

PLANNING FOR DEVELOPMENT OF SRI LANKA

Achievements to date & Possible Future Strategies

This study will concentrate on specifying a general framework for production planning and industrialisation in Sri Lanka. I will begin by looking into the country's economic progress since independence illustrating the peculiarity of its development. As we will see production expansion is one of the major objectives of economic planning and this analysis will be devoted to a discussion of achievements attained by the country to date. The purpose of this discussion is to establish a criterion that would enable us to see in what respect planning in Sri Lanka needs further development, and the extent to which this study may help in that direction. I will conclude with a possible approach to dealing with Sri Lanka's problem of 'catching-up' with the rest of the world.

The problem of economic policy formulation is to find a set of instruments that maximise the fulfilment of some chosen objectives subject to various constraints. The objectives chosen and the available policy instruments will depend on the political philosophy of the country as expressed by the government in power. Economic planning as defined in this essay is the process of selecting economic objectives and instruments of policy¹. Therefore, planning differs from pure forecasting, since planning is based on the assumption that the future course of production and other economic variables may be influenced, and hence introduces the possibility of choosing the most desirable course. The basic rationale of planning follows from the belief that allowing the price mechanism to work without fetters is not a satisfactory way to achieve the desired economic objectives of a society. However, what constitutes the most desirable course depends very much on the aims set and means admitted². It is difficult, if not impossible, to include simultaneously all the desired goals of society explicitly in plan formulation. Consequently, priorities must be used to rank the various objectives of development planning. Although the rate of economic growth may not be the principal goal, other objectives such as arresting rural poverty, attaining a fairer distribution of income and

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wealth, improving living standards, full-employment and creating a suitable environment for the social and cultural development of present and future generations, will depend on the realization of economic growth.

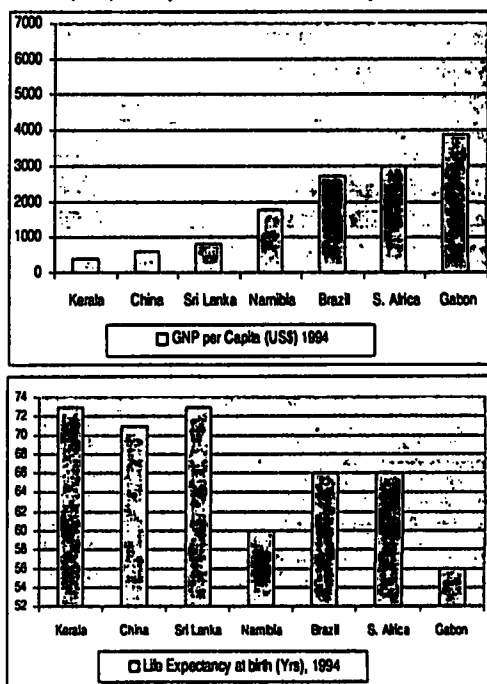
Rural poverty in Sri Lanka can be analysed with reference to development policies and associated changes to society observed since independence. As many an analyst has highlighted, Sri Lanka stands out here because of the relatively high quality of life, against a rather low income per capita. Life expectancy of 70+ years, an adult literacy rate of 90+ %, and an infant mortality rate of less than 20 per 1000. Professor Sen observed that Sri Lanka has a higher life expectancy than countries such as Brazil and South Africa which enjoy a much higher per capita income³ (see FIGURE 1). Large investment in health, education and nutrition underpin these achievements, expenditures on which averaged close to 10% of GDP during the 1960s and 1970s. Food subsidies, largely untargeted, accounted for almost half this expenditure⁴.

In order to appreciate Sri Lanka's economic complexities fully it is essential to view her colonial past. The economic structure that independent Sri Lanka in-

herited in 1948 was typical of a 'dualistic export economy'. It was an 'export economy' because of the heavy orientation of production activities towards export production. On the other hand, the existence of a subsistence agricultural sector alongside the dynamic export sector, with very little spillover effects from the latter to the former, has infused 'dualism' into the

Fig. 1 GNP per Capita (US dollars) & Life Expectancy at Birth, 1994⁵

Sources: Country data, 1994, World Bank World Development Report 1996, Kerala data Life Expectancy 1989-93, Sample Registration System cited in Govt. of India (1997), Department of Education, Women in India: a statistical profile; Domestic Product per capita; 1992-93; Govt. of India (1997), Ministry of Finance, Economic Survey 1996-97.



	Comparative GDP/GNP per Capita (US\$)	
	1960 ¹	1997 ²
Hong Kong	310	23200
Indonesia	91	1100
Malaysia	280	4530
Singapore	443 ³	32810
S. Korea	152	10550
Taiwan	149	12797 ⁴
Sri Lanka	152	800
Thailand	82	2740

Fig. 2

	Gross Domestic Savings / GDP		Gross Domestic Investment / GDP	
	Sri Lanka ¹	E. Asia ²	Sri Lanka ¹	E. Asia ²
1965 ¹	12%	17%	15%	20%
1990	17%	38%	22%	36%
1994 To 1998 ⁴	16%		25%	

Fig. 3

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Investment / GDP		Annual GDP Growth Rate	
1)	Present Situation	25%	5%*
2)	Desired Situation	40%	2%
3)	Investment Gap (2) - (1)	15%	
Financed By:			
4)	Eliminating budget Deficit	10%	
+			
5)	Foreign investment	5%	

* Investment / Output ratio = 5:1

Figure 5 PER CAPITA GDP

Malaysia (1997) ¹⁾	US\$ 4,530
Sri Lanka (1997)	US\$ 800
Feasible optimum scenario Sri Lanka (\approx 2020)	US\$ 3,200 ²⁾

- 1) GNP
- 2) Annual 8% GDP growth and
1% Population growth implying
7% per Capita GDP growth

economic structure. Under British rule, the country's export sector was based on three primary commodities - tea, rubber and coconut.

The export industries and the service sector which evolved around trade constituted the 'modern sector' of the economy, which depended on foreign entrepreneurship, imported or reinvested capital and migrant labour. Almost all of the consumer, intermediate and investment goods requirements of this sector were met through imports. As a result, the economic dynamism generated by export expansion had only a minor effect on the static traditional sector from which the mass of the population derived its livelihood. The disruption of imports with the outbreak of the Second World War resulted in a minor deviation in this established pattern; both the government and the private sector responded to the new situation by setting up factories to provide a wide range of consumer and intermediate goods⁵. However, the resumption of industrial imports after the end of the war put a sudden stop to this 'war generated industrial import substitution boom' without leaving any significant lasting effect on the structure of the classical export economy. In 1948 the contribution of export production to total GNP was 31.6%. Service industries contributed 43.3% while the local produce

for domestic use accounted for the remaining 25.1%. 64.3% of total government revenue came from taxes on foreign trade. The three major export items, tea, rubber and coconut, contributed about 92% of total export earnings⁶. At this stage the government did not need to have any expansionary financing of budget deficits as the economic situation of the country at the time of independence illustrates (Table 1).

Political independence in 1948 did not lead to drastic policy revisions aimed at significant changes in the colonial economic structure. The country's foreign exchange balances were in good shape, the purchasing power of export earnings

was at a steady level and government budgetary operations were remarkably sound⁷. With the change in political leadership in 1956, a significant shift in priorities of economic policy took place. In the new development policy which was embodied in the Ten year plan 1958-68⁸, Import Substitution industrialisation through import substitution re-

ceived a much higher priority. The 'population explosion' of the post-war years in the face of the declining prosperity of the traditional export economy had brought to the forefront the urgency to diversify the economy by establishing a dynamic industrial sector to create sufficient employment opportunities. In the plan, 20% of the total Ten year investment budget was allocated to industrial development⁹. The period after 1957 witnessed the construction of government-owned steel, tyre, hardware, sugar, salt, cotton, brick, tile, chlorine and ilmenite factories. Starting with the 1957/58 budget, government policy tended to reflect a tendency toward using import duties as a tool for promoting import substitution by imposing protective tariffs for some infant industries and by lowering import duties on capital equipment and industrial raw materials.

The year 1977 marks a turning point in the economic development of post-independence Sri Lanka. The change of government in that year resulted in a wide ranging policy reform which included liberalisation of foreign trade from the complicated system of direct controls; considerable relaxation of exchange controls with respect to many types of foreign transactions; restructuring import tariffs to a generally reduced level, while retaining high enough rates on a selective list to protect domestic production and for revenue purposes; mass-scale mobilisation of foreign finance, both from official and private

	1950	1960	1970	1977	1980	1985	1989
1. Total Revenue	691	1,403	2,736	6,686	14,068	39,009	56,761
2. Total Expenditure	863	1,821	3,672	8,761	28,840	57,788	81,850
3. Overall Deficit (1-2)	172	418	936	2,075	14,772	18,809	25,089
4. Current Expenditure	612	1,511	2,658	6,147	13,249	33,842	56,658
5. Current Account Surplus / Deficit (1-4)	79	-108	78	539	819	5,169	103
6. Capital Expenditure	258	471	812	2,263	12,352	23,632	25,836
7. Financing of Deficit							
(a) Domestic Bank Borrowing	74	241	454	-223	7,101	7,212	1,131
(b) Domestic non-bank Borrowing	-	174	282	1,579	1,607	3,651	13,875
(c) Foreign grants and Borrowing	-	29	220	1,211	6,135	10,416	12,333
(d) Cash balances	5	10	-25	-492	-71	-2,501	-2,250
8. Expansionary Impact of Fiscal Operations	79	251	427	-715	7,029	4,711	-1,190
9. (a) Overall Deficit as % of GDP (at market prices)	4.1	6.4	6.8	5.8	22.2	11.6	9.9
(b) Capital Expenditure as % of GDP (at market prices)	6.1	7.4	6.0	6.2	18.5	14.5	10.2
(c) Expansionary impact as % of GDP (at market prices)	1.8	3.8	3.2	-2.0	10.5	2.9	-0.4

Net of repayments
Provisional

Source: Central Bank of Sri Lanka, *Annual Report* (various years)

Table 2

Change in Production Structure: GDP at Constant Factor Cost, 1960-1979 (annual averages)

GDP	1950-53	1954-56	1957-59	1960-62	1963-65	1966-68	1969-71	1972-74	1975-77	1978-79
1. GDP. Million Rs.	4464 (4.4)	5460 (3.2)	5796 (1.6)	6519 (4.5)	7304 (3.8)	8349 (5.7)	9644 (3.1)	10484 (3.6)	11593 (3.4)	12190 (5.2)
Percentage Share in GDP and Growth Rates										
2. Agriculture, forestry, Fishing and hunting	46.6 (2.3)	46.14 (3.1)	44.9 (1.7)	45.9 (5.3)	45.2 (1.2)	41.9 (4.8)	39.4 (0.5)	37.9 (3.1)	35.4 (1.2)	25.4 (3.8)
2.1 Export agriculture (including export processing)	30.1 (2.3)	28.9 (1.6)	27.8 (4.9)	26.9 (0.4)	26.0 (1.5)	23.2 (1.0)	19.9 (2.0)	18.2 (0.4)	15.8 (-1.9)	10.2 (0.7)
2.2 Domestic agriculture	13.6 (4.1)	15.0 (6.3)	13.5 (-1.8)	16.1 (10.6)	15.9 (0.3)	15.5 (10.9)	16.5 (4.1)	17.2 (6.5)	17.5 (4.5)	15.2 (5.2)
3 Industry	10.9 (3.4)	10.3 (6.1)	11.1 (-1.8)	10.1 (0.0)	10.5 (4.8)	12.2 (14.3)	15.3 (9.6)	15.9 (3.2)	16.6 (5.1)	19.2 (5.3)
3.1 Manufacturing (excluding export processing)	5.6 (-3.5)	5.3 (1.4)	5.4 (1.7)	5.1 (5.7)	6.1 (9.8)	7.2 (12.1)	8.5 (10.7)	8.8 (-1.4)	9.2 (7.1)	9.7 (6.3)
3.2 Construction	3.8 (15.5)	4.6 (11.6)	4.8 (-3.9)	4.2 (0.1)	3.7 (-1.8)	4.3 (20.1)	5.6 (6.6)	4.9 (0.4)	4.54 (-9.2)	4.7 (8.3)
4 Services	42.4 (7.1)	42.3 (2.9)	43.8 (2.5)	43.8 (4.0)	44.1 (6.5)	45.7 (4.5)	45.1 (3.4)	46.0 (4.3)	47.8 (4.7)	55.4 (7.6)

Sources: For 1950 to 1958: Saundaranayagam (1976; 1968 to 1977); CBC, Annual Report, various issues Supplemented by national account files of CBC

sources, to meet balance of payments pressure in a considerably liberated economy; devaluation of the rupee by about 47% and the adoption of from that point onwards a system of floating exchange rate; promotion of foreign investment particularly in export-oriented industries; and the implementation of a specific export promotion policy package under a newly-established Export Development Board¹⁰.

The structure and trade dependence of the post-independence economy is illustrated in Table 2 which summarises percentage composition and annual percentage growth rates of sectoral value added in order to highlight the changing pattern of domestic production of the Sri Lankan economy during the period, 1950 to 1979. The structural changes that have been taking place since the early 1960s are more profound compared with the earlier period. The share of the agricultural sector has continuously declined from 46% in 1960-63 to 25.4% in 1978-79. The share of industry which stood around 10% throughout the 1950s had increased to 17% by the late 1980s. The contribution percentage of the service sector has also indicated a continuous though relatively mild upward trend throughout the period. When the composition of the agricultural sector is compared over time, one is impressed by the increasing importance of the domestic agricultural sector.

For a while, many an economist believed that one of the shortcomings of Sri Lanka during the first few decades after independence, was to dedicate too much to social sectors relative to the unfulfilled demands for infrastructure investments. More recently, however, most agree that investing heavily in human capital is a prerequisite to overall economic growth. Along

these lines, what is truly disappointing in Sri Lanka is that progress in human development has failed to encourage economic growth. As several economists have emphasized, Sri Lanka's per capita

subsidies had been invested in plant and machinery, the resulting extra growth, compounded over a 40-year period and with the marginal savings reinvested, would have accelerated



Planning is very important for this type of (highway) vast development projects.

income in 1960 (around US\$150) was similar to Taiwan's and South Korea's. Today, Sri Lanka's GNP per capita is US\$ 800 while Singapore's is over US\$ 30,000 and South Korea's over US\$ 10,000 (see Figure 2). The slower growth of the Sri Lankan economy is in part due to Sri Lanka's lower savings and investment rates than East Asia's (see Figure 3).

Why did Sri Lanka fail to make progress in regard to savings and investment? Economist Lal Jayawardene believes that the country's shortfall is due amongst other things, to large food subsidies in contrast to the other social sector investments in health and education. In his 50th Independence Anniversary Speech in London, he speculates that if the near 5% of GDP invested in food

Sri Lanka's economic growth to perhaps a level that could sustain savings and investment now observed in East Asia.

Advanced human development and literacy in the face of low economic growth, creates huge challenges to Sri Lanka. As can easily be understood, low growth generates few productive job opportunities. As a consequence, governments have had to struggle with the population's expectation for well paid and satisfying employment and the resulting temptation to meet them with public sector jobs, many of which are of a "make-do" nature. Youth insurgency since 1971 has been one of the results since fulfilling society's needs has not always been possible. The above mentioned tendency for



Township development without proper planning causes immense problems to the economy and the society

governments to themselves create jobs is evident in education, where the teacher pupil ratio has reached a high of 22 pupils per teacher¹¹. The combined effect of low growth and consequentially low budgetary revenues pushed up the budget deficits which averaged 14% of GDP over the period 1978 to 1994 and only slightly lower more recently.¹²

Sri Lanka invests a little over 3% of GDP on education which is rather low compared to other low and middle income countries. Her rapidly ageing population will require increases in health care with the government and the budget expected to foot good part of the bill. These factors will of course press the budget expenditures upwards even further. For Sri Lanka to grow faster, say, by 8% annually, it would surely need to drastically cut its budget deficit so as to raise national savings and investment substantially. This would no doubt be less of a pie in the sky if the current peace negotiations succeed as the conflict has so far cost some 5% of GDP. But the internal efforts by Sri Lanka may not be sufficient to raise growth to 8%. For an incremental capital output ratio of 5, - which is roughly the one observed recently in the country, - investment needed would be 40% of GDP. Even if the extra domestic savings arising from a possible elimination of a 10% budget deficit were applied to investments, raising the current investment rate of 25% to 35%, an extra 5% would be required to be mobilized from abroad in the form of foreign investment in Sri Lanka, both direct foreign investment and portfolio. This is much higher than current investment by foreigners in the country. Since an end to the civil conflict would substantially improve the investment climate, one can see that peace would have a double impact on growth through an increase in domestic savings and investments as well as in foreign investment. **Figure 4** below develops the numbers corresponding

to the above argument. An overall growth target of 8% implies, after allowing for population growth, a growth in income per capita of 7%¹³. This means that Sri Lanka's per capita income today of US\$ 800 cannot exceed US\$ 3200 in today's prices in 20 years time.

It is against this backdrop that the principal economic challenge facing Sri Lanka in the near future has to be viewed. The task is one of extracting the maximum possible economic growth out of the system before the labour force stops growing in 20 years' time at 14 million as compared with 12 million today¹⁴. This means making good in 20 years East Asia's average growth rate of 8% since 1960 and continuing to grow at that rate thereafter. Rapid economic growth in the face of a static labour force can only be achieved by sharply increased labour productivity. This requires rapid investment in human capital in the form of raised expenditure on education and skill development. As mentioned, financing such an expenditure will only be possible if the budget deficit is eliminated through reduced expenditure on defence and greater foreign investment, - both of which require peace. In sum, the country's economic welfare depends heavily on the success of peace negotiations, - the importance of which one cannot stress enough.

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Footnotes

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