

# Economic Policy Shifts in Sri Lanka

**E**conomic policies adopted by the political regimes in power espoused diverse economic models in their development strategies. The specific economic policies implemented to facilitate the selected economic model depended on the political philosophy and the foreign policy to which the political party in power was attached to. This article attempts to highlight the major shifts in the economic policies in the face of the changing political ideologies since independence.

It would rather be an interesting academic and an intellectual exercise to probe into the economic policies of governments that had been in power since independence. One may confess a strong relationship of one's economic policy with that of the philosophical thought, the ideology and the dogma to which a political party is attached to. A vigilant observer and an analyst may confirm that the mode of thinking and the policy stance of the political parties which had been in authority from time to time, had nevertheless been influenced by their ideological attachments. Since independence, the United National Party (UNP) and the Sri Lanka Freedom Party (SLFP) led coalitions had been the only parties that had been able to rule and govern the island of Ceylon. The UNP, the right of centre of Sri Lankan politics adopted basically a libertarian ideology in combination with an element of social democracy, while the SLFP was basically social democratic in its orientation from the radical left. In theory, irrespective of the fact that both confessed to be Non-aligned in its foreign policy, pragmatically symptoms of pro-western orientation were evidenced with the UNP, while the other was more oriented to the socialist bloc. In its fundamentals, the UNP, market oriented and pro-free trade party is a true believer of the market mechanism in the allocation of economic resources in the economy driven by the private sector. In contrast the SLFP at the birth of independence preached and practised the theology of state intervention in activities of the market forces and followed a more socialist oriented model which encouraged the system of centralised planning; later to have been convinced by the efficiency and the power of the market model, was baptised and converted and now a follower of the market mechanism with a human face.

## 1948-1956: The Liberal Economic Regime

UNP that came to power in 1948 represented largely the interests of the colonial bourgeois and elite groups. From the early 19<sup>th</sup> century the so called Sri Lankan bourgeois class emerged through the accumulation of wealth through engaging themselves in the retail of arrack, plantation agriculture and land ownership. Later, these bourgeois branched out into the trades of transport, labour contracts, graphite mining, commerce as well as serving the colonial bureaucracy at its middle and higher levels, while some made their mark by entering into "learned professions". Given these circumstances, the elites who were now enthroned to govern were more eager to sustain and maintain

the export economy. Probing into the foreign policy of the newly independent government of Ceylon would add an insight of its pro-western economic policies. The defence agreement and the agreement on external affairs entered into on the 11<sup>th</sup> November by the Government of Ceylon and the British Government confesses the pro-western economic outlook of the then government. The rationale for entering into a defence agreement was explained by the then government as they saw it was of high importance of protecting the sea and air communications of the island which inherited highly an import-export economy. The external affairs agreement was regarded as a reflection of Sri Lanka's pro-British foreign policy. During this era, Britain was the island's main trading partner and as the trading with the West was very favourable, the government did not require seeking new markets for her imports and exports.

At Independence, Ceylon inherited a dualistic export economy. It comprised a plantation sector linked to international markets and a backward subsistence agrarian economy. Tea, rubber and coconut brought over 90 percent of the foreign exchange earnings, while tea accounted for 60 percent. Other agriculture, particularly rice production, drew the attention of the government as rice was the staple food and a large proportion of the electorate were in paddy cultivation. During this era, the industrial sector received less attention, particularly since the economy could be still sustained on the production of few primary products. At Independence, the contribution of the export production to GNP was 31.6 percent. More than 64 percent of the government revenue was derived through the taxation of foreign trade and much of this was used for the importation of food as part of the food subsidy scheme exercised by the State. Given the government's commitment to social welfare, the UNP maintained a skeletal welfare system comprising the food subsidy, free education and free health. This served as a basic measure for sustaining political popularity. The economy during this regime was more or less "open", in the sense that quantitative restrictions on imports and foreign exchange transactions were almost absent. With the open economy and the free flow of imports, Sri Lankans enjoying high levels of consumption; the ratio of consumption expenditure to disposable income averaged 95 percent during this period. The economic growth rates recorded for the period 1951-1956 averaged at a low 3.6 percent, while the terms of trade deteriorated from 374 in 1950 to 275 in 1952 and then improved to 340 by 1956. Most of the first post-independence decade turned out to be a time of a liberal trade regime with few taxes on imports and exports for the purpose of revenue generation. During this decade much foreign policy advice received from international agencies encouraged the government for the gradual elimination of subsidies, curtailment of government participation in public welfare and so on. However, reluctance on the part of the government was exhibited due to political reasons. Soon after independence the development strategy had a strong commitment to maintain an open economy

Sajith de Mel

driven by the private sector and the market mechanism in the allocation of resources. However factors such as export pessimism at that time and the possible criticisms by the opposition retarded the pace of the government in moving in that direction. In this context, import substitution in agriculture and industry was considered a policy alternative, while industrialisation was postponed for a later stage. The import substitution strategy on agriculture was taken as a measure to attain self-sufficiency in rice and thereby to reduce the import bill of rice. Moreover from a macro-economic point of view, it was essential to reduce the dualistic nature of the economy. Due to several weaknesses, these goals never materialised.

## 1956-1970: Closed Economy with Interventionist Policies

The government which assumed power in 1956, a centre left based coalition adopted the Soviet type of central planning system where the State played a major role in the decision making of the economy and thus exhibited a major deviation in the political and economic ideology it held as opposed to the UNP. The coalition consisted of the SLFP as its principal partner, along with some leftwing socialist parties and a few other groups which represented sectarian interests. The government believed that the underdeveloped state of the economy which had a structure highly dependent on a few export primary commodities unsustainable on the long run. On the one hand the private sector had no investment capacity in order to undertake huge capital investments that would free the economy of its aggravated position in the face of deteriorating economic indicators. Thus the State was to play a major role in fuelling the economy. In finding solutions to the problem, the government extended the previous government's strategy of agricultural import substitution also to industries. The import substitution industrialisation after 1960 started with increased tariffs and quantitative restrictions on imports and controls over foreign exchange payments, designed to meet the growing balance of payment problem. A distinction was made between essential and non essential imports with a view to discouraging the latter. The placement of import controls had twin objectives. On the one hand, it reflected the government's desire in exercising control over the deteriorating foreign exchange position, while on the other hand it was used as an instrument to encourage the local producers and the local industries. By the beginning of 1960's, the government was facing a critical problem with respect to its external reserves position. Restriction of imports on the one hand was crippled as more than sixty percent of the imports represented essential consumer items. To this it responded in the budget of 1960 by sharply increasing the duties of cars, petrol, liquor and tobacco. In the following year, a five percent duty surcharge was imposed, and cars, watches, clocks, radios and high priced textiles were banned from importation.

The popular economic formula of the day even in the West was growth fuelled through industrial import substitution. Yet the private sector in the island was at its infant stages and was not in a position to undertake massive industries. The government announced several policy packages to attract foreign direct investment. But a restricted and a controlled economic regime never attracted the foreign investors in investing in Sri Lanka. A highly controlled economy coupled with a feeble private sector created a supply gap in the economy which made the State to take up the role as a producer in the economy. This made the government directly involve in the industry by expanding the allocation of economic resources to State owned industries and for the setting up of public sector industrial corporations with the assistance of the Soviet bloc. The government established a large number of State owned enterprises in industry for the production of a wide range of goods such as paper, cement, steel, hardware, petroleum products, fertilizers, tyres and textiles. From 1948 onwards, Sri Lanka produced an array of planning documents. Initially a six year plan was formulated in 1948 and subsequently a six year investment program was prepared. Before much work could be started under this plan, the government changed in 1956. This government which came into power placed a larger weight age on planning following the centralised planning model. The main objectives of the ten year plan emphasised on the need to expand the output, income and the standards of living, removal of unemployment, alter the structure of the economy and to promote equal distribution of incomes. A sound warning was given in this plan that Sri Lanka may lose the lead to some East Asian countries, if higher growth rates were not achieved. The plan projected a six percent growth annually, which implied that GDP would double every twelve years or so and by 1997; the GDP would become eight times the GDP of 1959.

With the assumption of power by the UNP led coalition during the period 1965-1970, the policy stance of this government saw a partial deviation from the pervious regime. However signs of reluctance to deviate from the policy framework of import substitution instituted by the previous regime were exhibited due to several reasons. At that time, the policy of import substitution was relentlessly fashionable and was even regarded by the western economists as the panacea for the underdeveloped economies in transforming their economies. Apart from this, a full scale liberalisation would nevertheless attract criticism from the political opposition. During this regime, the economy saw partial liberalisation in the fields of import trade, foreign exchange payments, initiation of some export promotion policy measures, an attempt restrict state intervention in economic activities, and a resurgence of policy emphasis on import substitution in agriculture.

#### 1970-1977: Regulated Economic Policies

A coalition of SLFP and left-wing parties known as United Front formed a new government in the general elections of 1970. This regime saw a complete reversal of the liberal economic policy stances initiated by the previous government. The State was to play a major role in the rejuvenating the deteriorating economic circumstances. The State assuming the role of a producer in the economy, a

radical import substitution industrial policy was implemented. Under the Business Acquisition Bill, several industrial undertakings were taken over, while under the State Industrial Corporation Act, new industrial corporations were established. The role of the State in the economy saw an expansion, while discouraging and crowding out the private sector investments. The size of the public sector increased from ten percent in 1950 to 30 percent in 1977 and the number of State enterprises increased from a handful in 1960 to more than one hundred by 1970. A five year plan (1972-1976) was introduced by the government that was to guide the development policy of the country. However the aspects such as the food subsidy, administered pricing policies by the State corporations and the worsening external payment situation, crippled the government in mobilising resources in the economy as per the plan. High levels of tariffs and quantitative restrictions over imports, quantitative controls over foreign exchange payments, individual licensing system and monopoly by the government over the importation of essential commodities were the order of the day. Along with the policy of nationalisation of the industries, the government also exhibited an interest in attracting foreign investments. A White paper issued in 1972, reiterated the governments interest in foreign capital. However, attraction by the part of the foreign investors was dismal due to contradictory economic policies. One of the major reasons that led to the defeat of the previous regime was the cut in the rice subsidy. This came under the attack of the SLFP led coalition in facing the elections. With the coming into power, one of the first steps undertaken by the government was to respect its promises and to thereby to reinstall the rice subsidy. With the cut in the rice subsidy and the installation of the administrative controls, the UNP led regime was capable of improving the rice cultivation up to two thirds of the countries requirements. However the massive welfare economics practised by the regime of the 1970's, almost paralysed the rice cultivation in the island. Confronted by the same combination of factors that led to the defeat of the previous regime; grave unemployment, rising prices and scarcities in essential consumption items, the United Front government faced a deadly threat from the JVP, an ultra left organisation dominated by the educated unemployed youth in 1971. The rebels although defeated played a significant part in shaping the future economy of Sri Lanka. Sri Lanka was pushed more rapidly towards being a socialist society. The liberalisation of the local economy initiated by the UNP regime being completely abandoned, the state established control and dominance over the economy. The Land Reforms Law of 1972 and the nationalisation of the plantations in 1975, state control in trade and industry were some momentous measures taken.

One may confess a strong correlation between the UF government's foreign policy and the economic policy. On the ideological front it was anti-capitalist, anti western. The external economic policy aims expressed by the UF regime were to enable the government to rely on more trade than aid, avoid making extensive borrowings from international lending institutions, putting forward Sri Lanka's own conditions in external borrowing that ensures Sri Lanka's self respect, independence and sovereignty. Such a policy would nevertheless confess a

commitment to liberate the economy from western economic domination. Naturally the response of the West to the economic approach of the UF government was negative, and thus this was experienced by way of sharp decline in trade and aid.

#### 1977- 1994: Opening up of the Economy

The development model in the post 1977 period is basically a liberalised trade regime in which export promotion received priority and in which the private sector was assigned to play a major role in economic development. The restrictions placed on the smooth functioning of the market forces by the previous regime was removed to fuel the economy by paving way for the private sector to play a dominant role in the economy as a producer. The State only assumed a role of facilitating the economic functioning of the private sector by embarking on huge capital investments beyond the capacity of the private sector and in the provisioning of public goods. In its policy statement, the UNP government elected promised a path of economic growth and economic development by transforming free economy through economic rehabilitation and transformation. It was also committed to reform the exchange system accompanied by substantial liberalisation of external trade through the assistance of international agencies and financial institutions. It also explicitly expressed their interest in getting substantial assistance from the West, from the Socialist and other friendly nations.

Liberalisation was at the centre of the UNP government's election platform. A series of liberalisation initiatives were taken by the government subsequent to sweeping into power. The prospective targets all had a strong liberal competitive flavour with an open economy particularly in capital, services, and labour markets. Measures were taken to improve foreign investments, including tax incentives. Import controls were abolished and tariffs were rationalised. The tariffs were mainly as nominal measures to protect the domestic import substitution industries. Many quantitative restrictions that were in place were abolished. Apart from the above, the dual exchange rate system introduced in 1968 was abolished and the exchange rate unified. The exchange rate was tied to a basket of currencies and allowed to float as the basket floated. Export expansion was to play a major role in the free economic structure. As a result the export licensing was gradually phased out and export duty structure reformed. The establishment of the Export Development Board by the government played a major role in the promotion of exports of the country. The policy reforms of 1977 were fundamental and far reaching as they facilitated the country's integration into the global economy. The main thrust of the economic reforms initiated in 1977 has been to stimulate the private sector economic activities by setting up a liberalised economic environment and providing infrastructure public investments. Thus in the global environment the new government emphasised less on planning models. In spite of anti-planning attitudes, major developmental projects were undertaken by the government. The Accelerated Mahaweli Development Program, the Housing and Urban Development Program, and the Free Trade Zone were some of them. The

seventeen long years of UNP regime came to an end when again the political pendulum swung in the direction of the SLFP led coalition, the People's Alliance. Ideologically, this political party was from the left based school of thought. Pragmatically, they saw moving against the direction of globalisation which was the renewed form of the open economy and liberalisation ideology would fail to guarantee them victory. Accepting the reality, the party was bold enough to promise its electorate that it will never revert to the era of 1970-1977. A newer variant of the theology of open economy and liberalisation which they named, "An open economy with a human face", was the main campaign slogan, while mitigating corruption, maintaining law and order was the core promises which brought the PA to power in 1994.

### Post 1994: Open Economy with a Human Face

The UNP regime which was in power for a continuous period of seventeen years came to an end with the coming into power the SLFP led People Alliance in the general elections of 1994. With the assassination of President R. Premadasa in May 1983, D.B Wijethunga was sworn in as the President of the country, which lasted till the presidential elections of 1994, where Mrs Chandrika Bandaranayke sworn in as the second lady president of Sri Lanka. The PA government as promised in their election manifesto continued the policy of open economy. Analysts point out that

this continuation enabled in removing the uncertainty regarding the direction of the economic policy, which had usually changed with the regime in power. On the economic front the PA led coalition cast aside the left wing views on economic policies and adopts and furthered the liberalisation policies and emphasised on the role of the private sector in steering the economy as the engine of economic growth. From the political point of view the government of Mrs Chandrika Bandaranaike was less stable as it was a composition of political parties with diverse political ideologies. This instability nevertheless had a negative impact on the government's economic policy, as much concentration had to be placed on satisfying the competing political parties within the PA coalition as opposed to what was expected, "economic management". It would be worthwhile to refer to a speech made by Hon. S.W.R.D Bandaranayke in 1932 in the parliament illustrating the repercussions when a political party is composed of several groups and rules the country. . It goes on, "Increasing the number of parties....., what happens? When ever an election takes place, and a government has to be formed, everybody has to go round begging and entreating one group and another to join up. What is the result of that? A number of incongruence groups are formed. In order to satisfy one group, that group must be given one or two Minister-ships, and in order to satisfy another group that group has to be given one or two Minister-ships. You get an

impossible position where the Ministry is composed of such diverse elements- for you fail to get anything like a coherent policy..." Thus it becomes quite evident that the economic policies initiated by the regimes that had been in power were a major function of their ideological attachments. However, presently we see a deviation by the political parties from their ideological attachments and becoming disciples of globalisation. Thus globalisation and its direction seem to have taken over the economic policy modelling of the contemporary political parties.

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