CHAPTER IX.

THE SPECIAL NATURE OF SRI LANKA'S PROBLEM.

Section 1. Features of Sri Lanka's Economy.

We may detail some indicators to compare Sri Lanka with the other countries of the region.

Population: Lowest growth rate of 1.6 per cent; birth rate fell by 28 per cent; lowest birth rate of 26 per thousand; and lowest death rate of 6 per thousand.

Manpower: Lowest actual population (per cent) for those under 15 and between 15 and 20.

Education: Highest literacy rate for adults.

Health: Highest life expectancy at birth; lowest mortality rate per thousand; lowest death rate; and lowest population per doctor, nursing staff, hospital bed, and access to safe water.

GNI: Highest per capita income of US$ 200/-; and lowest ratio under poverty line of 22 per cent.

Growth Rate: Modest for 1975, 1976 and 1977, but 3.2 per cent for 1978. Sri Lanka's public Investment Plan (1979-83) provides for a growth rate of 5.5 per cent for GDP, of 4.5 per cent for agriculture and of 6 per cent for manufacturing. A growth rate for GDP is estimated at 5.2 per cent in 1979. Sri Lanka is relatively less dependent on agriculture than others. It has a high rate of savings, next to India. Increase in investments is due to inflow of

1. Compare with Chapter V, Section 1.
resources from abroad. Reduction of food subsidies has been used to subsidise fertiliser for greater production. Inflationary pressure continues. The balance of payments position has fluctuated from year to year. The GDP is estimated to grow at 6.4 per cent for 1980.

Agriculture: It is one-third of the GDP, and about half of the population is engaged in it.

Balance of Payments: There is deficit, but it is covered by development assistance. The future prospects about balance of payments are uncertain due to the increase in the price of oil and the impending world recession. Net inflow of resources are subject to wide fluctuations from year to year. The uncertainty of aid made planning very difficult. External public debt is very large, and debt servicing is a burden on the balance of payments. Past debts must be rescheduled to reduce the burden of debt service payments. The balance of payments appears to be satisfactory.

The position is that the economic indicators are more favourable to Sri Lanka as compared to the other countries of the region. Furthermore, the external trade is an important sector of Sri Lanka and influence the economy to a greater degree than it does in the case of other countries of the region. It is so greatly linked to the west that it has a very negligible export trade with the region. Her attempts to diversify has not met with much success because of a high-cost economy and the small size of its market. Traditional exports still dominate and the non-traditional ones still seek western markets. Her imports mainly originate from the west though liberalisation seems to have benefited India considerably. Nor has the Free Trade Zone helped industrialisation because foreign privat
investment is shy as it fears lack of access to western markets for its products. Both her policies of import substitution and her export promotion have failed to achieve their objectives. Devaluation and liberalisation have not realised their promises. While exports continue to stagnate imports have flooded the country. Development eludes the country while inflationary pressure continues. The panacea and the palliative is a planned development through regional economic cooperation.

**Notable Trends since 1977:** With an abrupt reversal of economic policies since 1977 it is very relevant to note the salient trends in the economy since then. Devaluation and liberalisation produced a chain of effects that changed the complexion of the economy. The agricultural sector was disappointing due to tea and subsidiary food crops. There was a slackening of exports performance and a rise in the level of imports. The external resource gap more than doubled, but was financed almost entirely by long-term loans, and a surplus spilled over to enhance external assets. The external debt servicing did not rise because of a decline in capital repayments and the highly favourable terms of foreign loans. Foreign assets rose, thanks to the net inflow of resources. And the expansionary effects of the growth in external assets were considerably moderated by the contractionary stance of the Government sector.

The rate of growth was almost double that of the last decade, but it was almost confined to trade, finance and services. Agriculture and industry and employment did not fulfil the promises, and were almost stagnant. Per capita income rose but not enough

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to indicate the massive inflow of resources. Inflationary tendencies had to be curbed through a monetary policy package which was responsible for containing the growth in money supply. Thus monetary contraction was adopted through strongest policies. Interest rates were raised and savings mobilised. Prices rose but were kept down by the availability of goods. But unemployment did not come down even though Government investment almost doubled, 1/3 going into agriculture. The private sector took time to respond due to past repression. There was nevertheless a spurt of activity, but how far it was productive is a matter for investigation. Gross domestic capital formation rose while domestic savings declined. This was due to increased foreign resources which enabled investment to rise, higher. The success in maintaining a high level of public investment was an encouraging feature of economic development during this period. Besides agriculture, electricity and transport received a high share of the investment resources. Other productive sectors also received due share of investments. The private sector as already indicated was slower. The relative shares of consumption and capital however remained almost unchanged during this period.

More dramatic was the fiscal policy of the country. The Government Budget almost doubled and rose from 1/3 of GNP to ½ GNP. Both current and capital expenditure rose remarkably though there was a shift from consumption to investment. The deficit on current account had expansionary impact. Public debt rose. It was half domestic and half foreign. This was in spite of withdrawal of subsidies, rise in revenue and a minor rise in wages.

The impact of inflation on wages was a very notable aspect of the happenings in this period. At the end of 1979 real wages had
fallen to 1/3rd of its pre-1977 level and it is expected that at the end of 1980 it would be \( \frac{1}{4} \). The rate of inflation despite monetary and trade policies was damaging.

The last three years must be sufficient to judge the impact of devaluation and liberalisation on the economy of the country. If the past policies were unsatisfactory for development, the new policies were equally disappointing and frustrating. We shall examine the trends a little more closely before we advocate regional economic cooperation as the panacea and palliative for the ills of the economy of a small nation like Sri Lanka.

Section 2. Devaluation and Liberalisation, 1977-80

Since the middle of 1977 policies were reversed by far-reaching economic reforms. These far-reaching economic reforms were essentially aimed at removing the distortions that had arisen in the economic system as a result of long years of control and regulation, and at restoring incentives in a competitive atmosphere. These measures, it was hoped, would galvanise the stagnant economy on a path of self-sustaining economic growth. It was natural to desire to liberalise trade and payments and remove controls and allow the market mechanism to prevail. But the rupee was not strong enough to maintain the existing exchange rate, so the Government had to devalue and unify the trade. Between August and November of that year a system of “crawling peg” was adopted and the rupee was gradually devalued hundred per cent and therefore allowed to float. A further depreciation of 25 per cent took place later. The Finance Minister in his Budget Speech in November announced as a corollary of the exchange rate reform, a comprehensive trade and payments liberalisation policy for implementation simultaneously.
Imports were liberalised. A new tariff structure was introduced. Exchange control restrictions were relaxed substantially. Competition was encouraged. There was a trend towards freer market-orientation and fiscal contraction. There was a drop in capital expenditure of 19 per cent, though the 1978 Budget tried to shift from consumption current surplus to borrowing from non-inflationary sources. There was considerable scaling down of consumer subsidies. Public corporations were made more viable. There was credit squeeze with money expansion. Hence deposits rose. Contractionary monetary policies were followed. Thus devaluation and liberalisation set in motion a series of economic reforms which amounted to a complete reversal of economic policies since 1977, the effects of which were felt in the years 1978, 1979 and 1980. We shall now examine the effects of this policy on the course of events in Sri Lanka.

Industry: We may also note the changes in industrial policy before we examine the broad effects of devaluation and liberalisation. A major constraint to the growth of manufacturing output has been the small size of the local market. On the one hand, heavy and continuing protection to local industries, lack of adequate competition and a widespread system of licensing and controls appear to have prevented these industries from improving product quality and reaching the levels of efficiency necessary for exporting their products. On the other hand, there were difficulties associated with gaining access to world markets. Industrial policy was therefore changed. Imports were liberalised, freeing the majority of raw materials from licensing and permitting imports of machinery in consignments not exceeding Rs.700,000 without prior government approval. Export
orientated industries were encouraged in the FTZ, and also in the
rest of the country. Limited import competition under a new import
tariff was also permitted. At the same time competition was
encouraged between the public and private sectors.

But what actually happened under this new dispensation of economic
reforms in Sri Lanka between 1977 and 1980? This is of great
theoretical and practical interest to students of developing
economies in general. There was doubling of the growth rate and an
increase in the rate of savings. But this was reflected in the trade
finance and services sectors only and not in the industry, agriculture
and fisheries, whose rate of growth remained the same as before.
Industry, especially, showed no upward trend, nor was productive
employment. Inflation increased by 17 per cent in 1978, 25 per cent
in 1979 and is expected to increase by 40 per cent in 1980. This
has reduced real wages to a third now, and probably to a fourth
by the end of the year, if devaluation is taken into account. A
large share of the exports has gone as revenue to the government
and has not benefited the producer. It amounted to Rs.3,000/-
million as local receipts of exports. The 1977 surplus in external
trade was the largest ever recorded in the recent history of Sri
Lanka, but this was due to increased prices for tea due to coffee
blight. There were other reasons for the large surplus, e.g. the
inertia to invest with a change in government and a saving in import
on food item because of a rise in paddy production due to earlier
policies. Large aid was also forthcoming with the adoption of a

policy change. Since devaluation and liberalisation took place only at the end of the year, the 1977 surplus had nothing to do with the new policy. The magnitude was of the order of Rs. 3000/- million. Devaluation and liberalisation resulted in heavy deficits, in 1978 and 1979 of the order of minus Rs. 3000/- million and minus Rs. 6000/- million respectively. Inflation was staring in the face and production did not rise. The new policy had no positive effect on exports, production and employment. On the other hand tea exports declined, agricultural and industrial production collapsed against imports, and the employment spree of 1977 waned in the subsequent years. Only rubber and coconut improved in value. In fact the volume of traditional exports declined. This was made good by prices. The terms of trade improved in 1977 and declined later. The trade, finance and services sectors showed increased activity and contributed the high rate of growth and savings and continued to do so. Non-traditional exports like garments and remittances by migrants showed improvements, but it must be noted that garments leave only a very small margin since the materials for it are entered on the side of imports as well. Deficits are covered by loans and grants while it must be pointed out that Japan occupied a dominant position in the new imports of the country. Imports are made possible not by exports but by loans and other aid. The sources of loans are drying up. With its cessation what would happen to the economy? Inflation would spiral up and devaluation will become a continuing process. Already it has undergone a further depreciation of 35 per cent. The choice would again be to go back to controls or continue to devalue by leaps and bounds. This is in contrast to India where controls exist and help the country
to revalue the rupee against other currencies. The Indian and Sri Lanka rupees are at variance and are moving in opposite directions. This is the final outcome of the free trade policy. This cannot go on indefinitely. Foreign aid will stop, and a decision must be taken. The Finance Minister has already expressed the view that aid is drying up, though the U.K., West Germany, Canada and Japan have contributed substantially for the Mahaweli River Valley Project. In fact the consumers' interest outweighed the producers' interest in devaluation. The impact on prices, wages, and income distribution have been very adverse. Moreover devaluation has had no effects on exports and imports since they are inelastic, both demand and supply. The only beneficiaries are the government and the commercial class. The non-traditional exports fared better under the old system of FERD, CRA, etc. Created money in 1979 was Rs.500 million. The problem of increased imports being not covered by increased exports continued to plague the balance of payments problem despite increases in remittances, increased exports of garments, improved exports of rubber and coconut products, etc. This would eat into foreign reserves and cause inflation and debt burden. The lesson from all these is that devaluation and liberalisation have to be adjudged carefully and applied judiciously to each particular case, and that by themselves they would not help economic development. The rubicon of viability has to be crossed through the establishment of a large market to meet the economies of scale and specialisation leading to economic efficiency and this can be done only on the basis of regional economic cooperation. The Central Bank Report for 1979 confirms this (pp.9,10). This is nothing but an inaudible for
stagnation and a veiled admission of failure on the production front. All economic policies have been tried in Sri Lanka almost in parallel to India since the end of the First World War. Yet Sri Lanka has not been able to diversify its economy and raise its standards of living corresponding to its initial lead in the region. This is in spite of favourable indicators in the socio-political field. The answer is that the remedy has to be sought in fields hitherto unexplored, i.e. in regional economic cooperation. Sri Lanka has been suffering far too long from a sense of inferiority complex with regard to cooperation in the region and fighting shy to come to terms with other countries of the region in closer economic collaboration. There is no a priori reason for doing so. On the other hand she stands to gain. The sooner she sheds this fear complex the better it would be for her future economic development. The vast contraband and illicit and smuggled trade carried on both ways indicates the wide scope for mutual trade and development through economic cooperation.

Section 3. Efforts at Regional Economic Cooperation.

Though in the fifties Sri Lanka had her reservations to join any regional grouping, in the seventies she came out clearly in favour of ECOC. The first signs were seen at Algiers in 1973 when the Prime Minister proposed a 'World Fertiliser Fund' involving the production of fertiliser in the developing countries themselves.

6. Marga Reports, Colombo.
The West hailed it. This was repeated by her at the Colombo Beafe Conference in 1974. It was to be supported by a 'Food Tax' which would augment its funds. The Sixth Special Session of the U.N. responded well to it. The position was more clearly stated by the Prime Minister at the 1976 Colombo Non-aligned Conference. Its resolutions were similar to that of Arusha and Manila, though there were some additional special features in the Conference.

The 1976 Colombo Conference proposed the institution of Joint Financial Institutions (Item 6). It has gained general recognition in recent years. The establishment of a Joint Financial Institution in order to create a system of monetary relations among developing countries would - a) diminish their dependence on the so-called convertible currencies of developed countries for payment among themselves and for the creation of international liquidity and b) create mechanisms for developing financial flows among developing countries, in particular, implement a system of multinational investment guarantees. Two eminent economists prepared a paper on "Trade between developing countries: Proposals for a New Currency". They elaborated a scheme of monetary and financial arrangements which would help developing countries to expand trade and economic cooperation among themselves and diminish considerably their dependence on the convertible currencies of developed countries. Chief among the proposals for action-oriented research were those centred on multinational banking, production, and marketing enterprises.

Two important institutions were the outcome of the deliberations of the seventies regarding SGSCO. The Asian Clearing Union (ACU) and
the Bangkok Trade Agreement, both of 1975, provided great impetus to intra-regional trade. Their functions and workings are dealt with separately in this thesis as they are of some importance. Of special interest to us is the fact that the principal participants in these two arrangements are the countries of the South Asian region. Sri Lanka is an important beneficiary in these two organisations. Yet the South Asian countries, unlike Latin America, Africa and South-East Asia, remained outside this process of regional groupings mainly due to political disharmony in the region. The attempt of the South Asian countries to set up schemes of economic cooperation were restricted in scope and were limited to trade negotiations arrived at maximising each country's national advantage. Negotiations were often bedevilled by Balance of Payments difficulties. Negotiations were mostly of a defensive character aimed at preserving existing market and traditional trade in traditional commodities. Import substitution policies and those aimed at food self-sufficiency have tended to contract existing trade flows. The perspectives were narrow and they did not take into account the current and possible structural changes in the economies of the countries in the group. There were no clear perceptions of the desirability and mutual advantages of economic cooperation aimed at planned restructuring of production and exchange. Apart from periodic consultations between the Sri Lanka and a few countries in South Asia to identify specific areas for economic cooperation and an agreement between India and Sri Lanka on a few areas of cooperation, very little progress has been made in the region. The Indo-Sri Lanka Agreement of 1965 provides for sharing technology and giving aid. This was followed by the Agreement with
Pakistan in 1973 along with Nepal, Bangladesh and others. The trade agreements and other bilateral and multilateral agreements for economic cooperation with other developing countries currently in operation are renewed periodically. Institutional arrangements for continuing exploration of possibilities of new areas of trade and economic cooperation have been set up by mutual agreement between the government of Sri Lanka, and other governments of the South Asian region bilaterally. Sri Lanka's trade with her neighbours constitutes a small share of her external trade. Such trade was also characterised by large imbalances in the balance of trade position with some of the countries. Joint Commissions have been established to correct these imbalances. With India there is constant review of trade, lowering of tariffs, joint ventures for exports to India, joint business councils for joint investment in the FTZ, capital and technological aid and assistance, and technical assistance programmes. There is cooperation in the marketing of tea, cooperation between the State Trading Organisations, Shipping and Aviation, and in other fields. They are also participants in the Bangkok Trade Agreements and the Asian Clearing Union.

Notwithstanding these laudable efforts at granting trade preferences and clearing arrangements, and at strengthening regional economic cooperation, no real dent has been made to promote specialisation and economic development through regional cooperation. Dissatisfied with the progress made at official levels, non-governmental organisations, scholars in South Asia have since 1973 evinced some interest in promoting economic cooperation in South Asia. They have agreed on the need for research. The CBD held
seminars in Colombo and Nepal and Scaca and identified fields of study and research. Unctad proposals are in their mind, and wherever the Unctad has not covered by research, the Marga Institute has undertaken to fill the gap. This is a noble endeavour by a private body located at Colombo. New Delhi is also known to be keen on promoting research in the field of economic cooperation among the developing countries of the South Asia region. It is hoped, these efforts will bear fruit in the eighties.

In contrast to South Asia, the developing countries elsewhere have made good progress in the field of economic cooperation and integration. The Latin American and African countries have forged several links among themselves. Their endeavours are favoured by geo-political factors and their relations with many nearby industrial countries. The South-East Asian countries were favoured by their proximity to Japan. The South Asian countries have remained outside this historical process. There are also other political and military reasons that were directing the movement towards integration in those continents and areas.

But an egalitarian and altruistic attitude would prompt any observer to agree that this region above all is in need of regional cooperation. A thousand million people constituting a quarter of humanity living in an area hardly 4 per cent of earth’s surface, and the lowest living standards with an explosive population growth do deserve a philosophic attention which should overlook all other handicaps for integration. As the adage goes ‘Economics provides the best argument for integration’. Could there be a better example than the coming together of the U.S. and China. Necessity knows no
law. This is an experiment worth trying. The efforts of economists are worth the reward they will reap. Nehru has set the pace for others to emulate. Thirty long years of valuable experience have passed since the last war, and the world is ripe for such eventualities. Big and small, the South Asian countries have gained experience in industrialization and its problems. Policies will have to be altered according to its problems. Policies will have to be altered from one of autarky to one of regional cooperation. In a competitive world and technological advance that is the only answer for the developing countries. South Asia has all the potentialities for rapid economic development through economic cooperation.

An Illustration: Let us illustrate the implications of the theory and application of economic cooperation to the South Asian region by taking the simple case of the coconut fibre industry of Sri Lanka. Coconut fibre is exported from Sri Lanka to the west through big business houses and international shipping lines. It has to compete with Philippines and others and demand is the principal determining factor except when drought and other causes affect supplies. Prices fluctuate in the international fibre market and generally the coconut industry is not as prosperous as other commodities in international economic relations. What could intra-regional trade through integration mean for the industry and for economic development in general? A personal enquiry at Madras and Colombo revealed a whole set of problems and possibilities regarding the industry. Madras was prepared to absorb any amount of the fibre if supplied in large bulk from Sri Lanka. Colombo
wanted to know if Madras would be prepared to pay the world price for the fibre. Trade had always been outward-looking because of a colonial past, and there was no proper infrastructure in the region to promote intra-regional trade. There were other causes as well that prevented the flow of trade. India is now better industrialised and could prove a healthy market. Kerala would no doubt be in the way, but India could, without injuring it, find ways of satisfying her increased needs while providing a market for Sri Lanka coconut fibre. The basic need is for improvement of coastal shipping, which offers a great opportunity for mutual cooperation and for sufficient demand to afford bulk trade. But it does not stop there. Sri Lanka has national industries centred on coconut fibre and rubber later. These could bring down their costs by an enlarged market with bigger plants and through horizontal and vertical expansion. Moreover the national industries of Sri Lanka based on the raw materials of the country could develop an industrial complex related to these industries with the assurance of a bigger market. Industrialisation in Sri Lanka has been bedevilled with the problem of the market. Industrial exports have not shown any distinct upward trend despite three decades of economic policies to promote industrial development. A high-cost import substitution had eaten into foreign reserves. Traditional and non-traditional exports have stagnated, and international commodity problems: the lack of access to western markets for manufactured exports have been the result of western stubbornness and protectionism of the very industries in which the under-developed countries are interested. Hence the need for overcoming the balance of payments problem and the need for economic development through regional economic cooperation. It modifies the erstwhile
policies of the developing countries from one of import substitution and restrictive trade practices to one of economic cooperation and specialisation on an agreed basis. Coconut fibre could be linked to others like rubber and graphite and other raw materials. Sri Lanka though an island has several infrastructural facilities. Shipping is an important field for collaboration. National industries could become more efficient. This could lead to an arrangement to locate profitable any regional industry that could serve the interests of the whole region through joint investment. The coconut fibre industry would avoid price fluctuations and international instability. It would become the nexus of a series of connected industries and promote regional trade and industrial development in the long run. Thus competitive economies become complementary.

**Section 4. Sri Lanka and Intra-Regional Trade.**

A preferential trading area may be looked at from the point of view of both free trade and protection, for, on the one hand it liberalises trade by reducing tariff levels and removing the weaker producers for better efficiency, and on the other providing bigger markets and better competitive power for those projects for which the countries concerned are too small and inadequate a market to compete well with foreign products even with protection. There is no surer and safer method for the development of backward countries than for groups of them to join together and reduce tariffs in stages among themselves while retaining them against countries so that protection would be effective in providing bigger markets against more advanced countries. We might examine how a preferential trading system would work between Sri Lanka and South Asia. The primary effects of a preferential trading area must be favourable. We may
(1) Tea is the most important export (60%) of Sri Lanka and an important item of India's exports. Sri Lanka and India between them command the world's important sources for the products. Would it not be to their mutual benefit if close cooperation with regard to tea existed between them. The success of the Coffee exporting countries should be a pointer to this region to see joint efforts. It is a clear case where cooperation among producers has achieved what competition had earlier failed to do.

(2) Rubber is Ceylon's second largest export (20%), and would it not be beneficial if rubber products were also manufactured in Sri Lanka. But in relation to the technique and cost of production the local market is not an economic one. India produces some rubber but not enough for her needs. Both countries wish to expand the rubber industry. If the Indian factories were to meet its market and run as an optimum unit she would have to import rubber like many of the advanced countries. Even after production she may not be self-sufficient and may continue to import considerable quantity or it may be that she specialises in one or two varieties of rubber products alone. Sri Lanka on the other hand would also find it difficult to produce economically because of a limited market. If a preferential treatment were granted, it would be that India would be able to avoid the disadvantage of a bad location and Sri Lanka would gain the advantage of a bigger market, so that both India and Sri Lanka need not commence the manufacture of rubber products behind separate tariffs and both suffer from high cost of production and thereby both lose the advantages of international division of labour, but instead let Sri Lanka produce them, and enjoy theIndian
market under a preferential treatment, so that Sri Lanka would gain considerably, and India would not lose as much as she would if she produced part of her requirements and imported the rest from other countries. Thus a preferential trading area would help a group of underdeveloped countries to locate industries in the best place within that area, minimise the disadvantages of a tariff system, help each other by a give-and-take policy of mutual preference and promote the general economic development of the area. The rubber industry would illustrate the type of advantage a member of the area would derive without much loss to the others and which would diminish as time goes by. Of course there is some diversion of trade, but against that there would be mutual benefit and greater development. In fact Kerala should welcome it as the replacement of synthetic by natural rubber would boost the product, especially in view of the oil price-hike in the world.

(3) This applies to the other products of Ceylon like Coconut oil, Copra, Areocanut, Plumbago, Cocoa, Cinnamon, Citrenola oil, and other manufactured products from these agricultural products and raw materials under a plan for economic development. The possibilities are unlimited. Areas producing some of these products in the rest of the region are limited. Therefore Sri Lanka supply would not only enable India to develop her own resources under protection but also meet any deficiency. It is not so much agricultural products and raw materials that would require preferential treatment but the manufactured products derived from them based on a larger market than that of Sri Lanka.
(4) While for Sri Lanka a South Asian preferential trading area would be very significant and makes all the difference, it would also be of substantial benefit to the countries of the region, with India industrialising and still not as competitive as the advanced countries, and with Sri Lanka a very important market for many of her established industries as well as nascent ones, the South Asian preferential area would equally help the economic development of India as it does Sri Lanka and others. This applies to textiles and many of the new industries of India. Thus it will be seen that the South Asian preferential trading system would produce greater benefit to the member countries of the region by accelerating their rate of development, balancing their payments with the rest of the world, and enlarging their intra-regional trade on an ever expanding prospects.

Prospects of Sri Lanka's Trade with South Asia

Sri Lanka's trade with her neighbouring countries in South Asia constitutes a small share of her external trade. Exports varied from 8% to 9% and imports from 12% to 15%. There was also a large imbalance with some, especially India. In order to promote balanced trade and economic cooperation, joint commissions for bilateral consultation and cooperation were established, with India in 1968 and with Pakistan in 1975. Similar actions are being taken with regard to Bangladesh and Nepal. Much headway has been made in forging economic links. The work of the Commissions is mostly centred on the correction of Sri Lanka's large adverse balance of trade with India. India is to allow more exports from Sri Lanka. Joint
ventures are also expected to export products like cement, paper, etc., to India. New avenues of investment and trade are being explored by the private sectors of both countries. India is to provide more capital and technology for several projects. India also provides free technical training. Similar methods are followed vis-à-vis other countries of South Asia by Sri Lanka.

The current and proposed development programmes of the Government of Sri Lanka are expected to produce profound impact on the economy and foreign trade of the country. Projections have been worked out to indicate the changes that are likely to occur among the sectors and sub-sectors of the economy. Some leading projects are expected to bring about these changes for the country and raise the GDP and remove unemployment. In the field of foreign trade the achievement of national self-sufficiency in food would save on imports and along with increased exports would finance industrial goods, both capital and consumer, as well as service the external debt. The volume and composition of imports and exports in the ensuing period would be dependent on and largely determined by the progress of implementation of the twin policies of import substitution and export promotion. A high rate of investment is bound to alter the composition, size and direction of foreign trade. A radical change in the pattern of imports is envisaged. The share of investment goods and consumer durables should become larger at the expense of intermediate goods and consumer (non-durable) goods, although in absolute terms imports of all categories, except food and textiles, are expected to increase quantitatively. The value will depend on the trends of prices in
exporting countries. Similar expansion is expected with exports. While the traditional exports are expected with to be stabilised, increased exports of minor industrial products and mineral products would diversify both the exports and the economy. Past trends point in the same direction for exports. The snag is in the inflationary tendencies in the exporting countries which tilts the terms of trade against Sri Lanka from year to year. This produces greater decline in the volume of imports more than of the exports. Thus development is perpetually handicapped and a continuous strain is placed on the exports. Hence it is that Sri Lanka has to diversify her economy, invest in new industrial ventures, and seek new markets for its products, besides strengthening her commodity position for tea, rubber and coconut products in the international market. The huge investment programme is bound to create new opportunities for foreign technological collaboration and capital participation. A good share of it could find a growing market in South Asia. Regional economic cooperation at this juncture could be of mutual benefit to all the countries of the region, but if the investments (both governmental and private) take the form of external linkages, as is likely to happen, regional economic cooperation is bound to have a set back. Decisions taken without regard to the region would only aggravate matters. Hence it is that planning and investment made by individual countries in the region should be carried out deliberately to promote regional cohesion and mutual exchange. Policies cannot be decided in a vacuum. Many of the projects undertaken by Sri Lanka are within the scope of India and Pakistan to provide the external components. This would reduce the imbalances and promote mutual trade. The extent of regional participation in
the investment programmes and foreign trade is an uncertain trend. This is the result of lack of coordination between the countries of the region in their national plans which vitally affects the outcome of their policies and plan implementation. Better results could be obtained through regional economic cooperation.

Other avenues of cooperation are as follow: 1. Joint Capital Participation. 2. Export of capital and technology. 3. Regional cooperation in Shipping. 4. Regional cooperation in Civil Aviation. 5. Regional cooperation in Tourism. 6. Regional cooperation in construction of Economic Infrastructure. 7. Regional cooperation in Fishery Exploration and Research. A wide field for cooperation exists in the region. They could lead to economic efficiency and mutual benefit.

Monetary and Financial Cooperation: A very high priority has been accorded to the expansion of trade between developing countries in the programme of ECDC. Three important measures which could stimulate such trade expansion are trade preferences, infrastructural and institutional developments, and a new monetary arrangement. New monetary arrangements are required to promote both intra-regional and inter-regional trade. In the present world monetary system, developing countries have very little control over the payments system of international trade. About three-quarters of the SDR's of the IMF are issued to developed countries. Payments agreements among a few group

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8. Third Annual Report of the Asian Clearing Union; and articles of Memorandum.
of developing countries are also mainly dependent on convertible currencies of developed countries. Extension of GSP among Third World countries has met with difficulties because developing countries fear to enter into trade liberalisation arrangements, and because of the consequent loss of their scarce reserves of convertible currencies and the resulting balance of payments difficulties. A new system of monetary arrangements is therefore necessary as argued by two economists in their report to Unctad, in order to encourage multilateral trade; encourage use of local currencies for payments; arrange joint use of foreign resources; and create credit and new currency for payments by developing countries. Each country could provide credit to others.

The outcome of this was the Asian Clearing Union of 1975. This was established under the auspices of the Escap. It was signed by the countries of South Asia with headquarters at Tehran, for the Fund. The ACU is the first major experiment in monetary cooperation in Asia established under the Escap. The purposes of the ACU are as follow: 1. To provide a facility to settle, on a multilateral basis, payments for current international transactions among the territories of participants; 2. To promote the use of participants' currencies in current transactions between their respective territories and thereby effect economies in the use of the participants' exchange reserves; 3. To promote monetary cooperation among the participants and closer relations among the banking systems in their territories and thereby contributing to the expansion of trade and economic activity among the countries of the Escap region.
The unit of account is as follows: 1. The accounts of the ACU shall be kept in a common unit account hereby designated as the "Asian Monetary Unit", which may be referred to in the abbreviated form as "AMU". 2. The value of one AMU shall be equivalent to one special drawing right allocated by the IACF. 3. The Board of Directors may change the value of the AMU at any time by a unanimous vote of all the Directors. 4. In the event of a change in the value of the AMU by a Board of Directors, the outstanding net debtor and creditor positions as of the date of this change shall be settled on the basis of the value of the AMU preceding such change. The Agreement contains five sections: General Provisions; Operations; Organisation and Administration; Miscellaneous Provisions; and Final Provisions. India, Pakistan, Iran, Sri Lanka, Bangladesh, Nepal and Burma (1977) are the present participants of the ACU. A number of transactions have been cleared since 1975. India is the most active participant in the system (83% of total payments) and Sri Lanka is second (12%). Nepal and Bangladesh are still to open account. India and Pakistan are not creditors in the system, while Sri Lanka and Iran are not debtors. The ACU has made steady progress since 1975. Burma joined in 1977. Exchange rates are fixed fortnightly for the currencies of the member countries in terms of the AMU. The credit to participants has been extended from one month to two months now. The Unctad and Unctad Secretariats render technical assistance to the ACU. This experiment is being watched with great interest in order to explore wider fields of activity. Undoubtedly the ACU, along with the Bangkok Trade Agreement, is a great step forward in the direction of regional economic cooperation.
Conclusion: The main purpose of this Chapter has been to examine the scope and manner of a regional preferential trading system that would suit the needs of Sri Lanka in order to promote her economic development and solve her balance of payments disequilibrium. A balanced development of the economy was the sure means of raising employment and standards of living and of utilising both human and natural resources to the maximum and industrialisation would be able to overcome the problems of finance and market. A regional preferential trading system was therefore the best means of entering an expansion of the economy and at the same time alleviating the balance of payments problem. A careful choice has to be made of the countries forming the area and of the commodities seeking preference so that regional complementarity and self-sufficiency may be attained to a fair degree by wise location of basic and other manufacturing and agricultural industries. Attention should be paid more to future patterns of industry and cost structure than to present trends. The idea of an immediate common market or supra-national institutions is far from our minds. Nor is our judgment limited by the present quantum of intraregional trade, or by the possibilities or otherwise of expanding the intraregional trade of agricultural products alone. We have to look forward to the industrial development of the region in the future as well. The international position of the primary products has also to be strengthened. Mutual benefits have also to be gauged according to the size of a country and the rate of its development. The countries of the area have also to canalise their internal resources and
external finance and adopt uniform policies to secure the maximum cost-benefit. It would thus appear that the pattern of foreign trade would adjust itself to a changing economic structure and promote greater intra-regional trade, especially of manufacturers, so that greater equilibrium is restored to the balance of payments and better security and stability to the economy.