

PROTECTION POLICY IN SRI LANKA

D.H.Sathischandra

Director Planning

Ministry of Industries & Scientific Affairs

The protection of industries from competition from imports is an important element of industrial policy. The use of protection as an instrument of industrial policy is of recent origin. Prior to 1931 modern factory industry was almost non-existent. The colonial government was concerned primarily with the provision of infrastructure facilities required for administration of law and order in the country and for the production and export of the three plantation crops, namely tea, rubber and coconut. It had an interest in maintaining Sri Lanka as a source of primary goods and as a market for its own manufacturing industry. The promotion of industrial development was not accorded priority.

The depression of 1931 underlined the weakness of the economy with its lack of diversification and over dependence on the three main plantations crops. The Pokkanawala Commission appointed in 1931 recognised the need for industrial development and recommended the establishment of a separate Department of Industries and direct government involvement in industries by establishing model factories among other things.

However, no industries worth mentioning were set up until World War II. The war drastically affected normal imports and immediate steps were taken to implement the recommendations of the Pokkanawala Commission. Some pilot industrial enterprises to manufacture essential consumer goods, using local raw materials, were established during this period, a ceramic factory, plywood factory, paper

mill and glass factory. These industries which were profitable during the war proved unprofitable with the resumption of normal imports. The economic and political policies of the government did not favour protection for industries.

In 1945 a report was prepared on Industrial Development and Policy by the Executive Committee of Labour, Industry and Commerce. There was reference to protection as a potential instrument for assisting private enterprise for the first time. The I.B.R.D. mission to Sri Lanka in 1952 while recognising the importance of industrial development recommended efficient industries and those utilising raw materials available locally. There is no reference in this report to the use of protection as an instrument of industrial policy. The mission apparently had in mind industries which could compete successfully with imported products without protection. A Cabinet Planning Committee and a Planning Secretariat were set up as recommended by the I.B.R.D. mission. A six year investment programme covering the period 1954-1959 was drawn up but it could not be implemented as the government went out of office in 1956. The new government formulated a 10 year plan, but this plan could not be implemented because of snags and bottlenecks in implementation and the failure to transform the plan into a short term programmes of action. The plan's implementation was also effected by the demise of the Prime Minister and the unsettled political conditions which prevailed. The sluggish performance of the external sector coupled

with an increase in local consumption led to a severe shortage of foreign exchange and balance of payments crisis by 1960. High tariffs and rigid import restrictions, including a ban on import of non-essential consumer goods, were introduced to deal with the crisis. The import controls and financial incentives and other forms of assistance by the government provided a stimulus to investment in the industrial sector. At the inception protectionism had other purposes and aims extraneous to industry itself, such as reduction of balance of payment deficits and increase of public revenue. In the initial stages the customs tariff was used primarily to increase or maintain the level of public revenue. In subsequent years it was also used to stimulate some manufactures. Exchange controls, quantitative restrictions and multiple exchange rates had the aim of improving the balance of payments situation. Whatever the aims of these measures may have been there resulted a high degree of protection for industry. Industries once established sought more and more protection, and protectionist measures introduced after 1960 continued to be strengthened until 1977.

The protectionist measures introduced after 1960, provided a tremendous impetus to industrial investment and industrial output increased significantly from this time onwards. The protectionist policy followed during this period had certain short-comings resulting from the multiplicity of objectives sought to be achieved. Adoption of criteria extraneous to strict protectionism lead in some cases to anomalous situations; for instance the differences between rates applied to raw materials and to finished goods containing them were negligible in many cases. Multiplicity of objectives did not encourage long term decisions or the adoption of selective criteria that would help to stress protection for certain lines of production in a way that would promote a more rational structure of

industry. What ever the objectives of the protectionist measures they had undesirable and unforeseen consequences. Behind the high protective walls, market considerations prevailed over considerations of cost and national economic profitability. Industries covering a large number of consumer goods were set up even though they involved very little processing or only the final processing stages in these industries. This resulted in an extensive type of industrial growth as opposed to the intensive type which would have encouraged specialisation resulting from a more critical selection of industries based on long term benefits criteria. Productivity and efficiency suffered as there was no pressure to improve these industries behind the high protectionist wall, and high costs and prices resulted. The protectionist policy measures also created conditions which made it difficult to combine import substitution with export promotion.

The government which came into power in 1977 introduced a new policy package covering devaluation, liberalization of imports and exchange control and incentives for exports aimed at export led growth. High duties, which ranged from 5 - 500 percent were slashed and the number of duty bands was reduced. Import restrictions in the form of high duties and quotas were done away with and only a few items of imports were left under license control to achieve certain policy objectives. The new policy relies primarily on tariffs to give a measure of protection to local industries. A presidential tariff commission was set up to remove the anomalies and shortcomings in the existing tariff structure and to evolve a tariff structure which would facilitate the export led growth strategy. The level of protection to be given by the tariff commission to import substituting industries was to be based on the concept

of an "effective rate of protection".

The government policy on industrial protection has been spelt out in various government pronouncements and publications; for instance the Public Investment Programme 1983 - 1987, issued by the Ministry of Finance and Planning in May, 1983 envisaged protection for "import substituting industries in the initial stages of their development and these industries are to be encouraged to develop export markets when this is not already the case". Protection according to this publication is intended to be for a limited period until the industries concerned are in a position to stand on their feet. In a speech made in April, 1984 the then Minister of Industries and Scientific Affairs stated that the "Government would protect already established local industries as long as certain criteria are met". These criteria are:

1. Sufficient capacity existed to meet the local demand or would be available within a reasonable time.
2. Goods should be of an acceptable quality.
3. Reasonable prices are charged.

This policy statement implies tariff protection for already established local industries for indefinite periods. It also does not envisage protection for industries which held real promise for development in the near future and which have a good prospect of producing a quality product at low cost after gaining experience. The protection policy elucidated in the above speech differs from that envisaged in the Finance & Planning Ministry document mentioned above.

The presidential tariff commission implements tariff reforms by applying the concept of effective rates of protection. Effective rates of protection and domestic resource costs are two analytical tools applied to evaluate the efficiency costs of protection. The tool of "effective protection" can also be used to measure the real contribution of a

production activity to national product, by comparing the value added at domestic and world prices when there are tariffs on imported goods. However, the validity and reliability of "effective protection" as an indicator of the movement of resources has been questioned widely. The sensitivity of effective rates of protection to the variability of input coefficients is a subject of controversy. It is also argued that the criterion of effective protection would not succeed in ranking projects according to comparative advantage as it assumes perfectly competitive pricing in product and factor markets. Such conditions are not found in developing countries. Because of such shortcomings of and the problems associated with the tool of an effective rate of protection it has to be used with caution. In view of these limitations the government employs the concept of effective protection pragmatically. It strives to evolve a protection policy which is less burdensome to the consumer and efficient as a tool for stimulating industrial development. Rates of protection are being gradually lowered; but if protection is to be used as an instrument which anticipates and influences changes in the industrial structure to achieve policy objectives, much remains to be done. While industrial classifications have to be revised the priorities within the protection system may also have to be altered.

A careful review of the existing levels and structure of tariff is essential. As the production structure changes tariff on certain products have to be re-adjusted and product classifications modified. Tariff rates have to be constantly reviewed in such a manner as to anticipate and influence changes in the structure of production. The system should evolve in such a way that protection levels to already established industries are lowered while essential, intermediate and capital goods industries are given timely and effective protection.