

THE INDUSTRIAL SECTOR AND THE OPEN ECONOMY

A.R.P. Wijesekera

This has to be said at the outset. We would not have the dams, power houses and downstream development of the accelerated Mahaweli programme today, but for the economic policies adopted by the UNP Government over the last ten years. We would not have Lunugamvehera and Ingimitiya and innumerable other irrigation schemes. We would not have the rapid increase in housing stock and improvement in Highways. We have spent large sums of money on Telecommunications, Power and Transport. The results are debatable, but it is indisputable that this was possible only because we accepted the dictates of the IMF and the World Bank.

The effect of such dictates on the industrialisation of Sri Lanka has been the price which we have paid for success in other sectors of the Economy.

The UNP Government which took office in 1977 had no intention of reducing Protection for local industry. What it proposed to do was to substitute economic levers for bureaucratic controls. Licensing and Quotas would be removed and an Import Duty fixed at a general rate around 150%. Raw materials would flow in freely to activate manufacturing industry. Other goods would be imported in appreciable quantities to meet the needs of a population long starved of necessities. It was vital to obtain substantial foreign funds to tide over the period till a Balance of Payments was achieved through a realistic currency.

The search for funds brought in a team of IMF and World Bank officials to study our needs and to advise us on what we should do. The IMF took up the position that Sri Lanka should not industrialise, because we may not be able to sustain the burden of feeding manufacturing capacity in time to come and that it would in the long run be safer to import finished goods.

The intention of the IMF was very clear in 1977. Funds would be provided to develop a Market in Sri Lanka for the finished goods of developed countries. At the same time, increase in Sri Lankan manufacturing capacity would be dis-

couraged, so that our dependence on imported products would continue in the future, even in areas where we have the potential to commerce manufacturing ourselves.

The IMF ever since has with variations, sometimes subtle, consistently followed the policy which it laid down for Sri Lanka in 1977. Acceptance in general terms of this policy has brought Sri Lanka Foreign Aid in the form of Grants and Concessionary loans in adequate quantities to sustain its ambitious Development Programme. This was the Policy which in Sri Lanka's context is styled an Open Economy.

Let us define this Open Economy. In its ultimate form, Sri Lanka would import all goods which could be made cheaper elsewhere than could be made in Sri Lanka. Sri Lanka would develop export capacity in items in which we would be competitive in World Markets. Revenue would be obtained from Turnover Taxes spread widely throughout the Economy. There would be no difference between the Turnover Taxes on imported goods and Turnover Taxes on goods manufactured locally.

IMF blithely talks of allowing the free play of market forces and ignores the manipulation of prices by strong buyers in developed countries to the detriment of weak sellers in developing countries. The IMF ignores Cartels and the heavy subsidies granted by some countries to foster export of manufactured goods.

These interventions and distortions make it impossible for an import oriented developing country to achieve a Balance of Payments without massive foreign loans and increases in the debt service ratio. The country gets into the hands of money lenders. It is not difficult to imagine that this is deliberate IMF policy.

The IMF has persisted with its attempts to reduce import duties. The appointment of a Presidential Tariff Commission was ostensibly to rationalise the tariff structure. But what the IMF expected to get from it was a reduction in Import Duty, which in fact was reduced from a general rate of 100% to

60%. There has been a further reduction subsequently, and at present the general rate of Import Duties is 50%.

The effect of this reduction of Import Duties over the years on local Industry manufacturing for local consumption has been that small scale manufacturers of Matches, Sewing Thread and Footwear have more or less disappeared. The Handloom sector too has been very adversely affected. Silk screen painting on textiles and the local manufacture of Cycles and Umbrellas have been casualties. In fact one of the first casualties of the freeing of the Economy was the manufacture of low quality spares for motor vehicles and machinery.

Another important casualty was a Bus and Lorry Body Building Industry built up over many years. Second-hand buses and lorries from Japan cause traffic jams on Sri Lankan roads.

Most important, the large Engineering firms which have for over a hundred years manufactured machinery, equipment and spares for our plantation industries - Rubber, Coconut and Tea - are in the doldrums, if not in dire straits.

One of the reasons is a sprouting of a large number of small firms in plantation areas, who engage in servicing these industries and repairing machinery and equipment and manufacturing simple spares.

Another is the decision to import CTC machinery for re-habilitating a percentage of the Tea processing facilities. Sri Lanka has a traditional and well earned reputation for producing the best tea in the world. Tea made in Sri Lanka on CTC machinery cannot carry this label.

The Government has over its ten years made a determined effort to develop another portion of the Industrial sector. These are the Industries which manufacture primarily for Export. The Government has made much of the fact that there was insufficient local capital to enable rapid local expansion of Industries by local Industrialists.

The GCEC and the FIAC have been set up with the objective of attracting foreign investment into industries which would produce for Export. Such industries would earn foreign exchange and provide employment.

The sky is the limit in the incentives offered so as to attract foreign investment. Repatriation of Capital and Pro-

fits would be permitted. There would be no duties, no Income Taxes, no Turnover taxes and no Tax on the income of expatriates.

The foreign investors who have come into the Investment Promotion Zones at Katunayake and Biyagama and into FIAC projects have created considerable employment. But the increase in nett foreign exchange earnings has been disappointing. In fact, all propaganda on the GCEC and FIAC had been in terms of Gross Foreign Exchange earnings.

The IMF actively pursues a policy of discouraging local manufacture for local consumption. At the same time it wants an increase in Exports. Some people say that additional Export concessions have been made a condition for this Aid which has been negotiated recently. Whether this is true or not, Export Industries have received considerable attention in the report of the Industrial Policy Committee.

The Government in 1984, set up a Committee of top public sector brains and styled it the Industrial Policy Committee. The Task was to develop a strategy for Industrialisation. The Report of the Industrial Policy Committee will with modification, be the Master Plan, for the rapid Industrialisation of Sri Lanka.

What concessions does the Report of the Industrial Policy Committee offer to those Industrialists who manufacture for local use. Firstly Investment in expanding manufacturing output will be granted 100% of investment relief, up to a limit of 50% of Assessable Income. Secondly Corporate Taxes will be reduced to 35%. Both these concessions are to be afforded only when revenue considerations permit.

The performance of Export Industries has been mixed and rather disappointing in spite of the incentive packages offered to GCEC and FIAC projects. Therefore the Industrial Policy Committee hopes to accelerate the development of Export Industries by very heavy subsidies. The subsidies may be in the form of a Transferable Tax Credit Scheme.

Transferable Tax Credit can be used for paying all forms of taxes including taxes on the profits which a Company would make by importing goods such as Radios and Agro-chemicals. Large Im-

port/Export firms which today pay large sums of money as Income Tax and Turnover Tax will pay not taxes at all. Where is the replacement money to come from?

Where is the money to come from to pay the heavy Export Subsidies which will result from the Transferable Tax Credit Scheme? Surely not from additional Export Duty on Tea, Rubber and Coconut which are encountering heavy weather at present. Surely not from taxes on Import Competing Industries? The money will have to come from the Import cess and from Turnover Taxes on businesses other than Import Competing Industries.

In fact, the main and most important concession that the Government can make to Import Competing Industries today is the complete removal of the Turnover Tax on locally manufactured goods. The rationale for such a move would be that there is no Turnover Tax on Export products. Further, because the Import Competing Industries are part of the Lead Sector of the Economy it would be quite fair to exact Turnover Taxes on other sectors of the Economy and to leave the Lead Sector alone.

But IMF Policy clearly discourages local manufacture for local consumption. However unfair it be, the local manufacturing industry will have to bear heavy Turnover Taxes to subsidise Exports into Developed Countries. What is doubly unfair is that local manufacture which commands a large share of the local market is taxed heavier than local products which yield pride of place to Imports.

The Import Tariff Guide dated January, 1987 and issued later by the Customs reveals the intentions of the Government. This document which should be studied widely shows a General Rate of 60% on Imports. The duty on raw materials has been reduced to nil, but the Turnover Tax has been increased to 10%.

What is remarkable is that this official document dated January, 1987 shows Turnover Taxes on a full range of Agricultural Products, including Tea, Rubber, Coconuts, Sugar, Paddy, Rice and Minor Crops.

Heavy Export subsidies through the Transferable Tax Credit Scheme will make it possible for Sri Lanka to sell very cheap products in the World Market. The sale of such products would even lead to a foreign exchange loss.

It is not clear that an Export Drive in manufactured products into world markets will not make an appreciable impact on Sri Lanka's Balance of Payments problems?

What Sri Lanka needs most urgently is access into the vast Indian Market for Industrial Goods made in Sri Lanka with Sri Lankan and Indian Capital.

The position today is that if an Indian manufacturer, using his capital and know how, were to make bus and lorry chassis in Sri Lanka, he could export his products to most parts of the world except India. He is not able to export even one chassis into his home country, India. This is a very state of affairs which must be remedied.

It can only be corrected if the Sri Lankan Government makes a very strong point in favour of a very special trade relationship between India and Sri Lanka is that Exports of Industrial products from Sri Lanka into India on a barter agreement will make only a negligible dent in the huge market for goods made in India.

Sri Lanka has a very unfavourable Balance of Trade with India. To enable the reduction of the annual deficit, India annually grants Sri Lanka aid in the form of loans to pay for industrial products from India. How much better would it be if industrial products from India were paid for, at least in part, by industrial products such as automobile components from Sri Lanka. Finished rubber goods from Sri Lanka would fetch very good prices on the Indian market.

Is it not a fact that the Central Government of India is ready today, more than ever before, to make a special concession of this nature to Sri Lanka? Expanded Trade with India can lead to a better Economy.

Courtesy: INDUSTRIAL CEYLON