 10 — 8 per cent in 1982. The corresponding increase in the Wholesale Price Index of the Central Bank was 25 per cent in 1983 compared to an increase of 5.5 per cent in 1982. Some part of this increase in the price level was the result of the rising prices of export commodities which caused increases in the domestic market prices of these products. There were also upward revisions of turn over taxes, transport fares and certain items of essential goods.

During 1983 only marginal changes in interest rates were affected with the increasing focus on export led growth. It became necessary to provide concessional credit to the export sector. The Central Bank felt that the high interest rate policy pursued for demand management purposes had some unfavourable effects on the working capital requirements of priority sectors due, to the high cost of credit. With effect from 24th March 1983, the Central Bank reduced Bank rate from 13 to 14 per cent. The penalty rate structure was reduced from a range to 21 — 30 per cent to the average rate of 20 to 30 per cent with effect 13th March 1983. These measures were expected to reduce the cost of funds borrowed by commercial banks from the Central Bank, thereby, providing cheaper credit to priority areas. In furtherance of the latter objective the Central Bank lowered refinance rates on preshipment export credits from 12 to 11 per cent in March 1983 and further from 11 to 10 per cent in June 1983. The interest rate on export credits for non traditional exports was also revised downwards from 8.5 per cent to 7 per cent per annum with effect from 1983.

### **Increase in Reserve Requirements**

With effect from April 1983 the National Savings Bank the principal competitor of the commercial banks for time and savings deposits, reduced its deposit rate from 20 to 18 per cent per annum, on those paid at maturity and from 15 to 14 per cent on those deposits that earned interest monthly. The National Savings Bank also discontinued the practice of accepting 24 month fixed deposits



Following the reduction in the general interest rate structure, long term lending institutions like the Development Finance Corporation of Ceylon and the National Development Bank also reduced their interest rates. The demand for credit rose to higher levels in the second half of 1983 and this contributed to reduce the liquidity of commercial banks and hence the call money rates rose to a very high range of 20 to 37 per cent by the end of the year.

In this background of renewed credit expansion and increasing inflationary pressures the Central Bank imposed a credit ceiling on commercial bank advances to the private sector with effect from 1st November 1983. Commercial banks were required to ensure that the total amount of their advances to the private sector outstanding as on 1st November 1983 did not exceed the total of such advances as at 31st October 1983. This credit ceiling was withdrawn on 30th November and in its place with a view to immobilising bank resources statutory reserve requirements were increased from 14 to 16 per cent on demand deposits and from 6 to 8 per cent on time and savings deposits. In addition, for the first time, the Central Bank with effect from 16th December 1983, introduced a reserve ratio of 16 per cent on unutilized overdraft limits of the private sector held with commercial banks. Furthermore with effect from 14th November 1983 the Central Bank reduced the quantum of accommodation available at penal rates from 90 per cent of the value of collateral submitted by the banks to 50 per cent and further to 25 per cent on the 22nd November. With effect from 23rd November 1983 advances at the penal rate were discontinued and the commercial banks were required not to exceed the quota allocated to them at Bank rate for temporary liquidity requirements.

### **Intensification of Monetary Measures**

The main feature of price movements in 1984 was the sharp increase in prices in the first half of the year and the deceleration of prices in the latter half of the year. The Colombo Consumers Price Index registered an increase of 17 per cent on an annual average basis in 1984, as compared to 14 per cent in 1983. The Wholesale Price Index increased by 26 per cent in 1984 compared to 25 per cent in the previous year. However despite these price trends there was a deceleration in the money and credit aggregates in 1984 as compared to the previous year. The narrow money supply rose by Rs. 2076 million or 14 per cent, as against the much higher increase of Rs. 1988 million or 25 per cent in 1983. The major reason for the increase in money supply in 1984, despite the deceleration in domestic credit, was an increase in external banking assets due to the boom in the tea market.

The aim of monetary measures taken in 1984 was to achieve monetary stability in the background of a high liquidity situation in the economy. In this context the measures taken in 1983 were intensified in 1984. The general accommodation facility made available to commercial banks at Bank rate was withdrawn while the pre-shipment export credit refinance facility was enhanced



by an equal amount. Furthermore, the Central Bank employed a number of selective credit control measures to contain the demand for funds for non priority purposes and to ensure adequate credit facilities to priority sectors. The refinance facility on pre-shipment export credit was further enhanced by Rs. 100 million and another Rs. 300 million exclusively for tea exports. With these changes the overall limit on the export credit refinance facility was Rs. 1778 million. Along with these measures the Central Bank introduced regulations to ensure that export proceeds would be rapidly repatriated.

In order to restrict credit for non essential imports the Central Bank imposed a ceiling on credit for such imports and banks were required not to afford forward exchange facilities for non essential imports. The Central Bank also took steps in 1984 to safeguard the interest of depositors in finance companies by imposing a liquidity ratio of 10 per cent of their total deposits. In addition finance companies were required to maintain a part their assets in the form of Sri Lanka government Treasury bills and securities equal to 3 per cent of their average deposit liabilities. Since in the first quarter of 1984 there was a rapid expansion of credit to the private sector the Central Bank informed the banks, effective 16th May 1984, that the amount of their loans and advances granted and outstanding to the private sector, excluding those for exports and agriculture, should not exceed 5 per cent of the amount of such advances as on 11th May 1984.

Since the economy was very liquid the Central Bank decided to mop up liquidity through the issue of its own securities in terms of section 91(1) (6) of the Monetary Law Act. In order to further siphon off excess liquidity and to restrict credit, banks were instructed on 14th November 1984 to keep special reserves with the Central Bank in respect of their incremental deposits in addition to the statutory requirements already maintained. These measures had the effect of substantially reducing excess liquidity in the non bank private sector and commercial banks.

In sum these measures were effective in restricting both credit and liquidity in the economy. However it needs to be emphasised that 1984 was year which generated a substantial volume of liquid resources in the economy on account of the boom in tea prices. The Central Bank therefore was not able to appreciably influence the increase in external banking assets which was the major cause of the monetary expansion. More than in any other year, in 1984, the Central Bank endeavoured to utilize a wider range of monetary instruments to deal with the increase in credit and liquidity. Since 1977 it has deployed the widest range of measures and monetary instruments, both quantitative and selective, in an endeavour to achieve its objectives.



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