

Sri Lankan Economy in Transition: Progress, Problems and Prospects

(A Tribute to Prof. Jayantha Kelegama)

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Late Dr. Jayantha Kelegama was the first Professor of Economics at the University of Kelaniya which was known at the time as Vidyalankara University. As a distinguished economist, he served this country in numerous ways as an academic scholar, a central banker, a policy advisor, a researcher and a writer for over four decades, encompassing two conflicting policy regimes, i.e., the pre-1977 closed economy and the post-1977 open economy.

The publication of the book titled, Sri Lankan Economy in Transition: Progress, Problems and Prospects, edited by Ajitha Tennakoon of the University of Kelaniya is, indeed, a great tribute to Dr. Jayantha Kelegama. The book with 625 pages covers a wide range of economic policies and issues, including those which have been rarely addressed in the Sri Lankan development literature, and presented with well-balanced analyses. The introductory chapter by the editor contains two sections to provide the biography of Dr. Kelegama and to introduce the rest of the chapters authored by distinguished economists. There are 21 chapters organised under 9 parts as follows:

1. Issues on economic policy making
2. Reflections on policy making in a closed economy
3. Transition to an open economy: consolidating gains and lessons
4. Macroeconomy: fiscal and monetary policy
5. Macroeconomy: emerging issues

6. Industrialisation and infrastructure
7. Agriculture and food
8. Poverty: role of microfinance and micro-enterprises
9. Social transitions

It is a unique work in a sense that issues addressed in different chapters cover the closed economy regime, open economy regime, the transition bridging the two regimes, and finally, bringing the new issues and challenges that Sri Lanka has to face in its current phase of development. Very often, the policy regimes come under criticisms without reference to the context in which *why such policies were brought in and why they failed to achieve the objectives*. Today's economists, including myself, who were born as 'economists' after the policy reforms in 1977 are likely to make this mistake. This felicitation volume is unique in that sense too, as it can guide us to look at the policy issues in the contemporary political-economy context. One should ask why the United National Party, being based on a centre-right political-economic ideology since its inception, *failed to get out of the prevailing import-substitution regime when it was elected in 1965*. Following that, then the next question is *why it was able to do so in 1977*. The Sri Lanka Freedom Party as a centre-left political party with the support of other leftist parties at the time governed the country most of the periods coming under the closed economy regime that remained for over 20 years. But, an important question would be that *why the Sri Lanka Freedom Party was forced to give up its traditional political-economic*

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ideology in 1994. Therefore, it is rather difficult to produce a meaningful analysis of the economic policies and policy outcomes ignoring the contemporary political-economy environment, locally as well as globally.

The first two chapters set the contextual groundwork needed in the analyses of the issues covered in the rest of the book. Lakdasa Hulugalle, by taking Dr. Jayantha Kelegama's approach to policy-making, examines the limitations and controversies in the policy-making process. Similarly, the work of Laksiri Jayasuriya also set the background for analyses of policy issues by focusing on the role of social scientists as policy advisors. The policy advisory role has also been played by Dr. Jayantha Kelegama during the early part of the post-independent policy making process. According to this analysis, policy advisors have to play a complex mediating role between two cultures - politics and science. But, many analysts rightly or wrongly used to look at only one side in an abstract form.

Within this contextual framework, the third and fourth chapters reflect policy-making in the closed economy regime. Both chapters deal with two important and interrelated policy issues that have not been adequately addressed in the Sri Lankan development literature. Buddhadasa Hewawitharana provides

an interesting piece of work on the economic strategy of Dr. N.M. Perera during the period of 1970-1975 in the closed economy regime. In a nutshell, the author looks at the inner-contradictions of these economic strategies adopted obviously in altruist sense to promote growth and equity in a socialist way. Sarath Rajapatirana's chapter is on a particular monetary experiment adopted by Dr. N.M. Perera - Demonitisation of the Rupee. Sri Lanka is one of the very few countries in the world which made this experiment which has not received much attention of the analysts so far. In outlining the anatomy of this monetary experiment, the author explains the 'paradox' of the exercise in terms of expectations and achievements.

By drawing lessons from the closed economy experiments which did not yield the expected policy outcome, there are a set of chapters that focus on the success stories as well as new challenges during the post-1977 open economy model. The chapter by Premachandra Athukorala answers many questions raised by the critiques of export-led industrialisation after the policy reforms. This analysis suggests that the state-led import substitution industrialisation has increased the country's vulnerability to external shocks and led to abysmal employment growth, while policy reforms in 1977 have opened up the avenues to exploit potential gains from investment and trade liberalisation.

Ravi Ratnayake focuses on a political-economy aspect of tariff reforms in moving into an open economy. By comparing private interest approach and public interest approach to tariff reforms, with the use of an econometric model, Ratnayake concludes that national interests are more important than private interests in the case of tariff liberalisation in Sri Lanka. Therefore, reforms are easier when there is a

strong government supported by a competent bureaucracy.

J.M.P. Pathirage, in his analysis on the impact of the foreign direct investment (FDI) on the balance of payments in Sri Lanka during the past three decades, investigates into another aspect of the success stories of the open economy regime. Although Pathirage's main focus is on the balance of payments, this analysis clearly points out increased foreign direct investment (FDI) flows to Sri Lanka as a capital-scarce developing economy have contributed directly and indirectly to build up the national capabilities. However, for obvious economic and political reasons, Sri Lanka has been lagging far behind its potentials with respect to the FDI inflows. The total accumulated FDI stock in Sri Lanka during the past three decades amounts to US Dollars 3.5 billion only, whereas this amount is just an annual FDI inflow to a country like Vietnam, which initiated policy reforms much later than Sri Lanka.

Moving further down along the lines of liberalisation, K.G.D.D. Dheerasinghe, in his chapter on financial globalisation, draws attention to Sri Lanka's cautious and gradual approach to capital account liberalisation. In the process of global financial integration, financial capital flows from the rich countries to the poor countries. According to the author, this process brings about both opportunities to exploit and challenges to face. This key point has been well-established in the analysis with respect to the Sri Lankan experience in the recent past. Whether a country gains from financial liberalisation or drags itself into risks, all depends on investor confidence and speculation. This is the key point emerging from the analysis in guiding the policy makers. A related major issue is the increase in public debt of Sri Lanka. This issue which is likely to get aggravated in the current global environment is analysed in the chapter by Nihal Kappagoda. He identifies that

a major gap in public debt management is the absence of an institutional structure, suggesting a series of policy measures to be adopted in order to face the emerging challenge.

Everything in the open economy regime cannot be good as the country has paid for sins of both regimes. For A.D.V. de S. Indraratna who critically looks at the transition, the closed economy was 'too closed' and the open economy was 'too open'. The main focus of the analysis is on the social implications of economic models adopted in both policy regimes. The cause of the problem is that the government was doing 'too much' when the economy was closed and 'too little' when the economy was open. The key message of the analysis is, if we are serious about achieving millennium development goals by 2015, it is important to mix 'old and new' without falling into either extremes.

A few chapters in the publication are devoted to discuss the historical evolution of economic policies and issues drawing policy recommendations. The two chapters on fiscal and monetary policy address the non-conventional aspects of these macroeconomic policies. Wimal Hettiarachchi investigates into the issue of Central Bank independence in Sri Lanka, in spite of the growing global concern over its importance. Central Bank independence is important, because it is a fundamental requirement allowing the Central Bank to achieve its prime objectives, namely, the economic and price stability and the financial system stability. The author examines the need for supportive institutional and policy variables in achieving the Central Bank independence. The chapter on fiscal policy, by D.D.M. Waidyasekera, is about the historical pattern of changing fiscal policy and taxation with respect to the contemporary development

requirements of the country. The author summarises the main elements of the fiscal policy and taxation during the colonial and post-colonial period, highlighting the development objectives and strategies under the successive governments.

The chapter on manufacturing industry in Sri Lanka, by Chris Rodrigo, examines the evolution and expansion of manufacturing industry during the post-independence period, highlighting the underlying technology progress and innovative systems as key determinants of industrial dynamism. In the conclusion, the author identifies a list of things that should be adopted by the firms, the business federations and the governments in producing industrial dynamism and contributing to growth. The chapter by Jayatillake Bandara and Sisira Jayasuriya employ an econometric model to examine the correlation between agriculture development and the incentives and government support during the post-colonial period. They identify the importance of removing policy-induced distortions to realise potential efficiency gains in agriculture. To what extent Sri Lanka succeeded in achieving food security? This is the question addressed by Upali Wickramasinghe who identifies a series of missing elements in a successful strategy for food security and safety nets. By highlighting the current challenges, the author analyses these missing elements mainly with respect to the government intervention and the market inefficiency, and concludes that Sri Lanka has not progressed much during the past few decades in addressing these issues.

The chapter on inflation by Raja B.M. Korale is a special one in the context of macroeconomic policy, because, it examines, not only the inflation trends in the recent past, but also the robustness of technical details

underlying the measures of inflation. This particular approach allows the reader to connect the inflation trends to their specific sources. Because inflation and unemployment are the 'worst of both worlds', it would have also been quite appropriate if the book had the space to include a similar text on the unemployment trends in the country and their measurement issues.

The two chapters on poverty present analyses on the country's poverty issue from different angles. In the context of global credit contraction and the high domestic interest rates, M.U.A. Tennakoon examines the importance of microfinance for poverty alleviation and identifies the weaknesses of the current microfinance system in the country, including those of the Central Bank. His main conclusion is about the importance of institutionalising the microfinance system to alleviate poverty as well as to promote growth. In contrast, Ranjith Bandara's work is related to a microeconomic analysis on the micro-enterprise development programmes. By examining the determinants of entrepreneurship development in rural communities, the author with the help of a model, concludes that micro-enterprise development strategy is a sustainable and effective strategy, compared with other poverty alleviation programmes. The microenterprise development strategy provides an opportunity for utilising rural entrepreneurship skills, and thereby, upgrading the living standards of the poverty-stricken rural communities.

Finally, there are three chapters on very specific and timely issues related to the long-term growth and development prospects of the country. Nimal Sandaratne focuses on the historical demographic changes of Sri Lanka and identifies their economic and social consequences. A key issue emerging from the analysis is the economic and social readjustment to the realities of

the current demographic transition and how the country should be ready to face this reality with improvements in health, education as well as a system for caring the old-aged. University education has long been a major problematic area in the Sri Lankan education system, as analysed by Wiswa Warnapala. By summarising the historical evolution of the University education system in the country, the author identifies some of the major deficiencies in the current system and draws attention to the changes required. K. Dharmasena draws attention to a rather unique issue that has not been discussed widely at both academic and policy circles. How Sri Lanka is about to lose its comparative and competitive advantage in the Colombo Port due to the Sethusamudram Canal Project of India? This analysis highlights the forthcoming challenge and proposes vital recommendations, not only to face the challenge, but also to promote the country's port activity. In summary, these recommendations are proposed and justified under two broad strategies as deviating from 'one port concept' with the development of multiple ports in the strategic locations around the island, and designing and facilitating the specialisation of different ports for different port activities.

In an overall assessment, the book is a rare collection of analyses related to the issues of economic progress, problems and prospects of Sri Lanka. Most of the discussions in the book are new and innovative in terms of the policy issues covered and the analytical approaches used. The book enlightens the reader about, not only the economic issues therein, but also the importance of a political-economic approach to address an economic issue. With these outstanding qualities, the book is truly a unique honour to a unique economist.