

# Economic Rationale for the Privatization of Tea Plantations in Sri Lanka

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## Introduction

The privatization initiative in the tea sector as part of structural adjustment programs advocated by the World Bank and the International Monetary Fund is intended to balance the national budget by removing government subsidies and privatizing state enterprises such as the Janatha Estate Development Board (JEDB) and the Sri Lanka State Plantation Corporation (SLSPC). Theoretically, this policy initiative may generate more "efficiency," and perhaps "equity" on ideological ground, in the market-friendly Sri Lankan tea economy. Public funds, which were previously used in subsidizing inefficient bureaucratic agencies, can now be reallocated for the purpose of much needed infrastructure and human development programs. Moreover, the management of privatized entities may have the choice to operate freely of political influence and financial regulations of the government. Thus, the private entrepreneurs motivated by profit criteria have the conducive environment to create the necessary dynamics in the liberalized economy.

Beside these general arguments, is there an economic rationale, other than political ideology, for reprivatizing the management of state-owned tea plantations in Sri Lanka? Is such rationale applicable to both ownership and management of large and small estates which have traditionally been private sector enterprises? Was there a failure in the management of nationalized tea plantations? Should the management, nor the ownership (or both), of tea estates inherently be in the hands of private entrepreneurs? Would the privatization strategy circumvent the problematic issues related to political interference and morale of the unaccountable workforce if estates were reprivatized? Can one quantify the ineffectiveness of public sector management, *ceteris paribus*; and how does the private management change such organizations into efficient operations? If private management is more efficient and resourceful than state management, does that guarantee the success despite many reported failures and bankruptcies of private enterprises where governments eventually had to come to the rescue? These are equally important policy questions one must raise

even if the stated objective is to balance the national budget. The essence of reprivatization is, however, the economics what most mattered in the profit-maximizing mind-set. What is then, if any, the economic rationale for reprivatization?

## Economic Rationale and Estate Size

The "economic rationale" for privatization may be suggested when equal efficiency exists across varying sizes of state-owned JEDB and SLSPC tea estates. This is the case of the two study districts of Ratnapura in the low-elevation and Nuwara Eliya in the high-elevation (see map 1). Author's study concluded that the results of the Cobb-Douglas production function model, which provide statistical evidence to test returns to scale, suggest that Sri Lanka's tea production, on the average, experiences constant returns to scale. It implies that large estates do not necessarily obtain maximum efficiency in production and the smaller estates do operate at a relatively higher efficiency level than larger tea estates.

Studies have illustrated that each farm (plantation) size has its own merits whether they are small, medium, or large. Although one district may have some comparative advantages in tea production over the other, the existence of more or less constant returns to scale in both Ratnapura and Nuwara Eliya districts suggests that productivity and efficiency in every estate, despite of size, can be enhanced. Therefore, competition among small, medium, and large tea estates should be encouraged as well as within each size, category. Every estate, irrespective of size, can be developed and assisted with an intergrated policy of appropriate managerial, financial, and institutional support.

## Efficiency and Equity

One may ask whether Sri Lanka can achieve economic "efficiency" and social "equity" in the estate tea sector. When economies of scale exist, large tea estates are said to be more efficient and productive than small ones. The converse is true with decreasing returns to scale (diseconomies of scale). But the results of the Cobb-Douglas production function models have demonstrated constant returns to scale; whereby inputs increase, the amount of output rises in about the

same proportion regardless of estate size. The potential trade-offs between the privatization of small and large tea estates are, therefore, not significant in acquiring efficiency at the expense of achieving equity goals. Because every size of estate operates at the same productivity and efficiency level, equity considerations need not to be compromised to achieve economic gains.

If size, on the other hand, is an important issue to policy makers on the basis of social, economic, and political realities in the country, the existing organization of estate landholding should be maintained. In such a situation, the efficiency and equity consideration might best be enhanced by a policy designed to encourage competitiveness within and among various size groups. Promoting

one size group of estates over another may result in increasing efficiency, but could compromise equity.

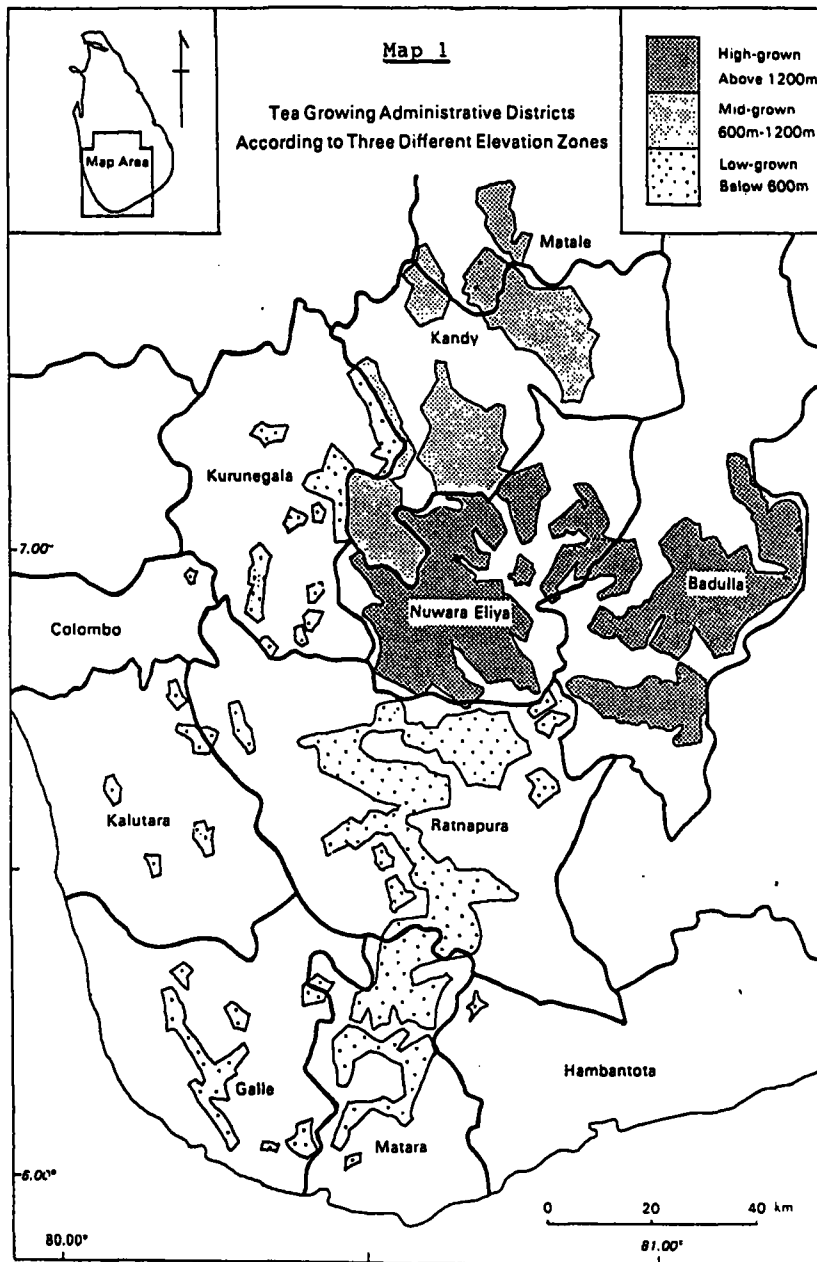
**Reprivatization and Peoplization**

When equal efficiency exists across varying sizes, selected estates can be given to private entrepreneurs to initiate competition under free market conditions. A Sri Lankan-style privatization known as peoplization, in contrast to a British-style, is meant to give the people and the employees of estates the opportunity to participate in private enterprises as shareholders. This would enhance both efficiency and equity because workers and ordinary citizens would then own and manage the enterprise. Private entrepreneurs, who are inspired by the profit motive, may become more productive and efficient because they are independent of government control. The results of the Cobb-Douglas model do not, however, provide a basis to identify specific estates on which the privatization option can best be considered. Nor would it preclude any from consideration.

If large estates in Ratnapura District are subdivided to increase the intensity of labour use, those subdivided lands could be allocated to private enterprises. Peoplization is a more viable option, politically and sociologically, in Ratnapura district than in Nuwara Eliya. Giving Tamil labourers the opportunity to participate in private ownership in the prosperous tea estates in the high-elevation district would probably be opposed by Sri Lanka's majority Sinhalese community. A relatively large number of entrepreneurs from other sectors of the Ratnapura economy (i.e., gems, rubber, and coconut) could be encouraged to buy shares in privatized estate enterprises. The Tamil population in Nuwara Eliya's tea estate is not yet adequately intergrated into the existing social system in the country to own shares in private enterprises (Tamils of Indian origin were granted Sri Lankan citizenship only in 1988). Therefore, the Sri Lankan-style peoplization efforts in the high-elevation district are not sociologically feasible.

Privatization measure could be recommended in Nuwara Eliya district if lands were to be turned over to private companies (e.g., transnational and national firms

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# **Economic Rationale for the Privatization...**

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such as Lipton/Unilevers, Brook Bond, Walkers, Aitken Spence, Maharaja etc.). This is the way British Government privatized its state-owned enterprises; the unprofitable, inefficient public enterprises were sold out to large corporations. The World Bank has proposed such a British-style privatization as an option for JEDB-owned tea estates. If selected estates were transferred to private companies, at least the management of them, competition among tea estates would emerge, production might increase, and plantations might become profitable. In a British-style privatization, however, the equity consideration would probably be compromised.

## **Conclusion**

Since the national tea industry faces increasing competition from the emerging East African tea producers of Kenya, Tanzania, Malawi and others, Sri Lanka needs to search for counter-measures by increasing productivity and efficiency. The privatization initiative, among other meso-economic policies, is an integral part of global economic restructuring which continues to take place under the sponsorship of many Western international donor agencies. Thus, reprivatization as a "second best" (the 'first' as being the already experimented policy on equity considerations over economic efficiency which has seemingly failed under the nationalization of tea plantations) may prove that competition within a free market environment could achieve at least economic efficiency.