CHAPTER IV

LIBERALISATION OF THE ECONOMY AND INDUSTRIALISATION SINCE 1977
The 1977 elections mark a clear watershed not only in the political evolution but also in the economic development of Sri Lanka. The new government's decision to discard the old inward looking policies and to launch upon expansion of activities, supported by import liberalisation, accelerated the economic development. The changes ushered in deserve a closer analysis as they represent a totally different economic philosophy, aspirations and approach. They represent a clear break with the past and paved the way for the starting of new industries and joint ventures. As these developments are of great significance, in this chapter, it is proposed to make a detailed study of the government policies and the reaction of the investors, both local and foreign, to the various innovative schemes, besides the general industrial climate in the country. The industrial development has to be seen in the wider backdrop of economic development and the growth of infrastructure.

The 1977 elections turned out to be a historic event. In returning the U.N.P. with an overwhelming majority the electorate revealed its keen desire for changes in both internal and external policies. No defeat in the annals of the island's volatile parliamentary history has been quite as comprehensive as that suffered by the S.L.F.P. in July 1977. The U.N.P. won 140 out of 160 seats and the S.L.F.P. was reduced to a rump of eight seats with the Marxists of

all shades drawing a blank. It was claimed to be a forthright rejection of the undemocratic excesses of Sirimavo Bandaranaike regime.

J.R. Jayewardene, who had twice rebuilt the U.N.P. from the ashes of defeat, once in 1956 and again after he took control of the party in 1973, appeared to be certain of victory right throughout the campaign. Jayewardene promised that his government would dedicate itself to establish a just and free society. The accumulated frustration and the expectations of the fulfilment of the well orchestrated promises of the U.N.P. made the people give the party a unique opportunity to decide the destiny of the country.

The U.N.P. Manifesto:

The U.N.P. pledged to the people that it would restore all democratic freedoms, abrogate repressive legislations, remove discrimination against minority races, ensure ownership of the means of production, distribution and exchange, by the workers themselves, give equal opportunities to all in education, open up the economy to the rest of the world, establish a free trade zone, increase employment opportunities and foster the country's cultural and moral values. As the Party Manifesto put it "In sum set up a righteous society on our religions in which incorruptible men and women would direct the destinies of

2. Ibid.

the people towards a non-exploitative and non-acquisitive, democratic socialist society". After assuming powers Jayewardene and his colleagues brought about changes in the style and manner of government. J.R. Jayewardene declared a year after the elections:

We fought the elections on a manifesto seeking a just and free society. We have created a free society in this country. Very few countries in the world have more democratic freedom than we now have. All the vicious inhuman laws that existed under the previous government do not exist to-day.

Basic Changes in Economic Policies:

The economic reforms introduced by the new government were strikingly different. As was seen earlier, between 1971 and 1977, almost all parts of the economy either stagnated or grew only slowly. The rate of saving and investment fell significantly and unemployment rose. According to government estimates, policy distortions during 1971-77 reduced the G.D.P. growth rate by about two percentage points a year.

The U.N.P. Government started making earnest efforts to arrest, if possible, reverse the economic decline of the

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country. Jayewardene reviewed every canon of the island's economic life and found them wanting. A new strategy, completely reversing the previous programmes of stultifying controls and costly subsidies was evolved. The U.N.P.'s. experiment in free economy and its economic philosophy are set out in two main documents. 1. The new policy programme of the U.N.P. adopted by its Twentyfirst Annual General Conference in December 1976 and 2. A Programme of Action to create a Free Society (Adopted in 1977 and put forward as the election manifesto of the Party).

Further elaboration of policies have been given by the leaders, mainly the President, on several occasions. To quote J.R. Jayewardene:

We have undertaken a stupendous task. In six years we are seeking to wipe out a colossal heritage of inefficiency, nepotism, corruption and stagnation. My government has the political will and confidence to take all the necessary steps to promote economic growth and stability so that the vast majority of the people in this country can lead happy and peaceful lives.10

The new government effected a 180° turn in economic policy from an inward looking welfarism to an export-led growth strategy.


9. Ibid.

10. Jayewardene, n.6, p.32.

J.R. Jayewardene believed that he had diagnosed the economic malaise of the island and declared:

If the economy of Sri Lanka was destroyed by a war or natural phenomenon and my government and I were entrusted with the task of rebuilding it, then building from scratch would have been easier than what we have to do today. We are saddled with an economy restrained, constricted and brought to the verge of collapse. I wish I could shatter this structure to bits and then permit the people to build it closer to their hearts' desire.

**Implementation of the Policies:**

The basic objectives of the new policy were to revive and resuscitate a run-down economy, stimulate domestic savings and investment, rapidly increase employment opportunities and increase the foreign exchange earning capacity of the country. The government carried through a series of fundamental changes in economic policy to achieve these objectives. The underlying strategies for the transformation was the dismantling of bureaucratic controls for resource allocation which had hitherto hindered initiatives for rapid growth. Incentives for innovative investments, savings and entrepreneurship, were also introduced to ensure a new climate of business confidence. At the same time, a massive programme of public sector investment was launched to improve the infrastructure facilities of the country. The major accent of the programme


was on development.

Defending that his policy was not capitalist, Jayewardene said:

We have only allowed freedom of exchange and freedom of imports. That is all. That is as far as the distributing trade is concerned. We have not touched the means of production, distribution or exchange; so you cannot say that we are on the capitalist path. We are trying to preserve the socialism that exist today, to make it better and less corrupt.15

Learning from the experience of the past three decades, the new government decided that its first priority was generation of employment to fight the scourge of unemployment. "We must start development schemes to generate employment" declared the President. "My proposal," said the Finance Minister, "is designed to accelerate the creation of employment opportunities. The Government has in hand, measures to embark upon a crash employment programme in the productive sector of the economy". For this it was necessary to invest more funds on capital and intermediate goods and reduce public expenditure on consumer subsidies such as food, transport, health and education. The government's view is that if there are more jobs, there will be more incomes. Goods are to be made available through increased production and liberalisation of imports. In the

16. Jayewardene, n.6, p.27.
17. de Mel, n.13, p.49.
process, it is believed other issues such as the high cost of living, inflation and poverty would be looked after almost automatically.

The emphasis on creation of employment opportunities is to be found in all the budgets since 1977. The spectre of the 1971 insurrection, when thousands of educated, unemployed and disillusioned youth took to rebellion, still loomed large. In the basic economic policies, the government started directing the country towards free economy, with the accent on free enterprise, based on free market forces and the motive of profit maximisation. The government 'liberalised' the economy by removing most foreign exchange and import regulations and permitting production and trade to operate within a free market. Likewise, it divested itself of nearly all import monopolies the state had accumulated, except for the import of a few basic food items. It also removed almost all curbs on foreign investments and repatriation of profits. It started inviting foreign collaborators offering terms that were more favourable than those offered by other countries of the region. Foreign investments had been encouraged by

20. de Mel, n.13, p.48.
21. Ibid.
22. Ibid.
The earlier government too, but they did not meet with much success.

The government held the view that foreign investment and technology along with skills and access to foreign markets, were essential for industrial development and economic growth. Without foreign exchange, the country cannot import for its needs. Hence, it was argued, it must export more.

The Government did not believe in central planning as such or in large doses of socialism. To quote Jayewardene:

To-day with the means of production largely invested in the state there can be no further advance towards a socialist ideal.....Our social and economic system almost to the extent of about 80 per cent, is now in the hands of the state and the number of corporations that are functioning, almost 150, show that extent. But we have found that in many of these areas there has been mismanagement as well as corruption.24

The Major Programme:

The main task of the government was to provide the infrastructure for the development of the country by private enterprise. The government, therefore, designed four major programmes which were expected to propel the economy to rapid growth and employment.

23. Balasuriya, n.4.


25. Balasuriya, n.4, p.31.
The Accelerated Mahaweli Project is a gigantic multi-purpose river basin development which was originally planned to be completed in thirty years, but later decided to be intensified and "telescoped" to six years, i.e., the lifetime of the first U.N.P. government. It seeks to bring irrigation facilities to over 600,000 acres and double the generation of power. It was expected that a large number of employment opportunities would arise in the course of its construction and that eventually 100,000 families would be settled in peasant allotments in the area.

The establishment of the Greater Colombo Economic Commission (G.C.E.C.) to promote industrial growth, with emphasis on the setting up of industrial processing zones—first such zone was to be located in Katunayake. The accent was on export oriented industrialisation thereby increasing export earnings and creating new employment opportunities.

The Greater Colombo Development Plan is designed to modernise the city and shift the administrative centre to Sri Jeyewardenepura, Kotte, a suburb, which was the ancient

Southern capital of the country. The new complex would serve as administrative as well as commercial centre of a rapidly growing Sri Lanka. It would take the administrative functions away from Colombo, which would allow the city to concentrate on commercial activities.

A master housing programme to construct 100,000 units within the period 1977-1983 was drawn up. This programme by its very nature was labour intensive and would greatly help in improving and consolidating housing and social amenities to both the urban and rural population.

A Master Plan was also drawn up for the Greater Colombo area, extending to Panadura in the South, Homagama in the East and Ja-Ela in the North. The whole of this area was to be developed or allowed to develop according to priorities set in the plan. Colombo was to be redesigned more functionally, with provision for industrial expansion, residential flats, markets and leisure activities. Pollution causing industries were to be moved to the countryside, away from the main residential areas. The slums will be upgraded in the urban development plan. Where squatters, shanties and slums are an impediment to productive

30. Tissa Balasuriya Quoting Quest 62 (Colombo), in n.4, p.31.
33. Balasuriya, n.30.
investment, they are to be moved and alternative accommodation provided elsewhere. The building of the new capital, Jayewardenepura, is to be given a very high priority involving, if necessary, emergency powers.

The main catalyst of change was to be the market force of profit, with money values determining the use of land and resources. The government stressed the need to transform the economy into a free economy as a necessary foundation for growth and development.

The Resources:

In its development policies, the government relied a great deal on the expertise and advice of international agencies like the I.M.F. and the World Bank and it sought also to obtain a large part of the finance necessary for this programme from these institutions and from donor countries in the developed world. No other government in Sri Lanka had managed to get so much foreign aid from the

34. Jayewardene, n.15, p.73.
35. Ibid.
36. In 1977 the government negotiated Rs.12,000 million in foreign aid exclusive of aid granted or promised for the Accelerated Mahaweli Scheme, the I.M.F. Extended Fund Facility and the Supplementary Finance Facility. The value of aid pledged in 1978 was Rs.6,000 million or U.S. $ 329 million, of which $ 129 million was in the nature of outright grant. In 1979 and 1980 Sri Lanka negotiated over 60 agreements and the largest single grant was Rs.3415 million from Britain, Rs.76 million from Canada, Rs.40 million from Japan and Rs.33 million from Norway. Ronnie de Mel, Budget Speech 1980 (Colombo, 1979), p.7.
developed capitalist West than the present regime.

Foreign aid became an integral part of the Budget and the relationship between aid and development became intensified; "Till we develop we need the help of developed nations" declared the President.

The aid giving agencies appear to regard Sri Lanka as a significant example of a country that could combine economic growth with social justice and democratic political institutions. The confidence that developed countries had in Sri Lanka could not be better illustrated than in stating the fact that Sri Lanka was able to secure enhanced foreign aid when official development assistance from developed to developing countries had been more than halved in 1978-79.

The Changes that Mark the Strategy:

In pursuance of its development strategy, the government effected the following changes:

Devalued the currency, thus making import more expensive and export cheaper, in rupee terms. The exchange


40. de Mel, n.28, p.3.
rate was unified by abolishing the system of multiple rate which was considered by the new government as the root cause of the extensive production instability and price distortions in the economy.

The rupee was allowed to float to its realistic level against a basket of currencies. Imports were substantially liberalised and the system of foreign exchange allocations abolished.

Lifted price controls and placed greater reliance on the market mechanism; effected a shift from quantitative restrictions on imports to tariffs as a means of protecting domestic industry.

Moved towards a free market economy by directing State Corporations to establish 'realistic' price levels; most products manufactured by the state sector have increased prices; services like electricity, post, public transport have raised their tariffs and fares.

Created a favourable climate for foreign investment and foreign aid. Established the necessary machinery to set up the Free Trade Zone; subsidised investments for tourism, the Free Trade Zone, house buildings and industry; generous tax

42. de Mel, n. 13, p. 44.
43. Ibid., p. 47.
44. Ibid.
45. Ibid., p. 46.
reduction was given to encourage savings and investment on both local and foreign development projects.

In order to encourage savings, the government increased the rate of interest on bank deposits to over 20 per cent. It invited new foreign banks to open branches in Sri Lanka.

Wealth tax was reduced as also the company tax (from 60 per cent to 50 per cent); capital gains on the transfer of company shares was exempted from tax. A withholding tax of 33.33 per cent levied on company dividends was also abolished. And a few year's tax holiday was extended to new companies engaged in construction and land clearing pioneer industries.

As a means of shifting resource from consumption into investment, the government ended a number of subsidies, e.g., the free rice ration was withdrawn from families with an income of over Rs.300 per month. They constituted virtually half the population in January 1978; instead of the rice ration, food stamps were issued to about 7,000,000 persons whose family income were below Rs.300 per month.

Handed over partially to private sector bodies such as agency houses, the management of public owned enterprises, e.g., textiles; or entered into joint ventures with foreign

46. Ibid., pp.51-4.
47. de Mel, n.28, p.49.
48. Ibid., p.45.
49. Ministry of Finance and Planning, n.41.
50. de Mel, n.13, pp.47-8.
companies, e.g., Tyre Corporation and National Milk Board. Sought assistance from the World Bank, the I.M.F. and other donor countries for its economic development schemes like the Mahaweli, Housing, Free Trade Zone, as well as to generate foreign exchange support necessary to maintain an open economy.

Commenced work on irrigation projects such as the Accelerated Mahaweli Scheme. In the first flush of enthusiasm due to almost overwhelming popular support and immense foreign aid, the new government decided to complete all the five schemes of the huge Mahaweli project (designed for execution in 30 years) in just five years; Saner and more sober counsel later reduced the immediate targets to three schemes; Maduru Oya, Victoria and Kotmale.

Attempted to control or discipline the trade unions which hindered economic progress. The government dismissed over 40,000 workers who participated in the strike for higher wages between 18 and 21 July 1980.

The Economy Reacts:

The early months witnessed a process of adjustment to the package of economic reforms introduced by the new government. After nearly two decades of economic controls and scarcities of imported goods, the economy was opened to receive a liberal flow of imported goods; restrictions

51. Ibid.
52. Jayewardene, n.4, p.31.
53. Jayewardene, n.24, pp.73-4.
placed on private sector economic activity were removed and incentives in the form of Free Trade Zone were offered to attract local and foreign investment into export oriented industries. The packages of rupee devaluation and the import liberalisation while removing scarcities in the economy by raising supplies both through higher imports and higher capacity utilisation in industry, required the evolution of new higher set of price and wage levels as a part of the new economic picture that emerged.

According to the official estimate, the Gross National Product in real terms recorded annual rates of growth of 8.2 per cent and 6.3 per cent respectively in the years 1978 and 1979. These represent considerable improvements compared to the growth rates of the 1970s which averaged only 3.2 per cent per annum. Thus from an overall macro-perspective, the performance of the economy in the two years showed a clear break with the past. Table 11 in the Annexure substantiate this.

Sector-Wise Analysis:

What were the main sources of the higher growth performance in 1978-79? Which sector of the economy contributed most to raise the growth rate? A breakdown of the growth rates of different sectors in the economy is given in Table 12 in the Annexure. As seen in this table, the sectors which contributed most to the higher growth performance were construction, trade and commerce.

transport and utilities. These sectors grew at an annual rate of 10-11 per cent during 1978-79. Nearly 58 per cent of the G.N.P. growth in 1979 originated in these sectors. The highest contribution to the G.N.P. growth came from trade (over 26 per cent) followed by construction (15 per cent) and transport (10 per cent). These three sectors together accounted for over one half of the G.N.P. growth during 1979.

Although the G.N.P. growth in 1978 and 1979 was characterised by progress on a broad front (trade, commerce, construction, etc.) the major productive sector in the economy (agriculture) failed to show strong growth impulses. The growth performance could, therefore, be said to be somewhat 'unbalanced' in that it was heavily biased towards trade, construction, commerce and transport while agriculture lagged behind. A growth process of this nature must necessarily generate substantial inflationary pressures in the domestic economy. Moreover, since lagging agricultural growth had also meant lagging export growth, the growth process failed to make a significant contribution to narrow the trade gap.

The Manufacturing Sector and the New Industrial Policy:

It is in this setting that one must examine the growth of manufacturing industries in the country during the

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56. Ibid.
period after 1977. Table 13 gives the value of various manufactured products. The industrial policy of the new government was set out in a nutshell by the President:

Industrially our long-term policy was to relieve the industrial stagnation, to arrest the growth of unemployment, to create new employment and new industrial and agricultural sectors, lessening the stranglehold of monopoly houses, encourage the indigenous technology and industrial self-reliance and to put into order the public sector that has become inefficient and corrupt. All sick units of the industrial sector will be reformed, reorganised and better managed and if they do not recover they will be closed.57

The objectives of the new industrial policy are as follows: 1. Make maximum use of indigenous raw-materials and other natural resources. 2. Generate widespread employment opportunities to the maximum extent possible, by a choice of appropriate technology and providing the maximum level of productivity. 3. Locate industries as much as possible in rural areas where the majority of the people live, also taking into account the provision of infrastructure, raw material availability and markets for the finished goods. 4. Foster economic and social progress by enabling the people to participate in the process of industrialisation and enabling them to share directly in the benefits of such industrialisation. 5. Establish machinery for the control of industries by society to ensure that no monopolistic industrial concentration would take place, which would exploit both the worker as well as the consumer. 6. Give equal opportunities to the private and public

sectors to enable rapid progress and expansion. 7. Ensure that public sector institutions are commercially viable. The government will not subsidise any losses except where it is considered a national priority. 8. Make sure that public sector institutions maintain as low a level of prices as possible consistent with commercial profitability and efficient management so as not to cast any burden on the consumer. 9. Encourage industrial research to enable domestic fabrication of machinery and equipment and enable an increase in productivity. 10. Foster research, enabling the lower and more efficient utilisation of energy dependent on imported fuels and promotion of greater utilisation of energy sources available within the country. 11. Reduce the gap which exists between management and employees in industry, both in the public and private sectors by enabling employees in industries to purchase shares in the institutions where they are employed. This would provide a greater motivation for employees to contribute towards the development of these enterprises. 12. Establish employee councils to provide effective worker participation in management.

**Industrial Promotion:**

With this policy frame the government started vigorously pursuing industrial and investment promotion. Since foreign private investment was expected to play a

very important role in the country's development efforts by supplementing requirements of capital, technology and market access, the government welcomed foreign private investment and sought to provide an environment congenial for its operation.

Thus, the way got paved for starting joint ventures in the country. The government encouraged foreign investment with local collaboration thereby ensuring local participation. Although the government permitted a 100 per cent foreign equity ownership, many of the approvals were joint ventures. Let us examine how the task of attracting and promoting foreign investment was planned and to whom the work was entrusted.

The establishment of the Greater Colombo Economic Commission (G.C.E.C.) to develop investment promotion zones in the areas of approximately 160 sq. miles in the northern outskirts of the city of Colombo, is one of the major steps taken by the government. Infrastructure facilities in this area have been developed to facilitate

59. Among the approved projects by the end of 1981, 95 projects were joint collaborations, 38 projects were wholly foreign owned ventures and 22 projects were totally domestic enterprises. Central Bank of Ceylon, n.29.

the establishment of export oriented industries. The main thrust of industrialisation was sought to be through the Free Trade Zone complex.

Projects outside the Investment Promotion Zone were approved by another organisation known as the Foreign Investment Advisory Committee (F.I.A.C.) which was already in existence but was less active.

A brief account of these two institutions which were entrusted with the task of attracting and promoting export oriented foreign investment, would enable us to understand better the important features of the industrialisation strategy.

The enactment of the Greater Colombo Economic Commission Law provided for the creation of the G.C.E.C. and gave the Commission wide ranging powers to introduce the necessary incentives to encourage the establishment of export oriented foreign investment in Sri Lanka. The Katunayake Investment Promotion Zone (K.I.P.Z) and the entire investment promotion effort was made the responsibility of the single agency, the G.C.E.C.

Facilities Offered by G.C.E.C.:

In respect of investment in G.C.E.C., there is no limit on equity holdings of foreign investors. Shares can be transferred freely in or outside the country with no tax or exchange control on such transfers. Dividends of non-resident shareholders are exempt from all taxes and remittance of such dividends are free from exchange
The regulation made under section 24 of the G.C.E.C. Law brought the zone area into that of "tax haven" category. The unprecedented tax concessions for G.C.E.C. enterprises compared very favourably with those offered by zones in any other part of the world and were considered particularly necessary as Sri Lanka was a late starter among the zone countries.

In its enthusiasm to ensure that the newly formed industrial area is not plagued by labour problem the Commission sought special powers to prevent the formation of trade unions and to vary the conditions of service. However, the courts ruled this as inconsistent with the country's Constitution.

To make sure that the investment of foreigners will not be expropriated on the whim of the government (or any of its successors), Article 157 of the new Constitution entrenched investment protection to agreements that have been negotiated with foreign governments.


62. G.C.E.C. Law No.4 of 1978, See Section 24 (a) and (b) and schedule B and C of the Act, pp.8 and 17.


Financial stability was another essential requirement. Steps were taken to gear the banking sector operations towards off-shore banking while leading international banks were invited to set up operations in Colombo. A foreign currency banking scheme was introduced in May 1979 as a step towards achieving the eventual objective of developing an off-shore banking centre in Colombo and making Sri Lanka an international financial centre. All banks in Sri Lanka were eligible to operate Foreign Currency Banking Units (F.C.B.U.) and permitted to engage in off-shore banking operations with non-residents, in designated foreign currencies. Deposit of foreign currency with the F.C.B.U. were exempted from income tax on their interest income. The banking units were guaranteed tax exemption on their profits and income from off-shore transactions and from certain designated foreign transactions.

Promotional Work and Initial Success:

Intensive promotional work was repeatedly carried out for propagating the F.T.Z. and securing investments. The G.C.E.C. organised investment seminars, interviews and media publicity at international level to attract foreign investors. The G.C.E.C. also participated in the United Nations Industrial Development Organisation (U.N.I.D.O.), sponsored investment conferences which brought together

foreign and local businessmen in Colombo.

By the end of 1981, the G.C.E.C. had approved 154 projects over the four years 1978-1981. Table 14 in the Annexures gives the details. The largest number of approvals was recorded in 1978, the year in which the K.I.P.Z. and its parent institution the G.C.E.C., were inaugurated. During the first nine months of its existence, the G.C.E.C. approved 52 projects with an estimated potential investment of Rs.1,625 million.

**Types of Industries in G.C.E.C.**

In the initial stages the majority of approvals were in the industrial category of textiles, wearing apparel and leather products. Over the first three years as many as 59 per cent from a total of 131 were approved for setting up of industries in this category. Table 15 in the Annexure gives the nature of the products.

The reason for this spate of investment in textiles and garments in the early stages of the K.I.P.Z. was that manufacturers from Hong Kong and other East Asian countries (on whom quota for import in U.S. was being clamped) decided to take advantage of the fact that Sri Lanka did not yet face trade barriers in the attractive U.S. market.

68. de mel, n.36, p.20.
69. Central Bank of Ceylon, n.29.
The G.C.E.C. however, realising the need to reduce dependence on ready-made garments began to discourage further approvals for such projects though agreements were allowed to be signed for projects already approved in this sector.

Approvals in the category of fabricated metal products and transport equipment occupied the second position. The other main categories were basic metal products where 22 approvals had been granted; and chemicals, petroleum, coal, rubber and plastic products where 20 approvals were granted. In rubber and plastic categories only 9 agreements had been signed in each up to the end of 1981.

Investment Outside the G.C.E.C.:

Private foreign investment outside the G.C.E.C. area, it was believed, would play a major role in the development of Sri Lanka's economy. Proposals for foreign investment are examined by the F.I.A.C. The F.I.A.C. is serviced by the International Economic Co-operations Division which is responsible for the co-ordination of all activities relating to private foreign investment outside the G.C.E.C. area. It is organised to provide advice to prospective investors on suitable areas for investment. It also provides assistance to investors, local as well as foreign, in finding suitable collaborators in joint venture projects. Further

71. Ibid.
72. Ibid.
more, it assists joint venture investors in overcoming various difficulties encountered in setting up an industry, particularly those relating to the government regulatory mechanism. The International Economic Co-operation Division thus operates basically as a co-ordinating agency, providing various services to investors from the time of initial inquiry to the stage of approval of the project and thereafter in their smooth and effective functioning vis-à-vis the government regulatory mechanism.

Investments outside the G.C.E.C. take the form of joint ventures where the majority share in equity is held by the Sri Lankan partner. Investments under the F.I.A.C. are limited to 49 per cent foreign ownership. However, this is merely a guideline and higher foreign ownership levels are readily negotiable.

F.I.A.C.'s Progress:

The F.I.A.C. had approved several projects with foreign capital investment during the four year period. Over the four years ending 1981, F.I.A.C. had approved 433 projects with an estimated total investment of Rs.12.9 billion. Tables 16 and 17 in the Annexure give details of approvals, investment, employment and sectorwise classification.

73. The Foreign Investment Advisory Committee, n.66, p.3.
74. Financial Times Survey, n.5.
Table 17 in the Annexure shows the dramatic increase in joint venture undertakings since 1977 involving Sri Lankan and foreign participation in projects approved for setting up outside G.C.E.C. area. Here, once again, the actual number of units in commercial production is considerably smaller.

The product line approved were in the fields of agriculture, food and beverage, textiles and garments, gems and precious stones, tourism, machinery, equipment and electrical accessories, civil engineering and construction work and provision of various services.

The F.I.A.C. was actually set up in the late sixties and it is surprising that the total project approvals up to the end of 1977 involved an investment of only Rs.200 million and most of that was in tourism.

By contrast in 1978, the first full year of the U.N.P. government, the F.I.A.C. approved 33 projects totalling Rs.200 million. But the snowball really gathered pace in 1979 when 113 projects were approved involving Rs.2,065 million in investment of which Rs.1,215 million was foreign and with direct job creation potential for 15,000. Of these 61 were in the field of manufacturing. The majority of the projects approved in 1979 were in the fields of textile,


76. Financial Times Survey, n.s.
garments, coir, rubber and metal products.

Rest of the Private Industrial Sector:

Apart from the achievement under the G.C.E.C. and F.I.A.C. schemes, there had been significant progress in the rest of the industrial sector also, particularly in the small and medium scale industry area. A major project that has commenced in this field is the International Development Authority (I.D.A.) assisted small and medium scale industry project which is designed to provide industrial credit through the National Development Bank and the commercial banks and technical assistance principally through the Industrial Development Board.

Public Sector Corporation:

Apart from promoting the G.C.E.C and activating the F.I.A.C. the government also focussed its attention on the public sector by attempting rehabilitation, review and infusion of managerial expertise to improve the performance. Such attention was all the more important since manufacturing in Sri Lanka was dominated by the public sector.

In the past the performance in the public sector has been initiated by misguided pricing policies which have been

79. Financial Times Survey, n.5.
accompanied by mismanagement. The government has pursued a pragmatic approach in dealing with these corporations. A few of them have been closed down because they had no chance of survival. In some others, foreign participation has been allowed in order to improve the technology and infuse new managerial talents. In still others, management has been handed over to foreign private firms under mutually agreed management contracts.

Petroleum Products:

The products of petroleum have a predominant share in industrial production and exports in the public sector. They account for much of the growth of industrial outputs. In 1980, the output of refined petroleum products accounted for almost about 45 per cent of the overall industrial production and the share of garments accounted for approximately 8 per cent. Thus, these two industries together contributed one half of the total industrial production.

The content of petroleum in the industrial production was so sensitively high that even the closure of the plants for maintenance care during a period of just over one month in two years affected the annual output. The Central Bank of

80. Nanayakkara, n.31.


Ceylon contends that a 6 per cent decrease in oil output was largely responsible for the decline in the manufacturing sector. The value added in the petroleum industry was however low. It was Rs.686 million for the category of chemicals, petroleum, coal, rubber and plastic products on a total production of Rs.4508 million.

It is useful to remember that the petroleum industry has the redeeming feature of earning back about a third of its import costs by re-exports of refined products due to its being a local and nationalised venture. Otherwise, comments an analyst, foreign companies could have given Sri Lanka a raw deal in this aspect of trade also. The main lines of increase in industrial production after petroleum products and garments were wood products, basic metals, cast iron and rubber products.

**Other Products:**

Cement production increased in 1978 rapidly through better capacity utilisation and improved efficiency. However, growth in demand had far outstripped production capacity for cement. The Cement Corporation had undertaken immediate investments in installing precalcinators to increase output by 30 per cent. Other important public sector industries are the geological and resource surveys.

83. Central Bank of Ceylon, n.77, p.35.
84. Ibid.
85. Balasuriya, n.4, pp.51-2.
underway at Appattite for coppermagnetite and ilmenite deposits and the explorations for oil in the north. Expansion in caustic soda production and leather production is programmed during this period. The state manufacturing corporations, taken as a whole, have accounted for 65 per cent of the total value of the manufacturing outputs.

Among the major undertakings in public sector are the commencement of commercial production of the state Fertilizer Manufacturing Corporation in January 1981, after the commissioning of the urea plant. The nitrous side plant of Ceylon Oxygen Limited was commissioned in August 1981. The stage-II of the Iron and Steel Project of the Steel Corporation which will produce billets by melting scrap metal in an arc furnace will provide the entire requirements of the rolling mill.

The Tyre Corporation, as a result of its technical collaboration with B. F. Goodrich Limited, will start manufacturing a more diversified range of tyres including radial tyres. It has also entered into an agreement with Bearcat Co. (U.S.A.) for the manufacture of solid tyres for exports.

A major bottleneck to faster industrial expansion in the public sector is associated with inadequacy of the level of corporate skills available both for speedy

86. Ministry of Plan Implementation, n. 61.
identification of productive industrial opportunities and also the application of technology for higher output.

**Results of Industrial Growth:**

The immediate outcome of the economic reforms of 1977 was a spectacular increase in industrial production, from Rs.7,004 million in 1977 to Rs.8,851 million in 1978. In real terms, industrial output rose by 11 per cent in 1978 against only 1 per cent in both the years 1976 and 1977. Describing the growth of 11 per cent as "an unprecedented achievement" the Central Bank attributed it to the availability of inputs, the ending of a long period of controls and to the competitive atmosphere that had prevailed after the liberalisation of imports. The Central Bank stated that "the economic reforms of 1977 signalled a fundamental change in emphasis from a narrow objective of import substitution under a high protective wall, towards an outward looking export oriented development.

Earnings from exports nearly doubled due to increased earnings from exports of garments, textiles (with factories in the K.I.P.Z. coming into production) and petroleum products. The export component of total production rose from 22 per cent in 1978 to 35 per cent in 1979 and the share of industrial exports in total earnings rose from 15 per cent.

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to 24 per cent in the same period.

An analysis of industrial performance in the years 1977 to 1979 shows that, while capacity utilisation has improved, there has been a sharp increase in the imported raw materials. Capacity utilisation improved from 60 per cent in 1977 to 70 per cent in 1978 and 72 per cent in 1979, but the removal of import curbs also resulted in a marked increase in the use of imported raw materials. The import content of raw materials used by local industries rose from 66 per cent in 1977 to 78 per cent in 1978 and to 82 per cent in 1979. The increasing dependence of industry on imported raw materials has reversed the earlier trend towards greater utilisation of local raw materials.

Sectorwise Progress:

While petroleum products and textiles are the biggest foreign exchange earners, both have a very high import content. Another noteworthy feature is that in the case of petroleum products 51 per cent of the increase in value was due to increase in price. Naphtha exports increased 46 per cent in 1979 in quantity but the increase in value was 187 per cent. In the case of textiles, the country still remained a net importer and there had been a sharp increase in imports with the liberalisation of imports. Textile

90. Central Bank of Ceylon, n.29, Tables 25 and 27.
91. Ibid., Table 70.
92. Ibid., Table 27.
93. Ibid., Table 70.
imports increased from Rs. 581 million in 1975 to Rs. 1,536 million in 1977.

There were, however, industries which recorded production declines in the face of import liberalisation. The most important among them were the indigenous textiles and such small scale industries as glassware, safety matches, all of which had to face competition from better quality imported products; and assembly industries such as radios, fans and electrical items. There was a tendency for some of these manufacturers to move towards trade or indirect import and distribution of the items they previously assembled locally. The textile industry, particularly the handlooms, suffered adversely as a result of import liberalisation and the institutional changes in the yarn import and distribution policy. While the price of yarn almost doubled, the final output could not be marketed owing to the competition from the better quality foreign products. By 1980 in most of the local textile firms stocks started piling up and a shortage of liquid cash stood in the way of production. Eventually, the government handed over the management of the five textile units of the National Textiles Corporation to foreign textile manufacturing firms for better management and technical conditions.

Production in the gem mining industry (as reflected in gem exports) showed no increase. Although the value of gem

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74. Ibid., Table 72.

95. Balasuriya, n.4, p.48.
exports in rupee terms (Rs.238 million) rose by 6.5 per cent over the first half of 1978 when measured in S.D.R. terms, there was a decline of about 13 per cent.

Set Back in 1979 :

The impetus and growth of 1978 was not maintained and fell considerably in 1979 when industries that had depended on import substitution felt the full impact of competition from imported goods.

The growth of manufacturing output slowed down to less than 5 per cent in 1979. In manufacturing, the year 1979 was a period of consolidation following the liberalisation of the economy. Liberalisation proved a double edged weapon in the manufacturing sector. While some industries expanded under the inputs of liberal economic policies (freer availability of raw materials, machinery and spares and tax incentives) some others suffered under competition from imported goods.

Sectorwise Analysis of the Setback :

Small scale and cottage type of industries such as those producing handloom textiles, wood and paper products, glassware, chemical products such as paint, hardware and metal products appear to have suffered heavily from strong import competition. These industries were, in general, inefficient and the product quality was poor. Once the shelter of heavy protection provided by import controls

96. Central Bank of Ceylon, n.29, Table 71.
97. Wijesinghe, n.38, p.73.
was removed many of them could not survive. There were also clear signs that some of these industrialists moved away from industry into activities such as trade and construction where the profit prospects proved more promising. On the other hand some small scale industries such as those making bricks and tiles, engaged in vehicle body construction and repair activities showed a significant expansion.

Production declines were also seen in several factory industries such as those producing fabricated metal products, machinery and transport equipment, textiles and paper. Many assembly industries such as radio and electrical goods suffered a decline in output in the face of strong competition from imports. Some of these imports substitution industrialists as seen earlier appear to have abandoned their industrial production and reverted to the more lucrative import trade. As a result there has been a diversion of resources from production oriented activity.

Another industry adversely affected by import competition was paper. The paper production at Embillipitya mill dropped by as much as 26 per cent and the paper board production at Valaichchenai dropped by 11 per cent. Import competition also led to drop in the production of 'Mamoties' and cast iron products of the Hardware


100. Ibid.
Corporation. Commenting on the impact of the import liberalisation, Ceylon Daily News wrote:

"we became a dumping ground for foreign industries. What we saw was a rash of imports of goods of every conceivable description from every conceivable country. Under the guise of freeing the economy we brought to face the rest of the world on its own. Here were our nascent, infant industries painstakingly brought up in a protected and sheltered environment, suddenly asked to face the growth of the industrial world. It had neither the resource nor the experience to meet the task, but these facts were not taken into account. A toddler against a seasoned runner, yet no handicap, no nothing."

Successful Industries:

On the other hand the output of some factory industries showed a significant growth during 1979. The cement output continued to expand and the total production at 660,598 metric tons was 15 per cent higher than in 1978. Despite this increase, however, the local production was found to be inadequate to meet the expanded demand and imports failed to fill the gap in supply.

There was a notable expansion in the output of export oriented textile garment sector. The value of garments exported in 1979 amounted to Rs.1,103 million (nearly US $104 60 million) representing a jump of 116 per cent over the 1978 level. However, in view of the high import content in the final product, the value added (and hence the

103. Ibid., p.7.
104. Central Bank of Ceylon, n.29, Table 70.
contribution to the national output) by the garment industry would be only a fraction of the export value.

**Socio-Economic Aspects:**

By 1980 the unemployment level fell from 24 per cent of the work-force to 15 per cent. The rate of growth of the economy which was 3.0 per cent in 1976 was 4.4 per cent in 1977, 8.2 per cent in 1978, 6.2 per cent in 1979 and 5.6 per cent in 1980.

Over the period public debt rose, but because of I.M.F. support and favourable terms of borrowing, the debt servicing ratio fell from 20 per cent to 12.4 per cent in 1980. However, from 1978 onwards the cost of living index moved up by double digits each year.

In 1979 the government abolished the old food subsidies which was geared to quantities and replaced it with food stamps to the value of the ration to which a family was entitled. But the purchasing power of the food stamps had kept on dropping. In a difficult budgetary situation, the government had to consider the claim to revise the value of the ration upwards.

No doubt the high interest rates brought about by the monetary policy of the new government, despite continued

105. de Mel, n.99, p.11.
106. Ibid., pp.3-4.
108. Ibid., p.103.
109. de Mel, n.36, p.36.
rise in external prices, remained a great strain on the 110 balance of payments position.

1980 and the Deterioration:

The year 1980 saw an alarming deterioration of economic indicators. G.D.P. growth was down from 8.2 per cent in 1978 and 6.3 per cent in 1979 to 5.8 per cent in 1980. Imports kept rising while exports slumped. Large increases in investment spending by Ministries led to a doubling of the fiscal deficit. While the increase in expenditure reflected to some extent an acceleration in physical investment, the overall value of investment rose from 26 per cent of G.D.P. in 1979, to a record 36 per cent in 1980, and the annual rate of inflation nearly doubled to 31 per cent.

The plantation sector on which the country continued to depend for most of its hard currency, was affected by the drought in 1980. However, there was improvement in the following year. But the price declines negated production gains. The budgetary situation was bleak and the Finance Minister was increasingly concerned over public sector fiscal indiscipline which it was desperately trying to control.

110. Economic Times (Bombay), 7 March 1983.
111. Central Bank of Ceylon, n.27, Table 1.
112. Far Eastern Economic Review, n.11, p.64.
I.M.F. and the Financial Discipline:

Critics suggested that Sri Lanka is another poor country caught in the harmful grip of the I.M.F. It is true, argued The Economist that various conditions were attached to the I.M.F. credit - the size of the budget deficit, bank credit ceilings and so on, but whereas many governments blamed the I.M.F. for coercing policies on them, in Sri Lanka's case there was something close to meeting of minds. The liberal policies that the government pursued were designed and put into operation perhaps earlier to the country approaching the I.M.F. for help. David Hopper, Vice-President of the World Bank, said:

The President has correctly diagnosed the roots of the stagnation: too much government intervention and subsidy. He and his government have taken bold decision to return the economy to normalcy. 116

Throughout 1978 and 1979 Sri Lanka was held up as an "I.M.F. Success" -- a phrase that understandably gained currency because of the headlines about "I.M.F. Failures" (for example in Peru and Jamaica). It would have been more accurate, concluded The Economist, to talk of Sri Lankan success, or a U.N.F. success, because the policies and the results were homegrown.

115. Ibid.
117. The Economist, n.114.
In July 1980 the I.M.F., worried about the rapid expansion of money supply and inflation, called for 'financial discipline'. The rate of inflation was estimated by most of the economists at 35 per cent although the Finance Minister claimed that it was not more than 25 per cent.

It has been observed by economists that inflation in Sri Lanka during the years since 1960 has not been directly linked with increase in money supply. The country has been heavily relying upon imports to meet its essential consumer goods requirements and the international inflationary pressure prevailing in other countries got transmitted directly through these imports. With the opening of the economy and the massive spending programmes, there has been an enormous increase in money supply thus causing inflation through both the sources, increased imports and creation of additional money supply. Thus, there has been an uncontrollable galloping inflation.

By the middle of 1980 supplementary votes had made gaping holes in the budget. The ceiling on Treasury Bills had been exceeded by an unprecedented Rs.5,000 million.

The I.M.F. realised that it would be little short of tragic


120. The Hindu (Madras), 27 February 1982.
if the promise held out by the policy reforms should be frustrated through a failure to adjust policies and programmes to a rapidly changing and adverse environment.

Describing the economy as 'overheated' the I.M.F. experts suggested that some of the more ambitious programmes be halted if not given up and the government confine itself to more modest development projects. They also suggested that attention be paid to repayment of the debts so far incurred. The I.M.F. acted; it suspended disbursement to Sri Lanka under a three year agreement signed in January 1979 for support amounting to about $350 million. The I.M.F. was demanding greater budgetary discipline while shutting off some financing until budget cuts were made.

Mahaweli grant was slashed by Rs.100 crores while the Randgale project, part of the giant scheme was postponed. The Housing and Construction Ministry also saw a 25 per cent cut in capital expenditure. Cuts in 14 other Ministries averaged 22 per cent.

**Trend Arrested in 1981:**

The trend was arrested to an extent by various policy measures taken in 1981 and as a result a degree of economic stability was restored. The policy measures activated in

121. Ibid.

122. **The Asian Wall Street Journal** (Hong Kong), 22 October 1981.


124. Ibid.
1981 helped to moderate the inflationary pressures experienced by the economy during this period, an indication of the slow down in the rate of inflation being the Central Bank's published wholesale price index which registered a 34 per cent increase in 1980 (over 1979) but an increase of only 17 per cent in 1981.

In marked contrast with the previous few years, the biggest contribution to the G.N.P. growth in 1981 came from agriculture and manufacturing, their combined share exceeded 50 per cent as against less than 15 per cent during 1979-80. Within agriculture, the largest share of the output came from minor and subsidiary crops rather than from the major crops. The area under cultivation increased. The improvement in produce prices was the major factor that raised the production in this sector.

Within manufacturing, the highest production increase was recorded by the export processing industries, reflecting the improved output of plantations which improved the scope of export. Government manufacturing made a significant contribution to raise the output of the factory industry. The industrial sector as a whole, however, suffered by the electricity shortages during half of the year.

**Reasons for Lower Growth Rate**:

The growth rate in 1981 was only 4.2 per cent compared


with 5.6 per cent in 1980. The principal reason for the lower G.N.P. growth rate was the substantial increase in interest payments, a load arising from external borrowings. The foreign debt outstanding at the end of 1981 stood at nearly Rs. 34.82 billion which represented an increase of 35 per cent over the level at the end of 1980. During 1971-81 the foreign debt had more than doubled. The interest payments abroad during 1981 (Rs. 2,116 million) were more than double (an increase of 119 per cent) the payment of 1980. Approximately 8 per cent of the export earnings from goods and services was absorbed by interest payment abroad.

Industrial Production:

The rate of growth of industrial production in both the public and private sectors declined in 1981. In 1980 the increase in industrial production was estimated to be 6 per cent compared with 4 per cent the previous year. The decline was mainly due to the substantial decrease in the production of the Petroleum Corporation whose refinery was shut down for repairs in February 1981.

Also the output of fabricated metal products fell by 29 per cent, output of basic metal products and wood products

128. Ibid., p.103.
129. Ibid.
fell by 14 per cent; food, beverages and tobacco products by 7 per cent and chemical products by 5 per cent.

Drop in production in the industrial sector was also attributed to the unprecedented interruption of power the manufacturing industries underwent in the early part of 1981. However, the effect was to a certain extent minimised when several affected industries promptly switched over to standby generators and by making necessary adjustments in their work shifts.

There was also increasing restraint on bank lending and money was costlier and difficult to get. This was the result of the policy to effect monetary discipline to fight the inflation in the country.

One other significant factor which began affecting the smooth running of industries was the gradual eroding away of important skills from the country. Scientific and industrial institutions have been affected by a shortage of scientific and skilled personnel. There was also the continuing shortage of other managerial skills such as accountants, categories of engineers and marketing personnel. By 1981, it was observed that even middle grades of skilled employees

133. Ibid., p.18.
were in short supply. Personnel for skilled operations and even others like welders, carpenters, masons, electricians and drivers were becoming very scarce. This affected the expeditious completion of capital projects and at times even hindered normal production. The Central Bank observed that the loss of professional labour tended to have a significant impact on the supply of manpower resources for development projects that the country had undertaken.

Import Liberalisation Affects Industries:

However, the question often raised is how far did the liberalised import policies affect particular industrial sectors? There is no doubt that in most of the particular products mentioned earlier (where production decreases were recorded) direct import and distribution has proved far more profitable. In the public sector the producers of paper, leather products, ceramics, steel and hardware products faced strong competition from the imported products. The Paper Corporation experienced marketing problem due to competition from imported substitute and as a result had to lower the price in order to sell its products.

The Ceylon Leather Products Corporation was finding it hard to face competition from cheaper varieties of footwear made from imported plastic materials. Another clear

134. Ibid.
136. Ibid., p.62.
137. Ibid.
example that has come to light is that of glass. The Chairman of the Ceylon Glass Company (a public company) is reported to have told its annual general meeting that imports had very seriously affected the company. There were 79,000 gross of unsold stocks of glasses and the loss for the year 1982 was Rs.14 million. The two factories of the company were temporarily closed for a period of 6 months as a result. But the Central Bank of Ceylon, however, justifying the policy towards the local industries stated "there is no economic sense in continuously protecting basically inefficient industries". The Finance Minister also emphasised in his budget speech, "this is the usual price that has to be paid to build vitality and dynamism into the industrial sector as a whole".

The Secretary in the Ministry of Industries observed at the end of 1981 that the importation of large quantities of low priced (even sub-standard) products was possible because certain countries offered special export incentives to enable surplus goods in their countries to be freely exported to countries like Sri Lanka, which have liberalised import policies. He added, however, that "in 1982 it is hoped that there would be some positive changes from

138. Ibid.
139. Ibid.
141. de Mel, n.113, p.9.
the present position in respect of imported finished goods since it is expected that with the modifications in the tariff structure a fair competition with imports would be permitted". His forecast of a 10 per cent growth in public sector industries in 1982 appeared to be based on this expectation.

**Industries that Benefitted - The Paradox:**

There were signs that the liberalised policies have benefitted the industrial sector in certain respects. For instance, there was a deliberate attempt by manufacturers to upgrade their products and compete in the market with the imported goods. New machinery, newer technology and higher quality raw materials were all more freely available. Among some industrialists there had been a new enthusiasm and so new patterns of production started from about 1978. The results were seen in the generally improved standards and quality of manufacturers in local industrial sectors such as textile and metal products.

The paradox in the situation was that while some industries enjoyed the benefits of the liberalised economic policies and adapted themselves to compete with goods of international standards, other industries found major constraints to their growth in these policies. A survey conducted by the People's Bank Research Department showed that in 1978 just over 50 per cent of local industries were

adversely affected by the new liberalised policies. The most logical step, therefore, would be to create an environment favourable to stimulating the expansion and upgrading of local industries while gradually eliminating the constraints they faced.

Additional protection to local industrialists was accorded by the imposition of turnover tax on most of the imports over and above import duty payable. Further relief to the local manufacturer was given by a reduction of customs duty on machinery and essential raw materials used in industry from 12.5 to 5 per cent.

However, critics contend that such indirect taxes have shifted the incidence on the poor and the prices of every essential goods have steeply risen. Neither complete controls of imports nor complete removal of price controls have helped; the former has only resulted in a sheltered market and shoddy goods for the consumer, while the latter has resulted in manufacturers making unconscionable profits at the expense of the consumer. While it is vitally necessary in the interests of local industry to discourage the import of substandard goods, it is equally important that the free imports are to be permitted especially of essential raw materials and machinery and also goods of quality which will help to set standards for local industry.

143. Ibid.
Striking a balance in these two seemingly contradictory objectives was the problem facing the different authorities responsible for industry, trade and aid. 'The government has not been unmindful of the need to provide some degree of protection to viable industrial enterprises', announced the Finance Minister.

Recovery in 1982:

In 1982 Sri Lanka's G.N.P. increased by 4.9 per cent and the G.D.P. also increased by 5.1 per cent. The decline in the growth of real G.D.P. in 1982 was mainly due to the lower rate of growth in agriculture, particularly in tea and paddy which recorded negative growth rates. Value added in the manufacturing sector also declined due to the lower output of tea that was processed. However, factory and other industries including industrial exports increased by 9.1 per cent in 1982 over the previous year.

One of the notable features of the economic performance in 1982 has been the significant betterment in the rate of inflation. The rate of increase in the general level of prices dipped to single digit. The government pursued a conscious and consistent policy aimed at controlling inflation by reducing the impact of budget deficits. The Central Bank continued its tight monetary policies, thus leading to the success in demand management policies.

146. de Mel, n.113, p.9.
Performance on the employment front was also satisfactory. The number of new employment opportunities created in the organised sector was 34,000 during 1982. This was, however, lower than the number of jobs generated during the year 1981. The share of the organised private sector in this was 25,625.

In 1982 the economy continued to experience large increase in investment well beyond the capacity to generate savings locally. Foreign savings, therefore, have had to play a large role in sustaining the high level of investment.

Balance of Payments Problem Persists:

One of the disconcerting developments during the year was on the balance of payments front. Adverse terms of trade continued to plague the external payments position for the fourth year in succession. While imports grew by 14 per cent, export performance has been disappointing with a rate of growth of 3.4 per cent in S.D.R. terms. Increase in debt service payments as a result of the increasing resort to commercial credits resulted in debt service ratio increasing to 15.2 per cent from 13.3 per cent in 1981.

One redeeming feature was the increased receipts from private transfers, consisting essentially of remittances.

148. Ibid., p.6.
149. Ibid., p.95.
150. Ibid.
from Sri Lankans working abroad and the larger net inflows of capital in the form of direct investment and long term foreign loan. The most disturbing feature of the balance of payments developments in 1982 has been the singular lack of dynamism by the export sector. The export sector almost stagnated during the year with a disappointing 0.6 per cent rate of growth.

**Industrial Production Lifts up:**

Industrial production in 1982 increased by 9 per cent. The comparable record in 1981 was an increase of only 2 per cent. Growth in the private sector industries has been impressive in 1982 with 18 per cent increase. The public sector recorded a growth of 5 per cent only. Even this was largely due to higher output in the oil refinery. However, production has come up to an appreciable level, most of the organisations achieving production levels to their budgeted targets. In some organisations actual achievements have exceeded budgeted levels in certain lines. The National Salt Corporation led this trend with a quarterly production of 98.3 thousand metric tonnes against a budgeted production of 32.4 thousand metric tonnes. The Sri Lanka Tyre Corporation exceeded its budget of production in the production of truck tyres, while the Ceylon Steel

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Corporation exceeded its budgeted limits in the production of steel fabrications. The Ceylon Oxygen Company also produced nitrogen and dissolved acetylene over budgeted levels. The Ceylon Ceramics Corporation exceeded budgeted quantities in the production of crockery, insulators and kaolin. The production of air mixed gas by the Colombo Gas and Water Company Ltd., also exceeded their budgeted estimates by an appreciable margin.

In contrast, the sales of Steel and Hardware Corporation continued to decline in 1982. The Sri Lanka Cement, State Timber and State Mining and Mineral Development Corporation too did not fare well in their performance in 1982.

Private Sector and New Projects:

As for the private sector industry, relatively large firms appeared to have performed remarkably well. In the private sector in 1982, the F.I.A.C. approved quite a good number of projects in the manufacturing industry as the leading sector replacing Tourist hotels. This was a noteworthy development in the F.I.A.C. approvals. Industrial projects approved include aluminium extrusion plant, manufacture of distribution transformers and rubberised coir products. Among the projects in this sector are those manufacturing tin cans, spares for motor vehicles, souvenirs and garments. Many among the industrial ventures

154. Ibid.
155. Ibid.
156. Ibid.
are export oriented projects. The second largest concentration of projects was in the civil engineering and property development sector. Four of these projects planned to undertake property development ventures with Singapore collaborators.

Tourist hotel sector which hitherto was the leading sector in F.I.A.C. approvals in terms of number of projects and investment involved, however, registered lesser number of approvals. The projects approved in other sectors include cultivation and processing of fruits, establishment of a meat processing plant, computer services and jewellery projects. The majority of these project proposals were from Singapore. The other countries which submitted proposals were Germany, U.S.A., U.K., Sweden and Hong Kong.

In 1982 alone the F.I.A.C. approved 102 projects envisaging a total investment of Rs.3.036 million with the foreign component amounting to Rs.1,943 million. The G.C.E.C. had approved 16 projects in 1982. Since most of the earlier projects were in the ready-made garment field the G.C.E.C. had taken meaningful steps to overcome the structural imbalance and encouraged a more diversified activity at the I.P.Z. Agreements signed in 1982 included projects to manufacture electromagnetic heads, electrical and

157. Ibid.
158. Ibid.
electronic products, terry towels, furniture, coir making and cotton yarn, hotwater bottles, ice-skating shoes and saw blades.

An encouraging development observed in 1982 was the successful attempt made by the private industry to face the challenges posed by sharp competition from imports, although some smaller and inefficient enterprises found it difficult to meet the challenges.

Most projects approved by the F.I.A.C. contain a higher export potential and the shift in emphasis from import substitution to export promotion is consistent with the outward looking strategy of the economic policy pursued since late 1977. In a situation where investment in public sector manufacturing capacity has been increasingly subject to more strict evaluation criteria, investment in private sector industry has a crucial role to play sustaining the increase in overall industrial production.

Summary of Growth Performance:

Thus, during the period 1977-82, Sri Lanka's growth performance, expressed in terms of Gross Domestic Product (G.D.P.) average about 5.9 per cent; compared with about 2.0 per cent average growth rate of industrial nations and a little over 3.0 per cent average growth rate of low income, oil importing developing nations as a group, during the same period. On the employment front too, the achievement...

160. Ibid.
161. Ibid., p.57.
162. Ibid., Table 1. See also The Island, 17 November 1983.
seems fairly impressive with nearly 3.5 lakh additional jobs generated outside the unorganised private sector during the 1978-82 period according to official figures. This performance was largely due to support by the favourable aid inflows from the West.

Also there has been unprecedented levels of investment during this period. Commenting on the progress the President said:

Never in the history of Sri Lanka have so many development projects been undertaken simultaneously. Whether in the area of agriculture or irrigation, electricity or water supply, or industries or fisheries, urban or rural housing, the results of this programme are visible in every part of the country.164

The annual average domestic investment was Rs.19.7 billion during 1978-82 as against an annual average of Rs.3.5 billion in the previous seven years' period. The foreign exchange gained for the country on account of value added (35 per cent export value in 1981) is Rs.400 million or US $ 20 million. The growth in real output of goods and services averaged 6.2 per cent per annum during 1978-82. In per capita terms this represents a growth of 4.4 per cent per annum. These were as against 2.9 per cent and 1.9 per cent respectively in the previous 7 years.

163. Ibid., p.69. See also The Island, 17 November 1983.
166. Ibid., p.56.
167. Ibid.
Pressure on Price Level:

These achievements in investment and growth were not without costs. The restoration of market incentives, reduction of consumer subsidies and movement towards international prices and adjustments in the exchange rate created severe pressures on the price level. Further, the sharply increasing world prices of essential imports, a major revision of the exchange rate for the rupee in 1977, followed by a further steady depreciation and the periodic revision of the administered prices of basic consumer goods, were all heavily influenced by the adverse developments in the international economic environment.

Lagging Export Oriented Manufacture:

One important weakness that has arisen in the open economy was a lagging export growth in the context of high import growth and the deteriorating terms of trade. One of the major objectives of the 'open economy' policy was to create an export oriented manufacturing sector based on the country's comparative advantage, mainly cheap labour, in contrast to the import substitution strategy of the earlier years. But the investment in manufacture itself has been on a low level compared with tourism, trade and construction. There was still no marked shift to export oriented manufacture.

Sri Lanka will have no option but to retreat from the country's open economic policy if export expansion goals are
not realised by the year 1987. The warning comes from a senior government official, Victor Santia Pillai, Chairman of the Export Development Board.

Cost of Infrastructure:

There are conflicting views on the recovery of costs on infrastructure and both the World Bank and the National Development Bank (N.D.B.) have in this regard emphasised the need for the country to derive maximum benefits from its investments.

The N.D.B. in its annual major report for 1981 stated;

It is relevant to draw attention to some observations made in the World Bank's Report entitled "Sri Lanka operations, and Prospects for Economic Adjustments" circulated in May 1981. In the World Bank Report it suggested that while the G.C.E.C. has had some initial success in attracting investors, in the wage terms it would be necessary for the government to lay emphasis on the recovery of costs of infrastructure which have to be provided at great expense using resources that could be applied elsewhere, if Sri Lanka is to derive adequate benefits from foreign investment under the G.C.E.C.

Lopsided Industrial Production:

A closer look at the pattern of increase in industrial production would reveal that the total output in petroleum and chemicals is more than the production in all other categories put together. Among these other categories textile dominates, accounting for nearly a third of the share. But the content of value added in textile industry is quite meagre, below 20 per cent. With the volume of

production nearly doubling between 1977 and 1979 the value added dropped by Rs.42 million bringing out the futility of the exercise. The high import content is responsible for this.

It is also to be noted that the proportion of foreign investment per unit in basic metal, fabricated metal and transport equipment and chemical project was higher than the proportion in the textile and readymade garment sector.

As much as 90 per cent of the total export earnings of G.C.E.C. enterprises continue to come from garment exports. The net domestic value added in most Free Trade Zone industries is estimated not to exceed more than about 20 per cent of the export value. Further, the recessionary trends and imposition of export quotas in the major markets has severely limited the scope for further expansion of garment exports.

*Investment Enthusiasm Wanes*:

Inspite of vigorous promotional activity, the investment community has not moved in as anticipated, into manufacturing investments. In an island economy with a small market any investor will have to bank only upon export market and in the back-drop of world recession, the prospects of exports are rather dim. This perhaps was the

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171. Ibid.
reason for the pull out of the giant Motorola Corporation of U.S. which had originally signed an agreement to put up an industry in the Free Trade Zone but subsequently changed its mind.

Involving in manufacturing is itself a new culture to the Sri Lankan entrepreneurs. Successful traditionally as traders, the business community looks forward more to avail of the opportunities in the enlarged import trade, tourism, transport, construction and real estate; the more certain return in these sectors dissuades them from venturing into manufacturing and thus account for the slow growth of a manufacturing base.

Further, the lack of trading activity before 1977 had led to a generation gap in the fields of marketing, advertising and packaging. Market research was another area that was neglected. Thus remaining isolated from the latest trends in modern business, the Sri Lankan entrepreneurs find it difficult to quickly adjust themselves to the changes that followed the opening up of the economy.

Sri Lanka's experiment with Free Trade Zone may at the most turn out to be a venture of moderate success. Nothing spectacular could be expected out of this. The world business climate in the early eighties was quite

175. Commerce, n.169.
unfavourable for such ventures. When South Korea, Taiwan and Singapore began their export efforts in the late sixties and early seventies, the international economic climate was most favourable. International trade was growing, exchange rates were favourable, prices of investment goods were stable and markets in the developed world were wide open. In 1982-83 in contrast, international trade was stagnant, exchange rates were most erratic and protectionist pressures especially in the developed countries were making access to their markets increasingly difficult.

One other problem of foreign participation in investment in Sri Lanka is the difficulty of finding local collaborators with sufficient capital to participate in joint ventures. While government has offered incentives in taxation to ensure the broad basing of equity in both public and private companies, there is a shortage of funds for investment owing to the 20 per cent annual rate of interest offered by the finance companies. These act as disincentives particularly when an industrial culture had not developed to any extent in the country.

Non-Productive and Long Gestation Project:

As seen above the economic reconstruction is sought to be built with principal emphasis on the lead projects, the Mahaweli scheme and the Jayewardeneepura housing complex. The wisdom of such heavy investment on non-productive and long...

176. Wijesinghe, n.38, p.65.
gestation projects is very often questioned. The *Lanka Guardian* asked: Why was the Kotte complex necessary? Why this large investment on housing and construction? The doubt persists all the more with the cost escalation all around throwing the original estimates to winds. There appears to be no estimates of the cost benefit ratio of the scheme as a whole. Judging by the earlier Gal Oya Scheme's cost benefit ratio the Mahaweli scheme is also likely to emerge much more unfavourably. Besides paucity of funds, the scheme bristles with many other problems such as water wastage, socio-economic problem in settling the farmers, low levels of productivity and performance on the part of the farmers making all estimates futile.

The 1983 Budget:

A study and analysis of the 1983 budget throws some light on the policies to be adopted during that year. The government's policy of 'no new projects' which was first introduced in 1981 as a disciplinary measure in maintaining the consistency of actual expenditure to the budgetary allocations of respective Ministries, has not been relaxed in 1983. This means that the Ministries were not permitted to undertake projects which had not been approved earlier and included in the budget estimates and implies that the 1983 allocation will be entirely utilised for ongoing development projects.

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179. Ibid.
The government's lowered priority on direct participation in industrial development is clearly borne out from the relatively small share budgeted for industry. Under the open and liberalised economic policy pursued by the government, the private sector is expected to assume a greater role in producing agricultural and industrial inputs and the government is strengthening the private sector expansion by providing services.

However, with the bulk of the heavy industries in the public sector, restrictions may adversely affect the economic progress in the country, especially when the expectations for more employment under the open economic system have been kept high. Without new development activities the growth of direct employment opportunities in the public sector and indirect employment in the rest of the economy will be gradually reduced, at least in the short run. The decline in the rate of income in economic growth and slackening of employment opportunities experienced from about 1981, partly emanate from lack of investments in new projects. A declining performance is likely to become more serious especially in the area of employment in the years to come as the government will have to face new issues such as the relocation of a labour force which will face displacement, once on-going projects are completed.

The private sector's role in the economy, especially in the area of production and employment, surpasses that of the

181. Ibid.
public sector by significant margins. It is for the purpose of stimulating its role that the private sector expansion in the economy has been given various production incentives under the liberalised economic setting and the tax structure.

Unfortunately, there appears to be a very slow response to such incentives, as producers are beginning to face high production costs which reduces the profitability of their business ventures. In addition, as seen earlier, producers are facing stiffer competition from imports despite increased import duties.

However there are some bright spots in the budget for producers. The government is making plans to boost exports by offering new incentives to the exporters and these incentives would bring at least marginal improvements in production and employment in the private sector.

Judging from the source of financing the budget, it appears that the budget will not exert much inflationary pressure on the economy. However, it is doubtful whether the government would be able to avoid bank borrowings to finance the budget of the shortfall. This may contribute to inflation. In 1982 the government could not avail of portion of the foreign aid because of want of domestic finance; such under-utilisation of the aid, it was thought, might occur in 1983 also and the Finance Minister had clearly indicated in the budget that in the coming period "we must reduce our..."
reliance on foreign financing by moderating the rate of investment and enhancing domestic savings".

One alarming trend in the economy is the government's indifference to the indigenous industries and to eventual self reliance, in the name of open market economy. The Presidential Commissioner's decision not to provide any more tariff protection to indigenous industries is viewed with great concern. At a time when countries like the United States of America are increasingly falling back on protectionist measures, Sri Lanka is not giving adequate safeguard to local industries from the competition that they face from the influx of foreign goods into the country. It is a well known fact that several industries have had to close down throttled by the competition from foreign goods. The government has a duty, argues an analyst, to ensure that indigenous industries are protected. But the demand for imported goods should experience slower growth in 1983 as a result of higher prices caused by the depreciation of the Sri Lankan rupee against the dollar.

On the export side, tea is reported to have made good progress with an almost doubling of average prices for all grades in current prices, relative to 1982. Based on current information, the tea export trade will remain favourable throughout the year and this should help not only the

184. Ibid.
185. The Island, 1 June 1983.
186. Ibid.
balance of payments situation, but also ameliorate the long period of stagnation in tea plantation production. The devaluation will also induce a higher volume of export of rubber and coconut, at least until higher production costs resulting from a devalued rupee begin to erode the higher income made possible to producers following the devaluation. These anticipated developments in 1983 should narrow the current account gap in dollar terms which would certainly help make the financing of the balance of payments much easier.

The Ethnic Violence and the Extent of Damage:

The year 1983 was an unfortunate year in the history of Sri Lanka. The ethnic violence that plagued the country during the middle of the year had put back the clock of progress by several years. The tension between the Tamils and the Sinhalese which had been smouldering since the unfortunate events of 1981, had erupted into an unprecedented orgy of violence in July 1983. These riots have left deep scars on Sri Lanka’s economy and the process of economic growth has suffered a severe set back.

It is reported that 152 industries within 30 miles of Colombo were affected by the disturbances; 63 per cent of the affected units are in the textile and garment sector where 11 per cent of the workers and 15 per cent of the
production was affected. Rs. 870 million worth of exports was lost. The other industries affected include P.V.C. pipes, asphalt, cosmetics and perfumery, coconut milling, tyre rebuilding and dry cell batteries. In the coconut industry nine mills were completely destroyed and a ban had been placed on the export of coconut oil and copra products. In the tea sector not much of physical damage had been done to the tea estates. But there was a disruption of the work and it may present long term problems, if estate labour decide to leave Sri Lanka out of fear. About 40 per cent of the affected industries would take at least six months to one year to be operational again while 25 per cent of the factories would start production in one or two months.

The Finance Minister expressed his apprehension saying the budget is going to be affected; our projected revenue will be less because of declining economic activity. Our expenditure which is already too large for our resources will increase still further due to increased expenditure on relief and rehabilitation, on essential reconstruction and on the armed services and the police.

The official version of the damage is contained in the Budget Speech presented in November 1983 wherein the Finance Minister admitted that there has been damage and set back in


189. Ibid.

the three leading sectors of the economy: 1. wholesale and retail trading, 2. Industries and 3. House building.

As for the industrial sector, my Ministry with the help of few other (six) Ministries made a survey and the estimates according to it is that within a radius of 30 miles from Colombo 116 industrial establishments were damaged. Out of these ten units were brought to normalcy in about a month and 55 units will take six months to commence production. 28 units were substantially damaged.191

Another issue is that manufacturers were affected by the riots because most of their dealers were among the victims. Since dealing in post-dated cheques used to be a common trading practice in Sri Lanka, many manufacturers were left with cheques which had no value.

To revive confidence both at home and abroad, it is necessary to establish law and order throughout the country and to bring about peaceful relations between the various ethnic groups.

The government had announced a package of concessions for industrialists affected by the disturbances through the Rehabilitation of Projects and Industries Authority (R.E.P.I.A.). The Finance Minister grimly warned that "any more violent outburst, any more signs of political instability and Sri Lanka can say farewell to the "open economy".

192. Lanka Guardian (Colombo), vol.6, no.15, 1 December 1983, p.3.
194. Ibid.
Minister Anandatissa de Alwis observed: "You cannot develop a country by taking economic pressures, you have to carry our people with you and if the people are distressed and are not walking together towards the common objective, then your economic goals will not be met".

Bleak Future for Investment:

The biggest blow to foreign investment was Colombo being affected during the disturbance. In the past instances of ethnic violence, Colombo was hardly affected and did not deter response from investors to locate their investments in Sri Lanka. Foreign investors in the past were not bothered about ethnic disturbances in other parts of the country. But since it happened in Colombo this time, it caused a lot of worries to investors and state authorities engaged in attracting foreign investors.

The other problem of balance of payments, inflation and imminent pressure to devalue the currency which were seriously threatening the economy have dwarfed in size and dimension once the ethnic violence had started rearing its head and this time striking at factories and industrial establishments. Although the government is claiming at frequent intervals that normalcy had been restored, for some weeks there were conflicting reports about the situation. For the country even to limp back to normalcy there should

be assurance of peace and stability. With the liberation 'Tigers' rumoured to be threatening to strike the Sinhalese strong holds and the Sinhalese elements planning to hit back, the chances of industrialists coming forth to put up industries are quite bleak. Although there is danger mainly to establishments belonging to the people of Tamil origin mob frenzy could not distinguish between Tamils and others of Indian origin in a moment of anger. No industrialist would like to venture and get entangled in such a situation.

Until the government demonstrates to the world that it can bring about durable peace in the country, prospects of new industrial ventures with foreign investment look very bleak. However, the Finance Minister feels that economic confidence can be restored quickly if there is no recurrence of trouble, if law and order and a strong government is maintained and if discipline is restored in every sector of public. Citing the examples of Malaysia he said that one will be surprised how quickly a country can bounce back to economic recovery if the necessary environment is created. Political and economic stability can be revived in a few months as it happened in Malaysia after the racial conflicts which were much more serious than anything that happened in Sri Lanka. How far this prediction will come true and how soon can peace be restored are all part of the future.

197. The Island, 17 November 1983.
198. Venkatramani, n.175.