

New Horizons in Development Planning

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In the last two decades, politicians and administrators have believed that an economic development plan in the form of a document is necessary before a programme of work is launched to rapidly develop the country. Practically every government other than the United National Party administration of 1960 to 1965 and the new government that was elected this year have prepared development plans. The first systematic plan was brought out in 1955 and was entitled a Six Year Programme of Investment. The M.E.P. government that came into power in 1956 was dissatisfied with the contents and the strategy outlined in the Six Year Programme and it set up machinery to prepare a plan more in alignment with its economic philosophy. The task was entrusted to the Planning Secretariat, and in 1958 the Ten Year Plan was released. The Plan was hailed as a thorough piece of work by academics. But, like its predecessor and those that succeeded it never got off ground and the Two Year Implementation Program was issued shortly after. The next great experiment in planning was the much talked about Five Year Plan issued in 1972. A great deal of optimism and fanfare accompanied the release of this Plan, and on the surface it gave the impression that it would provide answers to the most urgent problems of the day of which unemployment was the most important. Since none of the plans could even be partially implemented, various excuses were given for their failure. These included the inadequacy of financial resources particularly foreign exchange, the magnitude and long gestation period of projects and the lack of implementation capacities.

Several previous governments allowed a considerable amount of time to be spent on the preparation of plans and the development process seems to have come to a standstill until this was done. For example, the M.E.P. government elected in 1956 devoted two years to the preparation of the Ten Year Plan. Similarly, the S.L.F.P. government that took office in 1970 spent two years preparing a plan. The planners and the administrators believed that the mere preparation of a document would help to solve the country's problems and that the people could be rest assured that all was well if such a document was issued. Unlike today, in the fifties, the economy was not confronted with serious problems. Unemployment was less than one-fourth of what it is today and the country could have well afforded to spend time in preparing a plan. The economy was freer, the foreign exchange situation not unfavourable, goods were relatively cheap and there were no shortages; as a result people were not impatient, there was little or no discontent or agitation.

On the other hand, the Five Year Plan of 1972 was brought out in an entirely different political and economic context. One factor which hastened the release of the Plan was the insurgency of April 1971,

Government took certain major decisions: one was the implementation of the land reform programme on the advice of an I.L.O. team of experts led by Professor Dudley Seers. The other was the issue of the Five Year Plan and the confidence placed in it. All this was done because the government believed that the Plan would help to solve basic problems and that the masses could be won over by policies which were designed to hit the landowner and the entrepreneur and to redistribute wealth. To a government guided by an ideology, the impact of these policies on employment, income generation and productivity appeared to be secondary. It had faith in an ideology which preached the destruction of the capitalist class and paved the way for socialism. What it failed to see was that the masses were more interested in the basic necessities of life, particularly food and clothing, than in policies dominated by ideology.

Those who prepared the Five Year Plan of 1972 do not seem to have given thought to the fate of the earlier plans. Each of the earlier plans failed because they consisted of a large number of very ambitious and related large projects and very little was said how implementation was going to take place. Furthermore, by the time it had come to implement the proposals the financial resources that were earmarked were not available due to worsening of the balance of payments outlook. In fact, the planners of 1972 should have made a study why earlier plans failed. Their first task should have been to look forward and to make fairly accurate projections of future resource availability both from exports and other sources.

The most important part of the planning exercise is to produce a realistic estimate of financial resources and to make projections on less optimistic assumptions that the outturn would be far worse than one would expect. Their task would have been to prepare a programme of modest dimensions on the assumption that a minimum amount of resources would be available. The failure of the Five Year Plan was again attributed to foreign exchange difficulties seen after the onset of a world economic crisis following the increase in oil prices by the OPEC countries, and thereafter, by the acute global shortages and sharply rising prices of food grain mainly due to crop failure.

No plan could receive mass public support, nor can it win the confidence of the youth unless it is formulated with their active participation. In fact, although claims have been made that the Five Year Plan of 1972 was prepared in consultation with the masses, this was far from the truth. The period devoted to the preparation of the Plan was one of considerable difficulty when marked differences emerged between the administration and the youth due to the insurrection of 1971; all channels of communication between the people and

their elected representatives in Parliament had been almost completely severed. In consequence, the planners had no alternative but to follow the stereotyped technique of assembling a large number of projects and putting down the key variables such as growth rate, per capita income, annual levels of new employment created as the principal objectives. In a developing country, effective planning can only be based on pragmatic considerations. This is even more important in a country like that of Sri Lanka where the rural sector predominates and where the bulk of the people live in that sector. In other economies with a predominantly industrial population, orthodox planning techniques have more meaning because they relate largely to industrial activity and within that framework government influence and the participation of bureaucracy in planning is not so difficult.

In the past, the development strategy was centred largely on the growth of the modern urban sector with a heavy bias towards foreign aid and technology. Development was conceived in terms of large projects with very long gestation periods and this had hardly any impact on the village economy. The only exceptions were river valley and irrigation projects which benefitted the rural economy. Elsewhere the public corporation was the typical instrument of this type of development. Public corporations in Sri Lanka have had an unparalleled record of low productivity, inefficiency, corruption and waste.

In Sri Lanka where more than three-fourths of the people live in the rural sector, a plan must give considerable weightage to the needs and aspirations of the people in the villages, and it is through this process that people's participation can become a reality. Normally, the channels of communication between the bureaucracy and the rural population are far too weak and there is a natural bias among officials towards the urban sector and the industrial community. The town-based bureaucracy is not often sensitive and not geared to respond to the people's aspirations and their felt needs and are therefore not in a position to seek the best way of solving their problems. A strategy for the active participation of the village population in the development process has been markedly lacking in all the previous plans. Many of them have hardly made any reference to the rural sector or even attempted to analyse the socio-economic conditions in the villages.

The new strategy for development should begin with a greater sensitivity to the aspirations and the felt needs of the people in the villages. Central planning of the kind that Sri Lanka has copied from the West cannot solve the problems nor meet the needs of the people in the village. It can do so only if the principal plan consists of a synthesis of micro-level plans pertaining to the villages along with the larger and more sophisticated projects. This is something that conventional planning cannot achieve in the timespan available to the urbanised planners. They will need a long time because a large number of surveys and studies pertaining

to a village or groups of villages will have to be undertaken before plans are drawn up. An administration which will be in power for a period of 5 to 6 years will find it extremely difficult to produce a plan of this type unless it is prepared to implement the programme simultaneously with the preparation of projects at the village level. If some importance is going to be given to central planning at the national level its object should be to conceptualise the broad vision of the new society to be created and provide the necessary financial and technical supports to the village. In mobilising and allocating financial resources the conventional practice of first centralising and thereafter decentralising all funds for local expenditure should be simplified through provision for locally generated funds to be spent locally.

It is unlikely that the present government would spend a lot of time preparing a plan on orthodox lines. If this is done, it would obviously take at least a year or more, and the danger is that everyone may decide to do nothing until the plan is ready. A conventional plan, because it is primarily concerned with very large projects, cannot give adequate weightage to the smaller projects, at the village level which are likely to provide the greatest spread effect and generate more employment opportunities. The district level decentralised administration which the government proposes to introduce shortly is the basic administrative prerequisite for rapid rural development. For the first time, the government has recognised that the greatest results would be forthcoming through a decentralised planning mechanism spearheaded by a district level organisation under a minister.

Hitherto, in the implementation of development, programmes the channels of communication with the village were through various government officials like extension workers, cultivation officers, handicraft advisors, divisional revenue officers and others who either functioned in an administrative capacity or offered specialised services to improve productivity in agriculture and rural industry. Due to serious shortcomings in the administrative framework, these officers never went down to the village population. Surveys done in the past have shown that officials such as extension workers, who are required to play a critical role in agricultural development, hardly ever visited the villages with the result that they have had a minimum impact on agricultural development.

In the planning organisation that is suggested here, the task of the bureaucracy and specialised officials would be to train educated people from the village itself who would then act in liaison with groups at the village level. They could be called change agents or link cadres. The latter would undergo a period of intensive training depending on their speciality. Assuming that there are about 20,000 villages and 5 link cadres will be necessary for each village, this in itself will generate 100,000 jobs. People in the villages would be willing to work more closely with people who are known to them and who reside in the village itself.

and are one of their own, than those who are alien to the community with a different cultural, sociological and linguistic background. These trained village cadres would be the principal link between the village and the upper echelons of the administration. Each village, depending on its size, will have about 4 to 5 of these specialised cadres trained in skills which are essential for the kind of industrial or agricultural projects in the village. The trained cadres will provide the technical assistance that village level projects need and they will oversee progress. Some villages will need cadres that have had specialised training in agriculture while others in areas such as transportation or in exploitation of minerals.

The most suitable kind of local government cum development institution at the village level has to be worked out and this may involve modification to the present organisation of local government. If the whole village is going to participate in development, then the village must meet and elect its officials. In the proposed scheme the whole village will meet and elect its chairman who will be the principal administrator and development authority for the village. There would be no representation on the basis of wards but the village committee would represent the whole village and not individual divisions. The function of the village Assembly would be to conceive, formulate, implement and evaluate projects through the participation of organised village groups. The link cadres will provide the catalytic element in this process and establish a two way link between the village community and the expertise available outside the village, for the transmission of appropriate know-how, information and resources.

The overall co-ordination of the development effort at the district level would be overseen by the District Minister who will cover several electorates that come within the district. He will have a Secretariat which will be fully equipped to service the needs of the electorates and villages. The District Minister's Council would include the Members of Parliament representing electorates within the district. Below this, there would be an Electorate Assembly consisting of chairmen who would be elected from each of the Village Council; the Electorate Assembly would be presided over by the Member of Parliament of the electorate. In development planning, the function of the District Assembly under the District Minister would be to establish liaison between the electorate and the village level and the higher administrative machinery in the country which includes numerous government departments handling specialised areas of work and the appropriate Cabinet ministers that stand above them.

The most important unit in this framework would be the Village Assembly. The bulk of the new

employment generating activity has to be created through the Village Assembly. It should have a large amount of autonomy in planning, decision-making and in execution. The Village Assembly should initiate work through village organisations with specific interests such as co-operatives, youth clubs and peasant organisations. The first task of the Village Assembly, with the assistance of specialised cadres attached to it, would be to make a survey of resources in each village. To do this effectively they may have to depend on the services of specialists from outside. The object of the resource survey would be to ascertain not only the most abundant resource but those that could be used to produce goods and services which are easily marketable and could form the nucleus of viable industries.

Consideration will have to be given to the manpower absorptive capacity of projects because in most villages surplus labour would be the most abundant resource. There would also be exceptions to this particularly in the plantation villages in the hill country where adequate employment opportunities are available in the surrounding plantations. In most of the Dry Zone, the situation would be quite different and labour-intensive projects will have to be planned. The most important thing in planning investments is to think in terms of relatively simple projects which are going to fulfil basic consumer needs. This might mean that the initial efforts may be directed towards rudimentary activities such as growing fruits, vegetables or the production of other feedstuffs which have a ready market in the village itself and in the neighbouring towns. Particularly in villages close to the cities, there is tremendous scope for growing vegetables and fruits because these are items with a steady demand and high turnover. It also requires little capital and provides sustenance to families in the rural areas continuously over the years because unlike paddy and other longterm crops they are not seasonal but could be grown right round the year. The problem in development planning is that people often tend to think in terms of grandiose projects while overlooking the simpler ones which are likely to bring in quick and tangible results.

Once a resource survey has been completed the task would be for the Village Assembly to discuss the projects largely in terms of their needs, aspirations, the availability of inputs, the gestation period and the extent to which they would contribute to raise incomes rapidly in the district. Once a project has been adequately formulated, the next task would be to set up an organisation which will ensure rapid implementation and see that material inputs and equipment from outside will be forthcoming with minimum delay. Indeed, this would be the most difficult task because the project in the first instance, would have to be cleared by the District

Minister and his staff if it is going to become a charge on competing resources.

Unless there are adequate means of financing all projects there would be obvious difficulties in obtaining financial support for every project. In the present circumstances, the district development programme will have to provide resources for at least two projects in each village and this will mean that approximately 40,000 projects would be simultaneously launched in the 20,000 odd villages. Assuming that on the average each project would directly or indirectly give employment to 10 persons which of course, is a very conservative estimate, this is likely to create employment for 400,000 persons. If the projects chosen are of a very modest order the capital resources and the equipment could be easily procured and this would not tax the central budget. But on the other hand, if the central budget cannot provide the resources, the village level development effort would have to turn to other sources for financial support.

This is where plantation and private sector organisations could come in. Assistance could be obtained either in the form of financial grants or cesses on successful enterprises in the district. This would be

possible where largescale privately owned or government industries operate. The village authorities should have the authority to levy taxes on enterprises or on the services provided in the area and these funds need not flow through the central budget. There is also scope for village organisations to receive equipment in kind or have them fabricated at industries or business concerns which are operating nearby. Since the whole village cannot be entrusted with the management of projects the best talent in the village will have to be entrusted with implementation and daily management. The people will have to select from among themselves those who are most capable and talented for this purpose and with so much of unemployment among the rural educated this is not going to be a difficult task.

Village level development is the most effective way of regenerating the village and stemming the drain of manpower to the urban cities. It is the quickest way of providing jobs for the unemployed in their own villages and raising rural incomes. To the youth with the highest aspirations it would give an opportunity to provide opportunities of leadership and a sense of responsibility and direction which would be unknown to him had he taken employment in an urban industry or in the central administration.

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*Fiscal Policy — some Problems and prospects**

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Sri Lanka in the last three decades has moved away considerably from the conventionally defined state whose role was confined to gather taxes necessary to provide public goods (e.g. defence, law and order, justice and sanitary affairs) whose production by individuals was considered both inappropriate and undesirable. Today, all shades of political opinion accept a wider role for the State.

This can be attributed, among other reasons, to two major influences. At the theoretical plane, a justification was found in the Keynesian economics, that gained widespread popularity in the post-war period. It is true that the prescription of Keynes was postulated in the context of a world affected by a serious economic depression; to those economics that could be reactivated with adequate liquidity. Yet, the policy makers schooled or influenced by Keynes regarded it as an endorsement of public expenditure in every conceivable type of economy.

Secondly, the more socialist oriented view of the state with a higher responsibility for economic management, justified the extended state intervention in economic activity. This strand of thought induced a commitment to state sponsored economic development and a wide range of welfare policies. So much so, in the more recent years the expenditure on welfare in Sri Lanka almost correspond to expenditure on development.

This outlook in political philosophy has manifested itself in a wider role of the State with direct intervention in all levels of economic activity including both production and distribution. Consequently, the role of fiscal policy as an aspect of overall economic policy, has to be assessed in a much broader framework. It can no longer be looked upon as an exercise confined to balance revenue and expenditure laid down in the Budget. It has to be examined as a statement of policy guiding and directing the economy in pursuit of wider economic goals of improving production, distribution and stabilisation.

The prime instrument of fiscal policy, the Budget is nevertheless a statement of planned income and expenditure for a given period. As a statement of income and expenditure, it provides the basis for appropriation

and control of expenditure, in conformity with the law. It is mandatory for the spending departments to observe the limits and guidelines laid down in the Annual Appropriation Act. Any deviations are answerable to the Public Accounts Committee appointed by the National State Assembly. As the key instrument to enforce the economic policy of a Government, the Budget is used to realise the multiple objectives of economic development, mobilisation of savings, redistribution of incomes and stabilisation of economic activity by guiding the level and direction of expenditure and revenue.

In the more developed countries, fiscal policy is generally associated with economic stabilisation. Instruments of taxation and expenditure are used to manage the aggregate demand. In times of economic recession, a tax cut or an increase in public expenditure is advocated to stimulate demand. This is designed to increase output and employment in the economy. Similarly in times of prosperity, with a potential for inflation, they would increase taxes and cut public spending to arrest the increase in aggregate demand. Usually these techniques of demand management and counter cyclical economic policy is applicable only in the framework of a more sophisticated economic system, endowed with a well organised economic structure sensitive to changes in demand. The applicability of such methods in less developed countries is subject to much controversy. One cannot draw a parallel with a developed system and advocate high spending or tax cuts in a less developed country to stimulate demand in the economy. Tax cuts or deficit financing to mobilise resources by raising the effective demand is bound to set in motion a process of inflation. On the other hand, one cannot eliminate the limited relevance of demand management type policies associated with higher taxes and expenditure cuts even in an under-developed economy system and mop up excess liquidity generated through expansionary policies followed in an earlier period.

It is well known that most developing countries are operating within a narrow economic base with a low level of income. The problem confronted by them is one of overcoming supply bottlenecks either in the very structure of that economy or in the process of transferring externally mobilised savings into proper forms

* This paper is a documentation of personal views held by the writer and these should not be regarded as the official views of the Central Bank.

of investment, wherever such savings are available. A lasting solution therefore, has to be found through investment and saving that would revitalise the framework and raise the productive capacity of the economy. There appears to be no short cut either within the capitalist framework or within the socialist framework to short circuit the process of development that could only be achieved through capital formation resulting from saving a share of the current income. At the best, internal savings, could be supplemented with external savings, but it is equally important to note that investment so made should help to generate an economic surplus and improve the net worth of the economy. Consequently, any urgency for economic development, if it exists must be accompanied by a similar urgency to generate savings. Unless a sense of urgency is displayed in the policies to curtail current consumption, little can be achieved through the policies to promote development.

Savings and Investment

The relevance of fiscal policy for the promotion of savings and investment can be appreciated better by examining the concept of saving and investment in economic theory. From the fundamentals regarding the circular flow of income in the economy, we know that all transactions in real resources have its counterpart in factor payments or money incomes. The notion that savings in the economy corresponds to investment imply that there is an invariable equality between the unconsumed monetary incomes and unconsumed real resources. But there is nothing to prevent the accumulation of a part of this unconsumed income as idle cash balances with individuals and a corresponding amount of real resources as stocks or inventories. Given this kind of economic behaviour, the equality between savings and investments is always true and may become a mere tautology without much analytical content. The real significance of this concept is associated with the attempt in the economy to equate planned or desired savings with planned investment in the same time period.

In a sufficiently developed economy where transactions in real resources are adequately monetised, their unconsumed monetary incomes will be channelled to finance the purchase of unconsumed real resources through a broad range of financial intermediaries including banks. These institutions whether be it in the capital market or in the banking sector serve as the channel that mediate between the saver and the investor. Given this institutional setting the entrepreneurs will bid away a share of the real resources for investments. The balance between the relative cost of capital as reflected in the rate of interest, and the return from capital as reflected in the profits will guide the course and magnitude of economic activity. Excess demand for capital and investment would raise the cost of capital above the potential returns from such investment and prevail upon the uneconomic enterprises to liquidate. Similarly, excess profits will induce the entrepreneur to bid away

resources from consumption to meet any shortfall in production. Market mechanism therefore, generates both the efficiency and allocation of resources on the basis of consumer preferences as revealed by the prices. It is clear that financial intermediaries including banks, capital markets, entrepreneurs, rate of interest, loanable funds, and profits, find a place in this scheme of things as a matter of routine.

Supposing one or more of these situations are deficient or inadequate in an economy, could it function in the same manner to guide the course and capacity of the desired level of economic activity. Deficiency in one or more of these would impair the circular flow of income to the detriment of economic behaviour. Inadequacy in the institutional framework would generate hoarding of monetary incomes and lead to unwanted accumulation of stocks and inventories in the economy. Withdrawal of a certain share of income from the circular flow would therefore create an inverted spiral in economic activity. Similarly a structure of interest rate not sensitive to the pulse of movements in the economy would fail to guide the economy in the allocation of resources. Non-monetised economic transactions would keep the level of activity at a lower level. Deficiencies in each one of these situations would affect the level of economic activity. And adequate and suitable institutional framework to monetise the transactions in the economy and intermediation that create financial assets and liabilities as the counterpart of transactions in real resources would contribute to enhance the net wealth of the economy, generate savings and channel them eventually into productive forms of investment. A sensitive structure in the rate of interest would guide the allocation of resources. Economic planning and fiscal policy should therefore be used to stimulate such areas in the economy.

Apart from the deficiency in institutional framework, and the prevailing insensitivity of economic variables to stimulate development, the lower magnitude of the economic activity itself impair the capacity to generate adequate savings in the economy. In Sri Lanka, the level of domestic savings has remained in the neighbourhood of 13 per cent of the GDP in the last decade or more. Economic policies in the past have clearly failed to raise it to the level anticipated in the planning documents issued from time to time, and lift the economy from its present subsistent level. It is evident that a determined effort to raise the level of national savings is needed as a matter of urgent priority.

If it is not coming from voluntary savings it has to be realised through state intervention. Inadequacy of voluntary savings has been a fundamental problem shared by most developing countries; and state intervention in this instance demands taxation of a higher order. This means that fundamental decisions pertaining to the postponement of consumption has to be taken by the state by reaching a consensus in political opinion to

divert a higher share of current incomes from consumption, into savings. In the short run this is a painful exercise. Nevertheless one cannot shed the responsibility by postponement of decisions if we were to achieve any meaningful results in economic development.

In the face of these deficiencies, fiscal policy although not an adequate substitute for all these shortcomings, can be used effectively to rectify and set right much of it by creating the proper economic climate. It can be used to stimulate the process of saving. It can be used to channel such savings into investment. It can be used to step up the level of financial intermediation. It can be used to revitalise and restore the interest rate mechanism as an effective instrument of policy. These by no means are consistent goals. The objectives of one policy may conflict with the aim of another, but the Government has to strike a balance in its overall policy.

In regard to raising the level of savings, the Government can use budgetary policy to effect both the voluntary and forced savings. Voluntary savings is a matter for both fiscal and monetary incentives and the institutional framework. The scope for fiscal policy is mostly in the sphere of forced saving through taxation and it deserves more comment.

Taxation

Taxation we know could be both direct and indirect. Direct taxes can be levied on income and affect the disposable income. Indirect taxes could be levied on expenditure by taxing goods and services available for sale in the market. Under both methods it affects the real income of the people, to the extent that a share of the resource is channelled from consumption into savings in the form of taxation. Yet another alternative when one fails to take the decision to postpone current consumption is to generate resources for economic development through inflationary means. This again in the long run has the effect of a tax. In the first instance it brings about a transfer of resources to the State, but the consequent increase in prices and the erosion of real value of incomes constitutes the element of tax. Consequently, it is a method with strict limitations in regard to both cost and yield. Further if left control, it can lead to inflationary situations as was witnessed in certain Latin American countries, Indonesia or Korea in the recent past. Then it follows that there is no painless short cut to mobilise resources apart from voluntary savings or savings enforced through taxation.

Further the tax based savings do not create prior claim on a future increase in output; whereas private savings held in bonds and other instruments of indebtedness carry a cost of debt service and constraints the revenue-expenditure policy of the Government. Taxation as an instrument of policy has other advantages. It can be used to redistribute income resulting from the free working of market forces in the economy. However, the multiple objectives of state policy to

provide public goods, welfare and development expenditure tend to obscure the purposewise boundaries in taxation. Purposewise boundaries are important since they have major implications for expenditure policy. The state has a prime responsibility to provide law and order and the basic public goods. This needs taxation. Then the state can pursue a policy of redistribution through taxation. This latter justification for taxation commits the Government to certain welfare services. Thirdly, the Government can use taxation to generate savings for economic development. Now the real problem begins at this state. What is the level at which taxation for the supply of public goods and redistribution ends and taxation for development begins. In practice, it is almost impossible to draw a distinction. In normal fiscal classifications all proceeds from taxes constitute current revenue; and it could be claimed to finance redistribution oriented expenditure with a certain degree of justification. Nevertheless, one cannot avoid a demarcation if economic development with direct state intervention is a declared objective of the Government fiscal policy.

Economics in Expenditure

This obviously is a difficult political choice and the problem may be approached from another angle by examining the level and magnitude of desired re-distribution. Posed in this manner one has to examine the relative merits of different forms of redistribution as against the need for development.

In Sri Lanka even with massive re-distribution programmes the authorities have at the best been able to make only a marginal improvement in the living standards of low income groups. If the state were to raise the level of consumption and the living standards of these classes into what could even be remotely called "acceptable", massive doses of further welfare expenditure will be called for. Such a solution while perpetuating poverty and discontent will only remove the dignity and self-reliance of the large base in the population. In the alternative, a more longlasting solution appears to lie in economic growth that could broaden the base of employment and enhance the income levels of the population. Between the two extremes of all welfare and all development, a compromise solution seems to exist in selective welfare oriented re-distribution with a substantial allocation of tax receipts for development expenditure.

Selectivity in welfare leads to an examination of relative merits or consequences of the several kinds of welfare programmes now in operation. The bulk of such expenditure falls under education, health and transfer payments to households in the form of food subsidies and pensions.

Here again, one cannot look upon re-distribution with a welfare objective as something distinctly alienated from investment and growth. So called welfare expenditure to enhance the quality of human capital by raising

the standards of education, health and nutrition makes a positive contribution for growth. This however needs further elaboration. Usually in the standard classification of Government expenditure, outlays on hospitals and schools are undisputedly regarded as capital expenditure. Similarly, the outlasting equipment used in education and health is also classified under the same category. But salaries and wages in either instance is regarded as current expenditure. This now is a debatable point. If investment in hospitals and schools is regarded as capital, the expenditure on doctors and teachers who contribute to the productivity of these investments should also belong to the same category. If one were to use a concept of human capital there should be no dispute on this issue.

Regardless of this debate, the state through its policies over the last several decades is committed to provide free education and health to the public in this country; and the real issue is the ability of the state to undertake these services and maintain adequate standards befitting the development in these fields elsewhere in the world. Absolutely free education and health services though a laudable effort in promoting welfare, impairs the capacity of the government to mobilise resources for further development work. Further, one has to note that these services are financed from tax revenue and examine whether it is within the reach of the state to devote a still higher share of the revenue to finance these services at the expense of alternative development projects.

Public discussions related to these issues have often failed to isolate two important aspects. One is the desirability of the state to undertake these services and the other is the method of financing these services.

Given the political environment in Sri Lanka and the widening role of the state in economic management, one cannot dispute the right of the state to undertake these services. Necessarily it does not follow that the state should bear the full financial burden of these services. As much as there is a right for the state to tax the community to defray the costs of public goods such as law enforcement and basic utilities, the state could exercise the right to tax the services rendered by education and health. This could very well be done without violating the principles of equity usually observed in enforcing a tax. A graduated scale of subsidies offered to each individual depending on his or her circumstance would not violate the welfare aspects embodied in the current programmes. Those who are in destitute circumstances who fall below an officially adopted poverty line could continue to receive the same benefits they receive now, and the others depending on their ability could be made to pay for the services they receive.

In the field of health, a system of insurance analogous to the national health insurance scheme in U.K. may be adopted to service the working population. In the

field of education absolute free education could be extended upto a certain level but the state financing of further education could be subjected to suitable criteria of selectivity. A system of public assistance could finance the really promising students regardless of their circumstance. The criteria for selectivity are many and could be worked out to the satisfaction of the community, provided the principle of selectivity is adopted in the first instance. Adoption of this principle will certainly go a long way to improve the quality of the services that could be rendered and improve the state of public finances in this country to accommodate further development projects, to increase the productivity and enhance the level and quality of the community at large.

Food subsidies that constitute the bulk of the transfer payments of the government could be handled in very much the same manner. Here again one does not question the desirability of a food subsidy extended to those who really deserve a subsidy. What may be questioned is the need and desirability of extending this subsidy to all, regardless of their circumstances.

However, the food subsidy that constitutes the bulk of the transfer payments from the Government to the public, has acquired a degree of political sensitivity unparalleled in matters of economic management elsewhere in the world. In the first instance, it appears to be due to a policy of wooing the consumer for over three decades; but the more fundamental reasons could be found in (a) the relative stagnation of the economy with low growth rates that has failed to make an appreciable increase either in the per capita income or in the level of employment in the economy and (b) the failure of the domestic food grain sector to meet the demand for cereal production.

Since a political solution to appease the consumer further, would only perpetuate the problem and trap the government in deeper political impasse; a more lasting solution has to be found through a growth oriented economic policy that would transform the subsistent agriculture to a market oriented sector and raise the peasant incomes to a level above a minimum poverty line through suitable investment programmes.

It is clear that investment in agriculture to uplift the productive capacity of the rural farmer, and in industry to create more employment without sacrificing the productivity of such projects, demands the highest priority; but assuming that plans and projects to realise these objectives are forthcoming, the issue for fiscal policy is one of raising resources.

Alternatives for the policy-maker are fairly obvious. Hesitation to contain welfare expenditure at a level warranted by tax revenue would retard growth activity and defer the opportunity to extricate the state from this vicious circle; and measures to cut subsidies on the other hand is likely to receive instant hostile reaction from

the public. In view of this delicate situation, one must not necessarily question the desirability of a subsidy to those who really need it. What may in fact be questioned is the justification of extending it to the bulk of the community who really does not depend on it for their survival. If the state were to adopt a principle of selectivity to exclude those who do not depend on it for their very survival, and essential food items at subsidised prices are issued to that section of the population that falls below a suitably defined poverty line, considerable savings could be generated to finance the needs of development.

Implications of deficit financing

With almost the whole of total revenue used to finance current expenditure, the progressively increasing development expenditure is financed from floating a debt, both foreign and local. Consequently, fiscal management in the post-war period moved progressively towards deficit financing the budget. Throughout the period, the justification for the debt was the need to incur public expenditure to increase the productive capacity of the economy. Growth of the debt was relatively low in the earlier years, but the phase was more accelerated in the more recent years.

Quite apart from the issues related to debt management, any sizeable public debt would tend to pose a problem of debt burden with implications for Balance of Payments.

In the context of the burden it is pertinent to examine the time spread of the debt burden and the cost of benefit to each generation. It is known that the domestic debt raised to harness unemployed resources is beneficial to both the present and future generation, but interest paid on that debt is an irrelevant subsidy to the present generation at the expense of future tax payers. The more efficient method, purely in the context of burden would be to finance such projects with interest free creation of currency or interest free borrowing from the Central Bank. If such credit creation is solely for the purpose of utilising unemployed resources it cannot generate a substantial degree of inflation. On the other hand, if the debt is floated to shift factors of production to a preferred area, it is bound to raise the market rate of interest and adversely affect the rate of private investment. Here again the burden is shifted to a future generation and interest paid now is a subsidy on the present generation.

The external debt in either instance is a transfer of real resources in the current period whose burden is invariably shifted to a future generation. Further, the external debt has a direct bearing on the Balance of Payments. In an operational sense one could show that the debt contracted to finance the Government Budget constitutes a built-in import content into the economic system. Similarly, it is also true to say that a Government deficit not financed directly with external loans also cause a deficit in the Balance of Payments. That is, no matter how the budget is financed any deficit is likely to show up partly as a deficit in the balance of payments and partly as a saving in the non-government sector in the national accounts of the economy. This could be shown conveniently in the framework of Keynesian Income Identity.

* $Y = C + I + G - T + X - M$. This expression could be transformed and rewritten as $G - T = (S - I) + (M - X)$

Since a deficit in one sector has to be financed by other sectors in the economy, it follows that a deficit in the Government sector is invariably financed by savings in the private sector ($S - I$), and transfers from external sector shown as ($M - X$). The external sector savings transferred to the economy appear as a deficit in the Balance of Payments. It does not necessarily follow that the Government deficit is financed with external borrowings, but it means that the Government deficit will induce an import demand in excess of exports in the rest of the economy. It can be shown that the expenditure that constitutes the Government deficit, raise output and employment until planned saving equates planned investment and the planned savings, if not released through the domestic sector is forced through a deficit in the external sector. It is clear from this that unless an increase in Government expenditure (G) is followed by an increase of taxation (T) it is bound to aggravate the external deficit in the economy sooner or later. The usual remedy suggested to choke off this demand for imports is a devaluation of the exchange rate, but there is no clear evidence to suggest that this will balance the external account, and the savings to finance investment in both the Government and private sector accounts will come from the private sector. In fact, the experience in Britain and Italy in recent years has been that private investment rose as much as private savings and the balance of payments deteriorated as much as the budget deficit.

* The symbols stand for the following—

Y = Gross National Income
 C = Consumption
 I = Investment
 G = Govt. expenditure

T = Tax Revenue
 X = Exports
 M = Imports
 S = Savings

The Export Processing Zone as a Component of the new Economic policy

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A proposal to establish an Export Processing Zone apart from having its own merits and national benefits symbolises a significant change in the content and direction of economic policy. The previous S.L.F.P. government too was interested in setting up an Export Processing Zone in Sri Lanka, and the fact that this proposal was considered within the framework of a system of rigid controls is a virtual admission that the earlier economic policy based on increasing restrictions and state intervention had proved to be a miserable failure. The new economic policy of the present government must be looked at in the light of the policies of successive governments since 1956 and consequently the need for a complete reorientation of strategy. After 1970, the economy became rigid, dominated by inward-looking policies and an extensive system of controls which tended to debilitate the economy and create a very unfavourable climate for domestic and foreign investment.

Increasing Controls

Sri Lanka inherited a system of controls from the Second World War and was also committed to a wide range of welfare expenditure from about the same time. These have been the major obstacles to rapid economic growth in the last two decades and has contributed to virtual stagnation in certain sectors and an inward looking approach to economic development. The most important controls introduced in the war years were on foreign exchange. After the end of the war, these controls continued to be in operation for the purpose of conserving foreign exchange. Import controls were introduced in the early fifties with the object of ceylonising foreign trade, where licences were issued primarily to Ceylonese businessmen and firms. After 1960, the administration believed that the adoption of extensive controls would help to improve the balance of payments situation and promote investment in industry. This was the outcome of a static view of the balance of payments, where it was believed that the country's foreign exchange earnings can only come from existing exports and through import savings and not through export diversification and the attraction of foreign investment.

Thus a liberal and free economy which existed in the early fifties gave way to one of increasing controls. The administration did not realise that in the context of dwindling foreign exchange reserves an alternative course of action would have been to invite foreign investment without resorting to restrictions. Had the economy become less restrictive and state interference

in the economic life of the nation kept to a minimum the development process in Sri Lanka would have taken a different course. Foreign investors kept away after 1956 because the economic climate for investment became increasingly hostile, especially with the policy of nationalising both local and foreign enterprise. The only way of diversifying the economy and making it more export-oriented was through greater liberalisation, and not within an increasingly restrictive framework.

The proposal to establish a Free Trade Zone must be evaluated in the light of the contribution it would make to diversify and promote exports and the new overseas market opportunities it would open for domestic industry. In the last 17 years, Sri Lanka's development has had a heavy bias towards industry. Despite the appreciable progress in agriculture, the central planners have been largely preoccupied with the welfare of the new urban manufacturing industries. From the outset these were given a wide range of tax and other incentives. Although there are more than 2,500 new industries of varying sizes, most of them have survived because of the heavy protection afforded to them in the internal market. Domestic sales have been very profitable because of the high protective tariffs and severe import restrictions that fully insulated them from foreign competition.

Export Performance

In a protected market, under the conditions of scarcity, industrialists are able to determine the prices at which they sell, their profit margins and the quality of their products. Even with incentives offered to exporters such as FEECs, the Convertible Rupee Accounts, low tariffs on raw materials and machinery, duty rebates on exports and handsome foreign exchange allocations, most industrialists in Sri Lanka have not been able to export. Even the establishment of specialised agencies like the Export Promotion Secretariat have not made much difference to Sri Lanka's export performance. The export figures for industrial and manufactured goods show that the bulk of the earnings in this category still come from the exports of refined petroleum products. In 1976, out of a total of Rs. 755.7 million of manufactured exports, petroleum products amounted to about Rs. 505.2 million which shows that manufacturers only contributed Rs. 250.5 million, which was about 5 per cent of total exports and only about 30 per cent of exports of industrial goods. The relatively unimpressive export performance of manufacturers has been due to several factors. The quality of the products have not always stood up to the exacting requirements of

foreign buyers and industrialists have not found it easy to secure sustained export orders. This is partly because they have not been able to tie themselves up with recognised international firms who have well established markets and sell their products under popular brand names.

Impact on Exports.

One of the major objectives of setting up an Export Processing Zone would be to get recognised industrial firms to manufacture goods with or without local collaboration so that they may be assured of export markets and would produce goods of high quality. In India, a large number of industries producing goods for the domestic market and for export have tied themselves up with leading manufacturers in the U.S.A., U.K., Germany, France and Japan. Much of the success in India in the export of manufactures has been largely the outcome of these tie-ups. Unless this is done, it is most unlikely that Sri Lanka can make sufficient headway in pushing exports of manufactures. The objective should be to step up exports of industrial products from the present level of Rs. 250 million to at least Rs. 1,000 million. For instance, in 1976, tea, a traditional product, brought in Rs. 2,100 million in foreign exchange.

Once the Export Processing Zone becomes operative, the investors in the zone would become the principal means of promoting exports because they would be in a better position to expand sales overseas than the official agencies like the Export Promotion Secretariat on account of their superior knowledge of foreign markets, techniques of marketing and preparing and packaging products for export. However, existing export promotion agencies would have a role to play in Sri Lanka because they would still have to pay attention to exports from outside the Export Processing Zone.

The inward-looking approach to industrial development and the limited size of the Sri Lanka's market has considerably precluded industrial expansion. At the present level of incomes and the demand for manufactured goods, one or two medium or large units could supply the entire requirements of the country. In some cases, large units both in the public and private sector are unable to work continuously to capacity because of the limited size of the market and the latter does not provide scope for expansion. Both money and real income levels in Sri Lanka have not gone up appreciably to provide for the expansion of purchasing power to boost internal demand. People still tend to spend the bulk of their income on basic essentials, mainly food and clothing. Furthermore, increasing inflation in the last 4 to 5 years has also made inroads into real income and consumer demand for manufactured goods has not increased in proportion to the rise in money incomes.

Within the present framework more employment in industry could largely come through expanded markets and higher levels of production, either through greater capacity utilisation or through the establishment of new industries. A substantial increase in the demand for Sri Lanka manufacturers could result from a much higher level of exports than through a rise in domestic demand. So far, private and public sector industries have provided employment for only some 150,000 persons out of a total workforce of 5.2 million, which is around 2 per cent. The contribution of manufacturing to both the Gross National Product and to the generation of new employment has been very limited and the total industrial workforce has hardly increased in the last few years. The labour absorptive capacity of industries has been very low due to excess capacity and very often to the use of inappropriate technology. In the present circumstances, an Export Processing Zone could act as a catalyst and provide the momentum to activate a virtually dormant manufacturing sector.

The success of the Zone and the facility with which foreign investments could be attracted would depend on appropriate policies and the concessions which the government would provide. Move to liberalise the economy through the relaxation of controls and the introduction of a more realistic exchange rate that would help to boost exports apart from creating a favourable investment climate, will make investors feel that there will be fewer bureaucratic controls and a greater freedom to take decisions on their own. This would give confidence and an assurance to the investor that government interference would be at a minimum.

Characteristics and Impact of Industries.

Local industrialists have had a wide range of incentives and concessions to develop their industries. By now, most of the industries set up in the sixties and early seventies have utilised their tax holidays, development rebates and other incentives upon which they were able to grow and survive. There is a fear among local industrialists that investments in the Export Processing Zone would tend to wipe them out. This is unwarranted because it is unlikely that investors in the Export Processing Zone would get greater concessions than other export-oriented industries in the rest of the country. At the most, they would get a tax holiday plus all the concessions that industries in Sri Lanka enjoyed in their initial year. Beyond this, the main advantage of the Export Processing Zone is that the investor will be in a position to carry on his business with practically no bureaucratic controls and administrative delays and will be largely free of customs procedures which normally apply to the rest of the country. Industries in the Export Processing Zone would only compete with other export industries and not with those producing goods for the

domestic market. Export industries are relatively more efficient than those that cater to the local market. Furthermore, goods produced in the Zone will normally not enter the country, and even if they do, the usual customs duties and turnover taxes will have to be paid. This will afford protection to industries in the rest of the country.

Investors in the Zone will have the liberty to decide on the technologies they employ, the methods of production and the quality of their products. Presumably, investors will have the freedom to produce whatever goods they want, provided they are exported. The applicability of labour laws and regulations could be less stringent. Since production is for export, manufacturers will have to keep abreast of technological advancements in the rest of the world if they are to permanently establish themselves in export markets. It does not necessarily follow that labour-intensive technologies would be employed uniformly in the Zone. Especially in the fields such as electronic goods, vehicle and machinery components and chemicals, sophisticated equipment might be brought in and the employment opportunities generated in these industries could be less than what is expected. In other areas such as garments, the assembly of products, confectionery, food canning and agro-based industries, there is considerable scope for the employment of labour. All industries could not be expected to use labour-intensive technologies.

The Zone would, therefore, have a mix of industries, some based on sophisticated technology and others using more labour. However, since a large number of industries would come here to take advantage of the considerably lower labour costs, many of them on balance are likely to use labour-intensive methods of production and choose investments where labour can be employed profitably. This is one factor which could help to attract the kind of industries which the government would prefer to have. On this basis, within a period of about 18 months the amount of direct employment in the Zone could well exceed 50,000. If the Western countries do not intensify quota restrictions on textile products, a larger number of garment manufacturers already operating in other countries would be interested in coming here. In the first year, if 10 garment manufacturing units are set up in the Zone, as many as 30,000 to 40,000 jobs could be found in these industries alone.

Additionally, an equal amount of jobs may be found in the rest of the country as a result of primary employment in the Zone. These will largely be in services such as transportation, communications, advertising, packaging, maintenance and the supply of food and raw materials and entertainment. The salaries and wages paid to labour in the Zone would tend to be higher than in the

rest of the country, and all this money would be spent here by the Sri Lanka national working in the Zone. Industries that want to get started as soon as possible will tend to take the most skilled and talented workers from other industries in the country and to do this they will have to pay them higher wages. The movement of skilled labour into the Zone will open up new avenues of training and employment in older established industries in the rest of the country. Through this process, there will be much greater diffusion of skills and middle management expertise. The employment generating effects of the Zone in more than one way would thus tend to spread to other areas in the country and will not be confined to the Zone itself.

Business activity in the Export Processing Zone would not be limited to manufacture. The functions of the Zone could progressively increase as it expands and new activities especially in the area of finance, banking and entrepot trade could emerge. The concessions in the Zone could provide a stimulus for the development of these other activities. Foreign goods may be brought into the Zone without payment of customs duty for trans-shipment, re-exportation, for further processing for export or with a view to ultimate importation into the local market. Firms operating in the Zone could engage in the assembly, manufacture or the storage of knocked down components in order to get relief from customs duties and other levies. Since most countries, including Sri Lanka, levy very high customs duties and taxes, imports into the Export Processing Zone would be free of taxation, tariff laws and similar regulations which normally apply to the rest of the country.

Limitations on Operations

Although duties and concessions would apply to firms operating in the Export Processing Zone, the latter would be subject to the civil, commercial and banking laws of the country. These would include the registration of commercial and banking companies, laws pertaining to public health, security, penal offences, and the preservation of the environment, etc. Business and personnel taxes would also be applicable within the Zone. Direct revenue to the host country would accrue through personal taxes and levies such as a small turnover-tax on manufactured goods. As the Zone expands, these would be a substantial source of income and much revenue could also accrue from turnover taxes levied on the multiplicity of services provided. Duties on goods exported from the Zone to the rest of the country become payable when they cross the boundaries which will have to be clearly demarcated. Normally some kind of customs surveillance exists on the perimeters of the Zone in order to prevent smuggling and illicit trading activities.

A variety of goods could be brought into the zone, but this would not include goods that are normally prohibited in the host country. Narcotics, dangerous drugs, fire-arms, explosives, precious metals and precious stones which are normally denied free entry into the host country would not be permitted into the Export Processing Zone, unless these items are required for industrial purposes. Within the Export Processing Zone, retail trade in goods manufactured in the Zone is prohibited and even if such sales are allowed they would be subject to the regulations that would apply to them in the rest of the country.

An Export Processing Zone should not be confused with a free port where consumer goods could be purchased free of customs duties and other taxes. The Zone might house a few duty free shops to cater to tourists and foreign visitors who would make purchases in foreign currency. Furthermore, people are not encouraged to live in an Export Processing Zone unless they happen to be the owners of business enterprises or are senior technical, managerial and specialised personnel. Workers usually commute to the Zone and residence is discouraged because the Zone would not cover an extensive area; since land values are high and it would be wasteful to set up housing colonies within the Zone. Moreover, with fewer residents living in the area it would be easy to police the Zone and maintain security. The proposed Export Processing Zone area around Katunayake would be largely earmarked for medium and smallscale industries and residential housing within the area would be discouraged although housing colonies would have to come up in the adjacent areas.

Benefits to the Investor

To the foreign investor, the Export Processing Zone offers a wide range of benefits. Most important of these is that the businessman and trader will find that they could economise on the use of funds by not blocking them for the payment of customs duties, import taxes and for goods in bond. He could take advantage of low prices for raw materials in world markets and import in bulk because foreign exchange would not be a problem. The Export Processing Zone could have industries with facilities for refining raw materials or processing them further for export. In such cases, there would be an increase in value added and the improvement in quality would result in considerable saving in freight and duty for the importing country if the duties are leviable on a specific rather than on an ad-valorem basis and the exporter would get better prices. The Zone would be the ideal place for packaging, marketing and labelling of goods in accordance with customers' preferences, and it could be a centre for manufacturers to assemble and prepare goods according to specifications for particular markets. It could operate as a wholesale supply centre and thereby could help to reduce the time lag between the placement of an order and the date of delivery. Improved local delivery schedules could be achieved by firms in the Zone if they carry stocks of raw

materials and finished goods in anticipation of orders which would be forthcoming from the host country. The Export Processing Zone could also act as a shop window to attract buyers because it could have a permanent exhibition of the wide range of goods it produces. Foreign buyers would prefer to open up agencies in the area so that they could keep abreast with the new products which are being put out by manufacturers and also ensure that manufactures conform to specifications.

Planning the Infrastructure

The experience of a large number of other Asian countries shows that the Export Processing Zone could produce substantial results provided flexible economic policies are put into operation to give investors in the Zone maximum assistance and facilities. The administration of the Zone should be vested in an autonomous agency. The Zone Authority should have over-riding powers over other organisations in order to ensure that the infrastructure will be quickly made available. It should not be faced with the obstacles that normally confront government corporations. It should be able to operate free of bureaucratic controls and take decisions without any hindrance and have the power to get jobs done by other government agencies and departments on a priority basis. The success of the Zone would largely depend on the quality of the basic infrastructure and the wide range of ancillary services it will be able to provide. The Zone authority should be in a position to provide the prospective investor with a complete record of data and other relevant information on investment. It should have documents spelling out the financial laws and other details pertaining to investment in the country.

International private investment today is very competitive and it is extremely sensitive to conditions in the local environment. The foreign investor normally has a large number of options and he would prefer to locate his industry under ideal conditions. It is precisely these conditions that the Authority should endeavour to provide, in the other words, the quality of the services provided in the Zone should be superior to those in other locations. It is fruitless to think that foreign investors would come to Sri Lanka regardless of disabilities and unfavourable conditions prevailing in the economy unless it has some compensation in the high quality of services offered in the Zone.

The success of the Export Processing Zone and its capacity to attract foreign investment will depend essentially on how much planning has gone into location and the making of the infrastructure. Investors look far ahead and they would make a careful study of overall economic policy and the general environment of the Zone. They will examine the relative advantages and disadvantages of the Zone as against facilities available elsewhere. They would, at the very outset, expect a basic statement of policy, not only in regard to the Zone, but also, indicating the attitude of the government towards

foreign investment, and what safeguards would be given to the foreign investor. The promotion of the Zone will have to involve an extended publicity campaign overseas. There has been very little publicity given to economic activity here in the leading overseas financial journals and magazines. Without publicity, at an international level prospective investors may not know what Sri Lanka has to offer and such publicity should be undertaken well in advance.

The infrastructure will have to be carefully planned and in particular the land earmarked for the Zone would have to be advantageously located and clearly demarcated because it will have to satisfy a large number of requirements not only at the beginning but later on. It would have to have proper drainage, should not get water logged and should be easily accessible to the network of major roads; adequate land must be available in the vicinity for housing colonies and satellite towns. There should be ready means of access to ports and airports and the communication nerve centres. Although a considerable amount of land may not be required in the initial stages, it is reasonable to assume that 30 to 40 factory units may be operating in the first year to 18 months and the initial land area required may be 500 acres although at least another 1,500 acres may be earmarked for further expansion.

The government will have to decide at the outset whether physical planning of the Zone will be entrusted to the private sector or the government departments. Problems faced by private industrialists all over the Island is the lack of a stable electricity and water supply and efficient telecommunication facilities. These three services will have to be given greatest priority. The supply of electricity should be good enough so that most factories would be able to operate without standby supplies. In regard to water, a permanent water purification scheme may have to be installed for water not only to industries but also the housing colonies around the Zone. If the Zone is going to be located at Katunayake, it may not be advisable to link it to the Colombo supply because it does not have the capacity to meet the requirements of Colombo and the Zone. The water supply to the Zone may have to be based on separate purification plants linked to the Kelani Ganga and situated to the north of the river.

With regard to factory buildings and installation of plant, a large number of services would have to gear itself

to meet the relatively short deadlines for construction and installation given by foreign investors. They would be normally accustomed to sophisticated construction techniques in their own countries and would be unfamiliar with the methods used here and may not be satisfied with the slow pace at which construction takes place in Sri Lanka. In view of this, it may be necessary for construction firms, particularly those in the private sector, to gear themselves to meet the exacting requirements of the foreign investor. As the programme goes a head shortages of certain skills may occur both at the construction stage and later on for industries within the Zone. On account of the heavy drain of technicians and skilled workers to the Middle East, schemes may have to be launched to train technicians of all varieties and personnel of middle management grades in order to cater to the skills required for industries in the Zone.

The bulk of the equipment and raw materials for industries in the Zone will have to come through the Colombo harbour, even though it is possible for some part of the light industrial raw materials to come by air. This will involve efficiency at two points. There will have to be a very efficient system of transport between Colombo and Katunayake, moving raw materials one way and finished products on the other. What is even more important is that the services of the Colombo port would have to be pepped up to meet the needs of the Zone. It is clear enough that the Colombo port as it is presently organised cannot cater to the needs of the Zone. Apart from frequent labour problems and management inefficiencies there are also inadequate berths and unsatisfactory loading and unloading facilities. Additional warehousing space will have to be built to handle cargo to and from the Zone which would probably keep on arriving or leaving on a continuing basis. Furthermore, as the Zone gets more sophisticated, the bulk of the cargo will either arrive or leave in containerised form and the Colombo port does not have a single container berth. All this calls for immediate improvement to the facilities in the port and such improvements should be effected well in advance so that the investor would not have second thoughts about his investment here. He will realise that if he does not have excellent facilities for the movement of his raw materials and finished products he would be at a great disadvantage.

The Development of the Rural Productive Forces*

By G. V. S. de Silva

From "Some Heretical thoughts on Economic Development" Lake House Investments Ltd. 1973.

The central economic question in our country today is the development of the rural productive forces. By 'productive forces' are meant the instruments and technology of production, and the skills and productivity of labour.

Why rural? Why not urban, or both urban and rural? Firstly, the development of the urban productive forces is helplessly dependent on foreign equipment, technology, inputs and expertise. With the limits to industrial import substitution being rapidly reached, it is also becoming increasingly contingent on the availability of foreign markets. Hence, in the context of a severe foreign exchange shortage, the urban economy, far from expanding, is being forced to contract. The only growth possible for the urban economy, in such a situation, is as a satellite of foreign capital. It is doubtful whether even this road is open to it, since foreign capital is now extremely sensitive to the mood of a country, and most fastidious in its selection of these on whom it will confer satellite status. Secondly, the general level of urban technology and expertise available within the country, though comparatively low by foreign standards, and hopelessly inadequate for any independent and self-generating development of the urban productive forces, is infinitely higher than the technological level of the rural areas of the country, and is capable of developing rapidly the rural productive forces, with the minimum recourse to foreign exchange. Thirdly, it is significant that, while import substitution possibilities in industry are almost reaching exhaustion, import substitution in the non-industrial sector yet remains a wide open field. Food and agricultural raw materials still account for almost half our annual import bill. Thus, it is only a decisive breakthrough in the rural sector that can crack open the foreign exchange problem which confronts us at every turn today.

It is therefore abundantly clear that both the opportunity and the means for the swift development of the productive forces exist in the rural, but not in the urban sector. Besides, the tempo of development of the rural economy is conditional on the massive diversion to it of resources, technology and skilled personnel, from the urban economy. This, if nothing else, rules out the possibility of the simultaneous development of both rural and urban productive forces. On the contrary, it indicates that the development of the rural economy necessarily implies, in our present circumstances, the contraction of some bloated areas of the urban economy. We have apparently taken a wrong turning

which has led us to a blind-alley. Should we not even now retrace our steps, rather than stubbornly continue to knock our heads against an unyielding wall? This is a hard decision for urban policymakers to take. It may be softened by the awareness that the decline of the urban economy has already set in, and that there is very little anyone can do about it other than prolonging the end by injecting successively heavier doses of foreign aid sedatives. The danger is that the crisis, when it comes, will find us totally unprepared unless we resolutely turn back now and take the alternative road without delay. If there is still a doubt as to whether there is, in fact, another road, let us reflect awhile on the experience of North Vietnam, which fell back on the tremendous reserves of strength available in the countryside to fight a protracted war when American bombs threatened to disrupt its city life.

The deployment, on an immense scale, of resources, technology, skills and expertise, from the urban to the rural sector, is a necessary but not a sufficient condition for the development of the rural productive forces. Equally necessary is a transformation of the economic relations within the framework of which these productive forces operate. The basic cause of rural economic backwardness is that these economic relations have become a fetter impeding the growth of the rural productive forces. They must accordingly be changed into relations which are conducive to and foster growth.

What are these economic relations which obstruct the growth of the rural productive forces, and which must therefore be changed? They are:

- (1) the relations between the rural economy and the urban economy, and
- (2) the relations within the rural economy itself.

The present rural-urban economic relations are based on the exploitation of the countryside by the town. By 'exploitation' is meant the appropriation of the rural economic surplus by the urban economy. This exploitation takes many forms. The most vicious method by which the town plunders the village is through trade. The unconscionably high profits appropriated by the urban traders in rural produce are well known, but the extent of exploitation that takes place through the terms of trade (i.e. the price relationship) between rural and urban commodities is not so fully appreciated. To cite a few striking instances: * A bushel of paddy gives the farmer an income of Rs. 18/-, while a cotton

* Refers to prices current in 1973

shirt is also priced at about the same level. A pint of milk earns the dairyman 40 cents, while a bottle of aerated water costs him 50 cents, and a throw-away ballpoint pen is the equivalent of Rs. 1.25. The rural surplus is also pilfered by the cities through the provision of finance at exorbitant rates of interest. Often, the financier is also a trader, and the loan and interest are recovered through excessive trading profits. The urban transport contractor, too, takes his share of the spoils, and absentee landlordism is still another method of siphoning the rural surplus to the towns.

It is interesting to observe that the exploitation of the rural economy by the urban, takes practically the same forms as the exploitation of the urban economy, in turn by the imperialist economies of the developed countries. In both cases, the economic surplus is appropriated through the terms of trade, transport, finance and property ownership. The rural-urban relationship is a mirror image of the urban-foreign relationship, even faithfully copying a phenomenon such as the brain drain. Further, by being a satellite of the urban economy, which is itself exploited by foreign economies, the rural economy, in spite of its apparent isolation, is drawn into the mainstream of world capitalist domination and exploitation. Our rural economy, therefore, is a doubly exploited one.

The State, it is true, has attempted to redress the balance somewhat, through institutional and other devices. It has promoted the growth of consumer and, to a lesser extent, service co-operatives. It has sponsored co-operative and rural banking. It has carried out measures of land reform. It has instituted State Marketing schemes, and has guaranteed the prices of certain agricultural commodities. It has established a network of extension and advisory services. It has subsidised fertilizer inputs for some crops. It is also attempting to channel funds to the rural areas through District Development Councils and decentralized budgeting. The measures appear quite impressive, but the results are not. This is because these efforts have not even touched the heart of the rural-urban conflict, nor transformed the economic relations within the rural economy, which are the twin fetters imprisoning the rural productive forces. These measures, taken by them selves, are as reformist and ineffective as the attempts to solve the basic capital-labour contradiction through labour laws, profit sharing, diffusion of shares and Workers' Councils, or the basic imperial-colonial contradiction through economic co-operation, commodity agreements, financial aid and international currency manipulations.

The essence of the rural-urban contradiction is the domination of the rural economy by the urban economy. In Nature as well as in Society, two mutually contradictory entities (or aspects) coexist as a unity, because they are also mutually interdependent; but they never coexist as equal partners. One is dominant, the other subordinate. The character of any phenomenon is essentially determined by the dominant aspect of the contradiction within it. Whatever the changes that may

take place in the mutual relations between the two aspects, so long as the dominant aspect retains its position of dominance, the character of the phenomenon remains basically unchanged. The phenomenon changes into something essentially and qualitatively different, as opposed to mere quantitative changes, only when the dominant aspect becomes subordinate and the subordinate aspect becomes dominant. Hence, if the rural-urban relationship, which is one of both mutual interdependence and conflict, is to be qualitatively changed, the rural economy must become dominant and the urban economy subordinate. In our present situation, this is the only way of releasing our rural productive forces from the chains that restrain them. Anything short of this is only a palliative, and will not result in a fundamental transformation of the rural economy.

In countries where the urban economy has an independent momentum of its own and can carry the rural economy along with it, though as a subordinate subject to its exploitation, such a fundamental transformation of the urban-rural relationship may not be necessary. But in countries such as ours, where the urban economy is not self-generative, and is incapable of further growth without large doses of foreign technology, equipment, inputs and skills for which it does not have the means to pay, it is fast becoming inert and totally parasitic. It must therefore be made subordinate, if the country is to survive and not be dragged down with it.

What does subordinating the urban economy to the rural mean in practice? It means a complete reversal of Government priorities, policies, attitudes and thinking, in respect of investment, research and technological innovation, deployment of skilled personnel, internal marketing and the terms of trade, housing, transport, education, health administration and cultural activities. It means that the Government must organize a tremendous shift of resources to the rural economy, at the expense of the urban economy. The only resources that should be allocated to the urban economy are those that would serve the development of the rural productive forces. The urban economy must be reduced to the status of a satellite, the direction and pace of growth of which is solely determined by the development needs of the rural economy.

In the field of investment, the Government should give a very high priority to rural electrification, which is the power base for the development of the rural productive forces. The essence of rural electrification is the supply of cheap power to the rural economy; and our methods of generation, transmission, distribution and protection will have to be changed so as to make them as inexpensive as possible. The ancillary electrical equipment industries for the production of transformers, motors, meters, insulators, circuit breakers, etc., must be established and located, wherever possible, either wholly or in part in the rural areas. Along with rural electrification, the other investment priorities are agriculture, the manufacture of agricultural implements

and agro-based rural industry. The provision of irrigation and drainage facilities to existing cultivable land by the restoration of village tanks and the draining of swamps and marshes, must take precedence over the opening up of new land under costly irrigation schemes which have a long gestation period. Investment should also be directed to the manufacture of basic agricultural implements and unsophisticated equipment for agro-based rural industries such as food preservation and processing, sugar and paper manufacture, power loom textile weaving, timber impregnation and wood-working, distillation of essential oils and utilization of waste materials like coconut shells, coir dust, saw dust and organic refuse. The next in order of investment priorities are the regeneration of the rural fishing, boat building and ceramic industries, and the provision of stud bulls and insemination facilities for the upgrading of the local cattle.

It would be observed that in this scheme of investment priorities, there is hardly any place for capital intensive industries based on imported equipment and materials, for export-oriented industries also dependent on foreign machinery and subject to the mercy of capricious foreign markets, or for the assembly industries which import the major part of their finished product. In fact, this assembly type of industry is already on the way out, due to drastic reductions in exchange quotas. It is only a matter of time before every industry which is mainly dependent on foreign inputs begins to reel before the full blast of the gathering foreign exchange storm. It is therefore imperative that the Government immediately switches its investment priorities and concentrates all its resources on developing the rural productive forces. This is the only way of cushioning the impact of the mass retrenchment of urban workers, and the other consequential effects of the disintegration of the urban economy which is imminent.

In keeping with this overall strategy, the Government must change the priorities, content, methods and attitudes in respect of research and technological innovations. All the available skills and knowledge in these fields must be harnessed and purposefully directed towards the objective of initiating a technological revolution in the countryside. Research scientists, engineers, technicians and other skilled workers must be made to leave their laboratories, office desks, conference tables and relatively comfortable urban life, and to live and work among the rural people, educating them and at the same time learning from them. Agricultural experimentation must be done in the cultivator's field and technical improvisation in the village smithy with the full and intelligent participation of the rural people. The village must be shaken out of its torpor, and turned into a hive of lively discussion, creative thinking, technical innovation and productive activity, by a well planned and organized invasion of skilled and knowledgeable town folk who are anxious to teach and learn in a spirit of humility, seeking, as it were, atonement for their primordial sin of parasitic existence, and

intellectually rejuvenated by their deliverance from the soul-sapping, de-humanizing, urban rat-race.

In the sphere of internal marketing, the exploitation of the rural economy by the urban middlemen must be completely eliminated by the establishment of a widespread network of co-operative marketing and credit institutions, reaching out into every neck and corner of the country. Here, too, the magnitude of the task and its urgency is such that it cannot be left in the hands of a few Co-operative Inspectors, as has been done hitherto. The best organization, managerial and accounting skills available in the urban economy, both in the Public and Private sectors, must be withdrawn and utilized by the Government for this purpose. We again come back to the basic theme: that subordinating the urban to the rural economy means that the cream of urban talent, which incidentally is grossly under-utilized today, must be thrown into a frontal attack on rural economic backwardness. A prime responsibility of the Planning Authority is to plan, organize and direct this entire campaign.

The domination of the town by the village, however, means more than this. It means that the rural producer must have preference over the urban consumer, and the rural consumer preference over the urban producer. Hence the terms of trade (i.e. the price relationship) between rural and urban commodities must be significantly changed in favour of the former. The consequence of this will be a lowering of the standards of living of every section of the urban community. This must be accepted as the necessary concomitant to the raising of rural standards of living. The notion of simultaneously raising both rural and urban living standards is, in our present context, only a convenient myth which helps to salve a troubled urban conscience.

The utilization of resources for urban housing and transport must be stopped. The urban economy, by itself, is incapable of solving either its housing problem or its transport problem, the solution to which lies in the rapid growth of the rural economy, leading to a complete reversal of the direction of migration. Any expenditure on urban housing and transport, at this juncture, is a misdirection of resources. The cities will have to live with their slums and shanties until the manpower requirements of a buoyant rural economy relieve the pressure on urban housing. For many years to come, they will also have to suffer their belching buses, decrepit cars and pot-holed roads. The linking up of the rural economy through roads and canals must take precedence over the widening, macadamizing and carpeting of the urban highways. The movement of rural produce must have priority over the movement of urban people. Existing priorities in education and health services too, must be inverted. Rural schools and hospitals must be properly staffed and equipped, and this again has obviously to be at the expense of the urban facilities. Teachers and doctors must be included in

in the organized movement of skilled personnel to the rural areas.

A development strategy based on the rural economy being the dominant partner necessarily implies a far-reaching decentralization of administration and decision-making. The parasitic bureaucratic apparatus, which annually swallows up half the Government revenue and still finds its appetite unsatiated, must be dismantled. The hordes of file carriers, pen pushers, report writers, precedence addicts and conference flitters, who are today a terrible burden on the country's economy, must be shifted to more productive pursuits. Urging them to work a full eight hour day is beside the point; for, even if they were to 'work' sixteen hours a day, they would still be incapable of producing anything useful, while the cost of keeping them at their desks, in terms of the paper, filing cabinets, typewriters and electric power consumed, would increase considerably. It is ironical, but probably true, that the less the bureaucracy 'works', the less of a weight it is on the national economy.

All this must be done and still more, if we are intent on transforming the present rural-urban relationship. In the endeavour to make the village pulse with a new life, its cultural revival should not be overlooked. The traditional song and dance forms must be developed, and enriched with the new content of change and progress. A genuine national culture can never flourish in the arid wasteland of our urban cosmopolitanism. The lumpen language and culture of the cities must be dethroned from their positions of eminence, as part of the process of urban subordination. Every vestige of urban privilege in every sphere of life and thought, must be relentlessly unearthed and uprooted without compunction. This is the essential meaning of subordinating the urban economy to the rural.

What, then, is the future of our cities? Are they doomed to perpetual decline and eventual extinction? No. The urban-rural relationship is not only a mutually contradictory one but also one of mutual interdependence. The present relationship based on urban dominance

and exploitation is strangling the rural productive forces which if set free, have the potential for rapid and independent growth. Hence a qualitative, revolutionary change in this relationship is necessary. This can be achieved only by a total reversal of the dominant and subordinate roles. Once this conflict is resolved in this manner, and the dominance of the rural economy firmly established, mutual interdependence becomes the primary feature of the rural-urban relationship. As the rural economy takes off, it will lift the urban economy up with it, as a junior partner. Cities will once again grow, not as parasites living on the countryside and exploited in turn by foreign economies, but as useful satellites of the rural economy. This, however, will not be the end of the story. With the further development of the rural productive forces, economies of scale will become both necessary and possible. This will again require the concentration of industry, services and decision-making in urban centres. The decentralization inherent in the development of the rural economy may then come into conflict with the increasing need for centralization. Decentralism and centralism are not absolutes; the very decentralization which today is necessary to liberate the incarcerated rural productive forces, may eventually become a drag on the growth of the urban productive forces. 'Urban Centralization' could well be the heretical cry of a future economist. The movement of the urban-rural relationship may once again demand a reversal of the dominant and subordinate roles in that relationship. Their conflict will not end until the antitheses between town and country finally disappears as a result of their becoming indistinguishable from one another. But all this will be many, many, years in the future, and we are in danger of leaving the domain of the economic analyst and getting uncomfortably close to that of the soothsayer; for who knows, the future generations of our country may, in all their wisdom, turn their backs on the western heritage of unbridled urban industrialism, and deliberately spurn its material benefits in order to avoid its attendant evils. In that event, the urban-rural dialectic may unfold itself in our country in an historically unparalleled manner.

Liberalisation of the Economy —

An essay in Political Economy

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Most of the development models prescribed for the less developed countries—of which there are literally, hundreds—accept either a strong regimentation of the economy or a massive intervention on the part of the State in almost all aspects of economic activity. Except for a few economists, most of these who have written on developmental economies have implicitly advocated a plethora of controls and rationing, amounting to a strong ordering of society. Perhaps the popularity of such models may have stemmed from the experience of the U.S.S.R., and the People's Republic of China in elevating themselves into World Powers of the front rank. However, the costs of such development in terms of human misery and sacrifice, in terms of the continuing deprivation of human rights and in terms of the everlooming threat of agricultural crises have apparently been ignored. Even the vast and still barely tapped natural resources of such countries have not been taken into account. Perhaps there was also a psychological factor involved in making a fetish of such developmental models in that in such models, the Economist becomes implicitly a virtual dictator.

What has been said above is meaningful in the light of the experience of Sri Lanka in its efforts at development. In the early seventies the myth was woven that Sri Lanka was a model which most less developed countries of the world should try to emulate. In fact the myth was powerful enough as to bemuse the Governor of the World Bank, for he hailed Sri Lanka's efforts at achieving economic growth whilst also ensuring increasing equality in income distribution. In fact a number of studies highlighted Sri Lanka as a model of increasing redistribution of income coupled with growth.¹

Though there was a swelling chorus of praise for Sri Lanka in striking what was termed a fine balance between growth and income redistribution, there were economists who questioned this myth. Of course their voices were muted, perhaps even hushed. Faulty methodology used in basic research, circular thinking all led to this grand myth.

Like yesterday's fashions, these alluring ideas capture the minds of economists and then fade away into oblivion. Perhaps as Professor E. J. Mishan once pointed out, like yesterday's lovers economists write first and repent later.²

On top of all this we were strongly wedded to the idea of centralised planning. We had a plethora of plans, our own: six year plans, ten year plans and five year plans. All of these plans plotted beautifully the path along which the economy would traverse during the planning period: targets were set both sectorally and globally

and were put before the public with a maximum of fanfare and solemn oaths of dedication. These plans bring to mind what Professor Dudley Seais said once regarding what he termed Pseudo Planning:

"The basic reason why pseudo plans are produced are not always the same. Sometimes the plan is little more than an appeal for aid showing a large foreign exchange or savings "gap"....

"....a plan is a political asset—where there are elections an electoral asset....

"Sometimes the fanfare with which a plan's targets are announced is so loud that one suspects the publication of targets has been confused with achieving them."³

However the very statistics which our Economists used to prove that Sri Lanka had achieved a fine balance between Income Redistribution and Economic growth also revealed evidence which proved the opposite. Thus for example the Consumer Finance Survey carried out by the Central Bank in 1963 and 1973 revealed that between 1963 and 1973, per capita consumption of rationed rice actually fell especially in the case of the lower income groups:

CHANGE IN THE PER CAPITA CONSUMPTION OF RATIONED RICE

(Measures of rice per 2 months per spending unit)

Income class (Rupees per 2 months)	1963	1973
0 — 50	13.87	5.94
51 — 100	19.30	8.48
101 — 200	14.75	10.23
201 — 400	14.55	12.28
401 — 800	12.86	12.26
801 — 1600	11.67	12.01

(Source: Central Bank of Ceylon, Survey of Consumer Finance 1963 & 1973)

In addition to all this, unemployment was becoming a problem of gigantic proportions topping the one million mark. And this unemployment was chronic, seemed never to end—for these who were unemployed,

it is in this context that one must look at the latest concept which has been offered as a solution for the country's ills: Liberalisation of the economy. The question which arises now is whether the term liberalisation of the economy is a cry of despair brought about by the failure of past policies or whether it is a more positive meaningful concept.

It is a meaningful concept if one were to look at the functioning of an economy from a systems-analytic point

of view. If we look at economy as a system capable of self-sustenance (within limits, of course,) then we have to look closely at the negative feedback mechanisms which are built into the economy in order that it may sustain itself. For example, shortages give rise to a rise in prices which in turn should activate the negative feedback mechanism of impelling producers to produce more of the goods concerned which in turn will alleviate the shortage and reduce prices.

Thus any meaningful planning must try not to destroy the built-in defence mechanisms in the economic system but to strengthen them and make them work more efficiently.

What has been said above is very simple economic theory but none the less often forgotten.

In fact what had happened in Sri Lanka in the past was that the built-in defence mechanisms were deliberately atrophied by ill-conceived and massive intervention on the part of the State.

In fact State intervention down the decades since Independence was restrictive in the extreme, preventing the economy from functioning properly, in fact emasculating the economy. Let us take a few examples of how the economy got emasculated as a result of massive State intervention.

We have had a consumer subsidy and rationing scheme which to say the least has been counter-productive. When the consumer is given rice either free or at a grossly subsidised price, the price mechanism is so affected that the producer has to be given an incentive to produce, in the form of a guaranteed price for rice. This forces the Government to buy some minimum quantity of rice from abroad in order to meet its commitments to the consumer for which increasing amounts of foreign exchange have to be made available. This also has further effects on the economy, seriously affecting Government expenditure on the current account, causing budgetary deficits and affecting adversely the cost of living. Thus in fact despite the subsidies the consumer is not benefited for the government's desperate attempts at raising sufficient revenue causes the price levels to rise continuously, thus destroying the original aims of the subsidy schemes and causing the government to extend the subsidies and rationing schemes in a desperate bid to curb the rising costs of living. This, in turn, gives rise to further budgetary deficits and spiralling cost of living. Here is a classic example of the opposite of the negative feed-back mechanism—the positive feed-back mechanism where subsidies and rationing give rise to greater budgetary deficits which give rise to rising cost of living which in turn impels the government to extend the rationing and subsidy schemes which again give rise to further subsidies and so on.

In fact, even the guaranteed price scheme for rice has failed to make the country, relatively speaking, self-sufficient in the production of its staple food item—rice. For despite forty years and more of the Guaranteed Price

Scheme and the regular expansion of the area under cultivation and other supporting services for agriculturists, we are still sadly far away from the goal of self-sufficiency in the production of rice. The reason for the Guaranteed Price Scheme, being a failure was that among other things the price under the Guaranteed Scheme was often below the actual market price or even the cost of production. For the continually widening Budget deficits and hosts of restrictions on the economy have given rise to spiralling prices. In fact, the farmer, denied the most important inputs such as a regular supply of water and cheap fertiliser does not find that the price under the Guaranteed Price Scheme gives him any incentive to increase his production.

Literally hundreds of such examples of severe restrictions of the economy could be enunciated but I think the point has been made now.

Thus all the massive interventions on the part of the State in the workings of the economy gave rise to the emasculation of the negative feed-back mechanisms of the economy and led to the operation of what has been called positive feed-back mechanisms which dragged the economy deeper and deeper into the mire.

If we look at the economy in this fashion then the term liberalisation of the economy becomes meaningful. It does not mean non-intervention on the part of the State, it does not mean *Laissez Faire Capitalism*; it means that the government will intervene in the economic affairs of the country in order to activate, strengthen and fortify the negative feed-back mechanisms of the economy; it means to steer the economy when necessary and not to guide it forwards by pulling at the nose rings! Thus liberalisation of the economy is not to open the doors wide for a regression to the late nineteenth century, when capitalism stood exposed red in tooth and claw, condemned by all with a social conscience.

However the transition from a restricted and cramped economy to a more liberal and buoyant economy could be painful and a phased out program would be necessary to achieve the transition to a liberalised economy peacefully. This is not mere economics but political economy for subsidies and rationing schemes did shelter and cushion the consumer from sudden shocks and left him dependent upon the subsidies and rationing schemes. The consumer could resent—he might feel it painful—this sudden transition. This is why this article was titled "An essay in Political Economy". For from the point of view of political economy, a well thought out package deal has to be offered to the people during the transition period. This will alleviate the pains of transition whilst keeping political stability which is all important if the economy has to be set upon the road of rapid and self-sustaining growth.

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