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FOREIGN TRADE IN ECONOMIC DEVELOPMENT OF SRI LANKA

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SRI LANKA ECONOMIC ASSOCIATION

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This paper is one of the 18 papers, published under a special series of publications by the Sri Lanka Economic Association (SLEA) with financial assistance from the United States Agency for International Development (USAID). The objective of these publications is to provide economic literature on current and topical themes on the economy of Sri Lanka to a broad audience that is interested in economic issues, but has little or no background in theoretical economics, while maintaining high analytical standards. Hence, the papers have been written in simple language avoiding the use of sophisticated technical terms, mathematical equations and models etc. which are normally found in economic literature.

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INTRODUCTION

The purpose of this paper on "Foreign Trade in Economic Development of Sri Lanka" is to discuss the relevance and the importance of Foreign Trade in the growth and development of the Sri Lankan economy. An attempt will be made to discuss these issues in a non-technical manner. Foreign Trade is not a novel concept for Sri Lanka. A brief glimpse at the past will indicate the importance of Foreign Trade in the Sri Lankan economy and the important role Sri Lanka played in Foreign Trade of the South Asian Region. Even before the birth of Christ, Sri Lanka had trade relationships with western and the eastern worlds. Sri Lanka was famous for its Gems and other precious stones and was also known as the granary of the East. In today's economic terminology Sri Lanka was a country giving considerable emphasis to the export of its products, or a country following an export led growth strategy. There is historical evidence to indicate that Sri Lanka was engaged in trade with the Roman Empire in the western world and the Chinese Empire in the far east. Recent excavations in Anuradhapura have unearthed a large stock of Roman coins which proves the existence of developed trade links between Sri Lanka and the Roman Empire during the Anuradhapura period.

During the later periods, Sri Lanka became famous for its cinnamon and other spices, in addition to precious stones. After the 15th century when

Europeans developed sea routes to India and the South Asia, around the African continent, Sri Lanka became an important shipping centre for the Portuguese, Dutch, French and British who developed trade links between Asia and Europe. These trade patterns developed throughout the 17th and 18th centuries. After the British conquered Sri Lanka, Sri Lanka became famous for its coffee.

At the time of independence, Sri Lanka can best be described as a very good example of a 'dual economy'. The term dual economy is used to indicate an economic system which has two separate segments which are not linked to each other. Sri Lanka had a well developed plantation economy which was geared to the export of tea, rubber and coconut and also a subsistence economy producing paddy and other crops for domestic consumption.

After independence, various strategies were followed to develop the economy of Sri Lanka. First, a free trade strategy was embarked upon and later, Sri Lanka moved towards a policy of "import substitution" or the production of goods for the domestic market. These policies which prevailed from the late fifties to 1977 proved that this was not conducive to high levels of growth and thereafter Sri Lanka embarked on a strategy of export expansion. In the last four years, this strategy has been given high priority and other policy measures have been taken so that the overall policy package is conducive to the growth of exports. Under this programme, the development of industrial products for the export market has been given high priority. The whole country has been named an export processing zone. It would be necessary to examine the relevance of these policies to the growth and the development of the economy and in achieving its objectives.

In this paper, these matters will be discussed in a non-technical manner so that the discussion will be comprehensible to the general public. It is intended to discuss the relevance of Foreign Trade in Economic Development in a global context in the first instance. The importance of selecting the proper policy mix in order to obtain maximum benefits from foreign trade will also be discussed thereafter. Trade policies of Sri Lanka since independence upto the present, will be discussed and also the trade patterns during these periods. There will be a discussion on the impact of the terms of trade and the changes in the directions of trade from Independence todate. Then, the potentials for the future as regards trade policy, trade patterns and directions of trade will be discussed. The impact of regionalisation of the global economy and the relevance of regional co-operation in trade and the possible role for Sri Lanka in SAARC and also the role of SAARC in the global trade will be discussed in turn.

LINK BETWEEN FOREIGN TRADE AND ECONOMIC DEVELOPMENT

Economic activities can broadly be divided into three types; Consumption, production and distribution. In order that goods be distributed and consumed, it needs to be produced. Therefore, production must take place regularly in order that distribution and consumption may take place. However production and consumption are the two major economic activities.

Consumption and production can both be increased. Increasing consumption is an easier task. Consumption will increase with the increase in the population and also with increases in income. Production will only increase if more resources are used and the capacity to produce is increased. In order to increase production, more resources need to be invested. In order to invest more, it would be necessary to save from the production or income of the earlier periods. Therefore, savings is explained as foregone consumption. Savings of one period is invested in the next period so that it will result in increased production. This process will result in increases in the production of a country or increases in its gross domestic product (GDP).

In order to achieve a high level of production, it is not only necessary to invest more, but also to invest in the most efficient manner, so that the return on the investment is higher. What has been indicated above will be true for any country irrespective of their economic policies. It will be true for a country living in isolation without any relation with the rest of the world. However if a country attempts to live in isolation attempting to produce all its wants and be self sufficient, then that country may be using its limited resources and the technical know how in many diverse areas. Therefore, it may not be using these resources namely land, capital, manpower and entrepreneurial capacity in the most efficient manner. When resources are not used in the most efficient manner, the resulting output will be less than what can normally be expected from the use of these resources, or will be sub optimal.

How does Foreign Trade play a role in increasing the efficiency in the use of resources available in the country? Foreign Trade will allow each country to use all its resources in the most efficient manner and allow each country to achieve a higher rate of growth than it can normally achieve if all countries attempt to be self sufficient. How can this happen? Foreign Trade in very simple terms is the exchange of goods and services among countries for money. Goods that are sold by any country is named exports and goods purchased, imports. How can trade take place? What is the basis for trade? It may be argued that some countries are so developed, that they can produce all goods more efficiently than a developing country such as Sri Lanka. In economic theory, a situation of this nature is explained as a developed country having an 'absolute advantage' in producing all the goods. But still, there can be a basis for trade. The theory which explains the basis for foreign trade is named the 'Theory of Comparative Advantage'. This theory was formulated in detail in the 19th century by the British Economist, David Ricardo. In the 18th century, before this theory came into acceptance, many countries felt that they could be self sufficient and depend less on foreign trade. However, with the acceptance of Ricardo's theory, countries attempted to expand their foreign trade considerably. It would be useful to explain this concept without getting into theoretical detail. This theory says that even if some countries are more developed than others, there can still be a basis for trade between them. If one of the productive resources is scarce or more expensive in one country than in another, goods that use these scarce resources will be expensive. In the same manner, if a resource is abundant, goods produced using this abundant resource would be cheaper in that country. So the theory of comparative advantage states that the goods that use more of the abundant resource in the country will be cheaper in that country than in other countries where this resource is scarce or is more expensive. So a country such as Sri Lanka or India, where labour is abundant, the production of goods using more of labour or labour intensive goods would be cheaper or less costly than producing the same goods in countries where labour is more expensive. In the same way production of goods which use more capital or technology will be less expensive in countries where capital is in abundance. There is a lot more to the theory of comparative advantage than what is indicated above.

The application of the theory of comparative advantage will allow for specialisation in productive activity. Countries engaged in trade will specialise in the production of those goods for which they enjoy a comparative advantage. It will result in specialisation and countries will benefit from producing on a large scale. The gains from producing on a large scale are called 'Economies of Scale'. Therefore, all countries will benefit by engaging in foreign trade.

It has been stated that the rate of growth of the world economy has also been high in periods where world trade has been growing rapidly. Therefore it is stated that foreign trade is an 'engine of growth'. World trade will grow faster in periods when economies of developed countries, the major producers and consumers in the world economy, grow rapidly.

Therefore in periods where the rate of economic growth of developed countries is high, the rate of growth of world trade is also high. This is not a one sided phenomenon but a two way process. When the rate of growth of world trade is high, all developing countries will have high rates of growth. Rates of growth of developing countries which engage more in foreign trade will be higher. The level of dependence on foreign trade can be seen by the level of income or production that is generated in the foreign trade sector in relation to the GDP. If this share is high, that country is dependent more on foreign trade. Some countries are less dependent than others on foreign trade. Specially large countries which produce many of their needs on their own depend less on foreign trade. The USA and countries such as Russia, China and India fall into this category. On the other hand countries such as the UK, Singapore and Taiwan are more dependent on foreign trade. Countries can be listed according to the share of foreign trade in the GDP.

Therefore in periods where world trade expands rapidly, countries with high dependence on foreign trade will expand faster than others. If trade patterns of the world and the growth of the world economy is examined, it will be seen that during periods of world recession, world trade can be at a low level. However, as indicated earlier, this is a two way process. It can also be stated that world recessions had occurred in periods where world trade has declined sharply. When developed countries are not producing goods as in the past, the amount of goods that can be exported from these countries will also be less. As a result, the amount

Table I

Exports As a Percentage of Gross Domestic Product
Selected Countries

		1970	1980	1989
(1)	China	4	7	12
(2)	India	4	7	7
(3)	United States	6	10	9
(4)	Brazil	7	9	8
(5)	Mexico	7	11	16
(6)	Japan	11	14	11
(7)	South Korea	14	34	34
(8)	Germany	21	26	31
(9)	United Kingdom	23	28	24
(10)	Sri Lanka	25	31	28
(11)	Taiwan	30	53	50
(12)	Saudi Arabia	59	67	37
(13)	Hongkong	93	88	136
(14)	Singapore	113	205	226

Source: Table 6.4 - Gross Domestic Product by type of expenditure and by kind of economic activity-Individual country and Territory-Hand Book of International Trade and Development Statistics - UNCTAD 1991 of imports of these countries from the rest of the world will be low. When the demand for goods from developed countries is reduced, developing countries will have less income and as a result, the level of consumption will decline. Then the demand for consumables from the rest of the world will also decline. During periods of recession, goods that are consumed in the developed world and goods that are used as raw materials for the production of other goods will decline in demand. As a result, the demand for goods from developing countries will decline. The end result would be a decline in exports from these countries and a lower level of economic growth. The level will depend on the country's dependence on foreign trade. Countries which are less dependent on exports will be able to withstand this type of situation but others will suffer badly, if they are too dependent on foreign trade for their income, specially if they are exporters of a few selected commodities.

During the 19th century and the period upto the second world war the concept of comparative advantage was the basis for expansion of world trade. However there were periods in between where nationalistic ideologies prevented the expansion of foreign trade in a free and fair manner. During the period after the second world war, certain Economists led by Prof. Raul Prebisch from Argentina developed a concept which questioned the theory of comparative advantage as the basis for foreign trade. In developing their argument they divided all countries into two groups namely, developed countries which they named the 'Centre' and the developing countries which they named 'Periphery'. They indicated that dependence on the concept of comparative advantage as the basis for foreign trade would result in countries in the Periphery losing continuously from foreign trade while countries in the centre reaped the benefits of free trade. The reason they indicated was the differences in the rates of growth of demand for goods produced in the periphery and the centre respectively. The rate of growth of goods produced in the periphery which essentially were primary products was low, while the rate of growth of the demand for goods produced in the Centre was much higher. As a result of these differences in the rates of growth of demand, prices of these goods increased at varying rates. Prices of goods produced in the centre increased rapidly while those of the periphery either stagnated or increased marginally. As a result, the terms of trade behaved adversely to the periphery all the time. The terms of trade indicates the ratio of export prices over the import prices of a country. When export prices increase at a lower rate than import prices, the terms of trade will have an adverse impact on the country's economy.

It was argued that specialising in the production of goods or commodities that generates a comparative advantage would result in continuous transfers of benefits of increases in productivity to the centre by primary producers. In a situation of declining terms of trade, any country will have to use more units of its produce to buy the same unit of imports. For example, Sri Lanka will have to sell more units of tea than it sold 10 years ago to buy a tractor. Therefore it results in a continuous transfer of benefits of productivity to the centre.

Table II

World Trade and Economic Growth

	1968-77	1978	1979	1980	1981	1982	1983	1984	1985	1986
Growth of World Output	4.5	4.5	3.3	2.0	1.6	0.5	2.6	4.4	2.9	3.1
Industrial Countries	3.5	4.2	3.3	1.2	1.4	-0.4	2.6	4.7	2.8	3.0
Developing Countries	6.2	5.1	4.3	3.5	2.2	1.6	1.3	4.1	3.2	3.0
Growth of volume of World Trade	7.7	5.4	6.5	1.7	0.8	-2.3	2.8	8.7	2.9	3.3
Exports										
Industrial Countries	8.1	5.5	7 0	4.1	3.6	-2.2	2.5	9.5	3.9	2.7
Developing Countries	5.7	4.0	5.0	-4.0	-5.7	-8.1	2.9	7.1	0.4	3.8
Imports										
Industrial Countries	7.4	5.6	8.8	-0.7	-1.5	0.1	5.1	13.0	5.2	5.0
Developing Countries	9.2	7.1	4.8	8.5	7.1	-4.2	-3.2	2.2	-0.3	-0.6

Source: World Economic Outlook
IMF April 1986

As a solution to this problem, they argued that countries producing primary products should develop industries for the domestic market with tariff protection. The policy developed along these lines is named the concept of 'import substitution'. It was also argued that comparative advantage was not static but a dynamic concept. It would be possible to generate a comparative advantage on the production of certain commodities over the long term after establishment of economic activity with tariff protection. Once the industry is well established, tariff protection can be removed.

Even though there was some truth in the arguments developed along these lines, this argument was never universally established. However, it gained prominence in the economic development plans of most of the developing countries specially those in Latin America and South Asia. The fact that comparative advantage is a dynamic concept however has been proved beyond any doubt. Sri Lanka which was an exporter of primary products namely tea, rubber and coconut has now developed a comparative advantage in the production of labour intensive industrial goods such as garments for the developed world.

However, weaknesses in the other aspects of this argument resulted in countries adopting this strategy generating lower rates of growth than others with more outward oriented strategies. However, it has been proved that all countries should move along a technological spectrum and not believe in the comparative advantage in a static sense.

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In the 1960s and the 70s when it was found that the concept of import substitution too had its weaknesses as a strategy for rapid economic growth, the policy of export led growth gained prominence as the most suitable strategy for rapid growth in the developing countries. The argument against import substitution was that restrictions on imports lead to inefficiency and under utilisation of installed capacity and also to an increase in the import intensity of the economy as raw materials and intermediate goods need to be imported for industries established with tariff protection. As a result, countries which followed this strategy faced more severe balance of payments problems than earlier.

Therefore export led growth strategies gained prominence in the 1970's with countries such as South Korea, Taiwan and Singapore who followed these strategies expanded rapidly while others in Latin America and South Asia who followed the inward oriented model faced economic problems.

In addition, the changes in the international monetary system that took place in the early 1970's when the international monetary system moved to more flexible exchange rates was also conducive to export led growth. Therefore, it was possible to grant incentives to export oriented industries and to use the exchange rate to maintain relative competitiveness in the international market by making suitable adjustments to offset any differences in the rates of inflation in the country as against that of its trading partners.

These policies became accepted as the proper policy mix for rapid growth of developing countries. Even countries in Eastern Europe which followed an inward oriented growth strategy using a centrally planned economic model also shifted to export oriented strategies with the liberalization of their markets and the economy from most of the restrictions in the recent past.

IMPORTANCE OF AN APPROPRIATE POLICY MIX

Even though foreign trade can play a positive role in increasing the level of global economic growth, it is essential for all countries to follow an appropriate policy mix in order that available resources are used in the most efficient manner and contribute to an increase in the level of economic growth.

Economic theory emphasises benefits of free trade. However, no country in the past has followed a policy exclusively of free trade and no country follows such a strategy today. At all times, many countries have adopted various trade practices which restrict free trade. Foreign trade even during the past was a lucrative source of income for the State or its rulers. Rulers insisted on charging levies or duties on goods that passed through their territories. Duties were imposed on exports out of the country and also imports into the country. These duties were levied purely for revenue purposes. As a result, prices of goods differed from the cost of production; thereby foreign goods were always more expensive than those produced within the country. In addition to revenue, levies were also imposed on imports to protect local production. Therefore, duties had a dual objective of revenue and protecting domestic industry. In addition to duties, there also are other restrictions which are called non-tariff protection. These would include various methods by which imports are restricted. Quotas are one such type of restriction. A quota system would restrict the volume of imports to an overall level over which no imports will be permitted. There are many such restrictions of various types used by developed countries as well as developing countries.

Unlike in the case of an appropriate policy mix for the domestic economy, it is difficult to ascertain the appropriate combination of policy in foreign trade as trade patterns will not be a result only of policies followed by the country in question but also of policies and strategies of all countries with which the country has trade relations. At times, these strategies will counteract each other resulting in anticipated benefits not being reaped by the country in question. In the selection of an appropriate policy mix, countries would have to assume policies that would be followed by the rest of the world. Normally the policy mix will depend on Ricardian principles of comparative advantage. Facilities will be made available for the production of goods for which the country does enjoy a comparative advantage keeping in mind that the concept of comparative advantage is not static or permanent. Many developing countries which now have been named newly industrialised countries (NIC), were exporters of primary products in the not too distant past. But moved over to more sophisticated types of production along with increases in wage levels.

Sri Lanka too has moved to labour intensive industrial products in this manner. China and India are also examples for such movements in the product mix.

In addition other considerations such as attaining self sufficiency in food are also important. Once an appropriate policy mix is decided, it would be implemented through a series of tariff and non-tariff measures. Encouraging or discouraging imports or exports can be carried out by the use of restrictions or concessions. Normally there are few export restrictions in any country. Even though there are cases of collection of a surplus by the state by export levies as in the case of Sri Lanka's export duties for tea. But most countries use import restrictions of one type or another; even developed countries. Even though level of tariff or import duties may be low, there may be many other types of non-tariff restrictions. The Multi Fibre agreement (MFA) is an international quota arrangement which restricts the volume of garments imported to the developed countries from the developing world. They are not a set of concessions granted to developing countries, but a set of restrictions aimed at protecting the industries of the developed world. In the same way, subsidies granted to the agricultural sector in the European Economic Community are a different type of import restriction which allows the domestic producers to sell their goods below the cost of production and compete effectively with imported products. In Sri Lanka too, producer subsidies were extended in the past. Most of these subsidies have been taken off along with the removal of other import restrictions. However, countries such as South Korea, and Japan protect their domestic agriculture from foreign competition. In addition, licencing which is followed in the developing world is another type of restriction which is believed to be inefficient as it leads to corruption in allocation and issue of licences.

The policy mix should be consistent with monetary and fiscal policies followed by these countries. The consistency between the policy mix for the foreign trade sector and for the rest of the economy is very important for the success of the policy mix in achieving the desired objectives. Such policies should aim at price stability in the domestic market so that the levels of inflation will be compatible with rates of inflation of its trading partners. In the present context of flexible exchange rates it would also be necessary to make regular and timely adjustments in the exchange rate to maintain competitiveness in the international market.

Based on these concepts, a country will have to decide on the appropriate policy mix taking into account all external and internal factors that needs to be taken into consideration.

TRADE POLICIES IN SRI LANKA SINCE INDEPENDENCE

Sri Lanka at the time of independence was a very good example of a 'dual economy'. In Sri Lanka, the plantation sector which produced tea, rubber and coconut for export was very efficiently managed and consisted of large properties. There were also a fairly large number of small holders in rubber and coconut. This Sector was geared to the export of these three crops in semi-processed form to the developed world. Tea was exported direct to London in bulk where these teas were blended and marketed in retail and also re-exported to other countries. Rubber was sold essentially in the form of sheet rubber, while coconut was exported in the form of desiccated coconut, coconut oil and copra. Other by-products of coconut were developed for the export market much later. These commodities were produced for the export market with cheap labour. The labour mainly for the tea industry came from India during the 19th century. In the rubber and coconut industries there was more indigenous labour. Raw materials required for the production of these commodities were imported. The export sector, therefore, was not dependent on the rest of the domestic sector for any raw materials or other resources except labour. Fertilizer for crops and other essential machinery were imported. Food for the labour force such as rice, flour, sugar etc. were also imported. Therefore, the plantations were a well developed and efficient sector geared almost exclusively for the export of primary products.

But the domestic sector which produced paddy and subsidiary crops for domestic consumption existed at a different level of efficiency. The paddy sector was working on age old methods of cultivation and was dependent on rains for its water except in the areas where irrigation facilities were available either through the restoration of ancient irrigation schemes or those that were developed in the 1920's and 1930's. Therefore, a vast area of the country existed at a subsistence level, with a low level of productivity and little or no surplus for re-sale to the plantation sector, with its primitive methods of production, transport and marketing.

Even though there was no direct link between the two sectors, there was a link through the government budget. The government collected a fair share of the surplus that was generated in the plantation sector by way of export duties and other levies and spent a substantial amount of this money in the post second world war period for the benefit of the whole population, essentially by way of consumer subsidies, the most important of which was the food subsidy made available to each and every member of the population. Facilities such as education, health, rail transport and other social services were also subsidised. The population of Sri Lanka enjoyed free education from the kindergarten to the university and had a well developed education system capable of catering to the bulk of the population, even though until 1960, the medium of instruction in the university was English. Health services in Sri Lanka was one of the best in the developing world and was offered free of charge to every member of the population. There were various other social services which continued from the time Sri Lanka obtained limited self government, resulted in Sri Lanka having a very high level in the Physical Quality of Life Index (PQLI) which compared favourably with any developed country. The PQLI which indicates the quality of life of the population without any relation to the income of the population, is measured by the levels of literacy, infant mortality and the life expectancy at birth. All this was possible because of the revenue that accrued to the government from the heavily export biased plantation economy.

At the time of independence the economy was functioning smoothly and there were no serious problems of an immediate nature. In addition Sri Lanka had the benefit of accumulated foreign assets as a result of the trade patterns that existed during the 2nd world war. Sri Lanka benefited from sharp increases in rubber prices which doubled during the period 1939 to 1945. As imports were low due to supply problems, external assets increased five fold by the end of the war. However even with this favourable reserve position the fragileness of the structure in depending totally on three major exports, the demand for which was not expanding rapidly for the country's imports of staple food, raw material and other essentials would have been visible. The continuation of Sri Lanka's social welfare schemes and subsidies depended totally on the success of the export sector to earn a surplus in order to import the required items at resonably low prices Therefore, the economic policy followed was not conducive to sustainable growth over the long run. Developing countries such as Sri Lanka sustained losses by continuing to be primary producers as the demand for these products increased at a lower rate than the demand for imports of these countries. The producers of primary goods could not increase the production of their goods without a tendency for prices to fall. There were two reasons for the low level of the increase in demand. Due to technological developments, a unit of raw material required for the production of a unit of a finished product has become lower.

The other reason is somewhat more complicated. It is stated that the demand for goods produced in the developing world increases at a lower rate than other goods along with the increase of the income of the consumers, in the developed countries. For example, if incomes of consumers in the U.K. doubled, there will not be a corresponding increase of the amount of tea that they will consume or the amount of rubber that will be used in products that they will demand. However, the demand for the other items such as clothing, other consumer durables such as electrical goods and electronics and other services will increase more rapidly. Therefore, producers of tea or rubber will continue to sustain losses. It is on these lines that Prof. Raul Prebisch developed his theory for the protection of industry in the developing world.

In fact, in the second half of the 1950's, Sri Lanka experienced, first hand, the problems that were foreseen by economists who questioned the conventional wisdom. At the time of the Korean war there were sharp increases in the price of rubber which resulted in an increase in export earnings. In addition, there was an increase in export earnings due to increases in export prices of tea in the 1955 and 1956. However, these additional resources resulted in increases in the demand for consumer goods rather than in increases in investment. This resulted in pressures being developed in the balance of payments with the disappearance of the boom conditions in the export market After 1956, prices for tea and rubber declined drastically resulting in sharp trade deficits. A trade deficit is a situation where the income from exports is not sufficient to cover the expenditure on imports. Sri Lanka was faced with two options, either to adjust the exchange rate in order to make exports more attractive than imports or to restrict imports by other means so that the amount of foreign exchange available for imports will be restricted by way of high import duties or by other types of non-tariff restrictions such as quotas, licencing etc.

At this time, Sri Lanka was examining the relevance of the current economic policies and was in the process of formulating a medium term plan for economic development. The experience of the continuing trade deficits and also the continuing dialogue on the pros and cons of free trade resulted in the Ten Year Plan formulated by Sri Lanka in 1958 emphasising on a change in the economic strategy. The Ten Year Plan indicated that import substitution in industry assisted by tariffs and other types of protection would be necessary for rapid development of the economy. The plan emphasised that protection should consciously be granted so that investment can be encouraged in the industrial sector. It was considered to be a solution to the problems of balance of payments and unemployment. It recommended that the investment in the industrial sector be doubled during the plan period. State intervention in industry was encouraged as it was believed that private entrepreneurs would not move into this sector in direct competition with industrial products from developed countries. It was also implied that the exchange rate will be kept over valued. However at that time in the late fifties continuous adjustments in the exchange rate were not a part of the economic strategy as even international monetary organisations believed in stable exchange rates during this period.

In terms of these policies import licencing was introduced since 1960. The open general licence scheme that existed hitherto was suspended. Import duties were revised with high duties being imposed on luxury and non-essential goods. Public corporations were established to carry out manufacturing activity with protection from imports. Printing, steel rolling, hardware, textiles, tyres, fertilizer, sugar and oils and fats were some of the industries that were established as state enterprises. Almost all enterprises had monopoly control on local production. In addition, cement and leather factories were also revamped and made state corporations in terms of the State Corporations Act of 1957.

These policies were followed upto 1965. This strategy did not succeed mainly due to lack of investible resources and distortions created in the economy as a result. No corrections were made in the domestic prices or in the exchange rate. In a situation where the demand for imports in the domestic market was higher than its supply and export earnings were not sufficient to finance the amount of goods demanded in the economy, no attempt was made to adjust the exchange rate in order to allow for an automatic adjustment based on demand and supply. However, it would have been difficult to allow for flexibility in the rates of exchange in a regime of subsidies, controls and protection. If it was possible, it would have permitted at least some entrepreneurs to embark on export oriented economic activity. However, leaving the exchange rate intact and attempting to restrict imports by way of licencing, quotas and other types of controls resulted in the creation of an excess demand for imports that kept expanding, resulting in various malpractices. This also resulted in a black market being created for foreign currency.

There were two reasons for the failure of the policy package. The atmosphere was not conducive to large scale private sector investment and inflow of foreign investment. The state sector which was expanded on the initiative of the government became at a later stage a burden on the government and the government budget. Instead of generating a surplus for further investment and for other budgetary expenditure, the state sector became a continuous burden on the budget and the economy. As a result, the budget had to transfer funds to cover losses in state operated activities. Along with the change of the Government in 1965, economic policies changed somewhat. Sri Lanka experienced a phase of limited liberalization during this period and also experimented with a dual exchange rate system. Since the liberalization of certain import controls in 1968, two types of exchange rates operated upto 1977. The official exchange rate was applicable to the three major export crops on the export side and to all essential imports such as rice, flour, fertilizer etc. on the import side. The Foreign Exchange Entitlement Certificate Rate (FEEC Rate) was applicable for all other transactions. Along with these changes, there were certain concessions given for imports by removal of some import restrictions. However, these concessions did not exist for a long time.

Policies experienced another change along with the change in the Government in 1970.

The Government's five year plan identified the importance of export growth and concessions were granted for export promotion. However, these policies were coupled with rigid exchange controls and state intervention. The plan envisaged an increasing role for the state sector in economic development and also less dependence on foreign resources. As indicated in detail in the section on trade patterns these policies did not bring about expected results. During this period, the rate of economic growth was lower than in the past. This was partly due to some bad harvests resulting from continuous drought. As a result of low economic growth, unemployment increased to a high level.

Along with the change in the Government in 1977, there was a fundamental shift in policy. Sri Lanka took the bold step towards total liberalization of the economy. Initial steps were taken to remove most of the non-tariff controls on imports and other restrictions that had hindered economic activity. Restrictions were limited to import duties. The exchange rate was unified and allowed to float with effect from November, 1977 while steps were taken to give high priority for export promotion. The Greater Colombo Economic Commission was established for approving export oriented economic activity while an export processing zone was established in Katunayake with generous concessions for foreign investment. Exchange controls on day to day transactions were removed in order to facilitate more import and export trade. Steps were also taken in the domestic sector which complemented these policies. Price controls were removed and consumer subsidies were sharply curtailed so as to attain price stability in the domestic sector and to encourage domestic production. A lot of emphasis was given to expansion of exports and arrangements were made to obtain a quota for garments from the Multi Fibre Agreement (MFA). The policy package that followed also had the blessings of the multinational financial organisations, particularly the IMF and the World Bank. This resulted in generous foreign assistance being received from Governments around the world which led to development of investor confidence, paving the way for foreign private sector investment.

These policies have been intensified since then and are followed upto the present time. In particular, action has been taken to liberalise most current account transactions in the balance of payments. Another major step taken in recent times is the liberalisation of the financial sector. Concessions granted for exports were also extended to cover activities in the whole of the island. The Greater Colombo Economic Commission established earlier was expanded to be a Board of Investment to cover activities of the whole country. Along with these policies the private sector was expected to play the leading role in economic activity. Commercial activities of the Government which created a burden on the budget in the past were passed on to the private sector by the establishment of private companies or by way of outright sale. These policies have resulted in a higher rate of growth being generated in the period after 1977.

TRADE PATTERNS

During the period since independence, Sri Lanka's trade patterns indicated a change from being an exporter of primary products to an exporter of labour intensive industrial goods and from being an importer of consumer goods to an importer of machinery and other equipment as well as raw materials required for rapid economic growth.

The impact of trade on growth can be ascertained by an examination of the share of the export sector in the national income. During the period after independence export agriculture was the major sector playing the leading role in the country's economy. However, over the years the importance of export agriculture declined along with the rapid growth in the domestic agriculture and later in the services and construction sectors. After 1977, manufactured exports too played an important role. Therefore, export agriculture was relegated to a secondary role. At the moment even though export agriculture contributes a substantial share to economic growth industrial exports, services, trade and construction have become important growth sectors in the economy.

Exports

At the time of independence, three major exports were tea, rubber and coconut which accounted for over 90% of total exports. Therefore, the country depended totally on the export income of these products to finance its imports. Tea was exported to London in bulk to be blended and packeted in London and re-exported to other countries in Europe. As a result, Sri Lanka was unable to obtain any benefits from marketing its tea in retail form. In addition, Sri Lankan quality teas were used for blending with other poor quality teas coming to London from various other production Centres. Even though Sri Lanka was one of the major exporters of tea, it did not have the capacity to determine prices. Sri Lanka was a price taker even though a major producer. The price was determined on the wishes of consumers and wholesalers and therefore, Sri Lanka did not gain the benefits from increases in the quality of production or productivity. Even during times when the output was high, there were periods when prices were depressed resulting in low incomes to tea producers.

Rubber too experienced a similar fate. Rubber accounted for nearly 20% of export earnings at the time of independence and was the second highest export earner for Sri Lanka. However, globally, natural rubber was facing severe competition from synthetic rubber. As a result, the demand for natural rubber did not expand rapidly to keep pace with increases in production. Technological reasons were also responsible for the low growth in the demand. Sri Lanka being a small producer in global terms producing only 3 to 4 per cent of total world exports was not in a position to influence the world market price for rubber in any way. In addition, little use was made of rubber in domestic industry. Therefore, Sri Lanka was totally dependent on the world market for prices. Prices fluctuated sharply due to many reasons. Rubber being an industrial raw material, the demand was subject to cyclical fluctuations of the economies of the developed world. In addition, many developed countries maintained huge buffer stocks, releases from which had an adverse impact on prices. Therefore, rubber was not the basis for continued economic growth in a developing country such as Sri Lanka.

Coconuts accounted for nearly 10% of export earnings in the fifties. Coconut was exported in three forms, as desiccated coconut, coconut oil and copra. In the case of desiccated coconut, Sri Lanka was a major exporter along with the Philippines. However, the scope for expansion of the market was limited. Coconut oil faced sharp competition from other edible oils as well as industrial oils. Copra which was also exported in semi processed form was also a commodity with limited export potential.

Over the years, the importance of these three crops declined. Even in 1975, as indicated in Table III export earnings from these three crops accounted for nearly 75% of the total export earnings. Over the years, Sri Lanka expanded its export of industrial products, mineral products and minor agricultural crops. With the development of the industrial exports sector in a small way, Sri Lanka commenced exporting various industrial products such as preserved foods, garments, chemical products, petroleum products, leather and rubber products and gems. During the next decade, these exports expanded rapidly while the three tree crops lost their importance.

Table III

Composition of Exports

Percentage Shares

	1960	1965	1970	1975	1980	1985	1990
(1) Agricultural Exports	90.8	92.0	89.0	75.8	57 7	52.5	36.3
of which Tea	59.8	62.0	55.0	49.1	35.7	33.1	24.9
Rubber	20.7	16.0	22.0	16.6	14.9	7.1	3.9
Coconut	10.3	14.0	12.0	10.1	7.1	8.5	3.5
(2) Industrial Exports	9.2	8.0	11.0	24.2	31.7	39.5	52.2
of which Garments					10.5	22.0	31.6
(3) Other					10.3	8.0	11.5
(4) Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Sri Lanka
Annual Report-Various Years

By the mid 80s exports of industrial products inclusive of garments expanded rapidly to overwhelm the exports of tea, rubber and coconut. Total earnings from industrial exports accounted to over 60% by the year 1991, the three tree crops accounted only for 27% of which tea accounted for 21%. Garments were the major item of export with 39%. In addition, there were various other items of industrial exports accounting for nearly 16%.

It would appear that from the time of independence to date, that there had been a substantial structural change in the composition of exports. From being an exporter of primary products specialising in three tree crops which were exported in semi processed form, Sri Lanka moved on to be an exporter of industrial products which accounted for nearly 60% of total exports. Even though a major share of these exports were made up garments, there was a substantial amount of other industrial goods too. It is also true that Sri Lanka's exports consisted of goods that are termed labour intensive products. However it is equally true that Sri Lanka has moved away from exporting low growth primary products to other labour intensive industrial products where the growth is somewhat rapid. It is argued that these labour intensive industries generate a low level of value added as these products are based on imported raw materials and other imported inputs, the only significant domestic input being labour. It is also argued that a significant share of profits are repatriated as many of the industries are owned by foreign investors. However it should not be forgotten, even though the value added is low, the net gains to the economy are

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high as the rate of growth of these industries are much higher than the other sectors with high value added. Therefore, inspite of the low value added, expansion of these industries has resulted in higher levels of economic growth.

Sri Lanka has developed many industrial products for the export market using raw materials available in Sri Lanka. Preserved foods and beverages, leather and rubber products, ceramics and chemical products are few of these products which account for nearly 16% of the total exports. These include jams and other food preparations, frozen fish (specially prawns), chemical products such as activated carbon, leather footwear, bags and travel goods and rubber products using rubber available in Sri Lanka. Sri Lanka also exports diamonds after cutting and polishing raw diamonds imported from other countries. In addition, gems and other semi precious stones continue to be a major export commodity in Sri Lanka.

After some time, there may be possibilities of Sri Lanka being able to produce some of the raw materials required for the production of these goods and to expand the structure of industrial sector. The argument of dynamic comparative advantage which was discussed earlier comes to one's mind. Over the years, any country will be able to move into new areas, with experience gained in production and the technical know how gathered over the years. The next step in the development in these industries is the production of raw materials that are used in the manufacture of the finished products. However, Sri Lanka being a small country with limited production capacities, and a limited

Table IV
Composition of Imports

Percentage Shares

	1960	1965	1970	1975	1980	1985	1990
Consumer goods	56.6	52.8	55.8	50.5	29.0	19.4	26.4
Intermediate goods	19.4	28.1	19.5	36.0	46.0	54.2	51.8
Investment goods	14.8	17.7	23.5	12.4	24.0	19.2	21.7

Source: Central Bank of Sri Lanka
Annual Reports - Various Years

demand may find it difficult to compete in the intermediate goods industries, which is a more capital intensive activity than the production of the finished product which is essentially a labour intensive activity.

Imports

At the time of independence, Sri Lanka's major imports consisted of consumer goods mainly food products inclusive of rice, flour, sugar and other food items. In addition, fertilizer, petroleum and also other materials required for the tea factories and a small amount of capital goods. The country depended on imports for its staple foods and other essential food stuffs. Upto 1960, imports were free of any type of controls such as licencing or quotas. There were some import duties which were imposed purely for revenue purposes.

Along with the problems in the balance of payments due to low export prices after 1956, Sri Lanka had to impose various types of import restrictions. As explained earlier, these restrictions came into effect after 1960 along with new strategies for industrial development based on import substitution as envisaged in the Ten Year Plan. The state sector was expected to play a leading role in commercial and industrial activity after the enactment of the Public Corporations act of 1957. In order to comply with the requirements of the new strategy for economic development, import controls were imposed to restrict imports. There were two objectives in restricting imports; to alleviate balance of payments problems and also as part of the economic strategy to encourage industrial development.

However, these two objectives were in contradiction with each other. Imports were restricted on items that were considered luxuries due to balance of payment reasons. These restrictions resulted in unintentional incentives being created for the local production of the very same items. As a result, some of the very first industries that commenced operations in Sri Lanka were for the production of luxury items, imports of which were restricted for balance of payments purposes.

The import structure during the period in which these policies were followed did not reflect the true demand for imports. Imports were restricted by various types of controls such as licencing and quotas. These resulted in a black market for imported goods and persons who would have engaged in legitimate productive activity being engaged in transactions relating to resale of imported goods which was a lucrative source of income. Even though some of the restrictions were removed in 1968 and a partial liberalization exercise carried out, it did not last long. After 1970, import licencing and quota restrictions were reimposed. Even though the Five Year Plan (1972 - 1976) gave much prominence to the growth of the export sector, the rest of the incentive package was not conducive to rapid growth of the export sector. There were no foreign investments flowing into the country and the level of foreign aid was also low. As a result, there was a shortage of investible funds. This resulted in a lower level of economic growth which resulted in increases in unemployment.

After 1977, most quantitative controls on imports were removed. Any restrictions on imports were by way of import duties. After the liberalization, there was a sharp change in the import structure. The demand for intermediate goods and investment goods increased rapidly. This was partly due to the availability of funds to finance investment imports for many development projects such as the Mahaweli Development Programme which commenced after 1977. As a result, a structural change occurred in imports with a sharp shift from consumer goods to intermediate goods and investment goods.

The popular belief was that the removal of import controls would result in a sharp increase in the imports of non-essential goods. Even though there were few items of non-essential goods which were imported during the first few years, imports generally reflected the demand for imported goods. Therefore, an examination of the structure of imports after 1977 indicates a sharp change from the early 50's or 60's where investment goods imports were a small share. It was stated earlier that this was partly a result of availability of funds to finance economic activity. The developments in the other sectors of economy too contributed partly to this change in the import structure. With more emphasis being given to domestic production of rice and other subsidiary crops by the Government, the necessity to import these goods declined. A successful import substitution activity was carried out in the domestic agriculture sector. Rice which was a major item of imports in the past was imported only to meet buffer stock requirements. In addition, many other items which created severe supply problems in the past were all produced locally with imports covering temporary supply shortages. These items included chillies, potatoes, red onions, big onions, many other items of pulses and dry fish. Domestic production of these items increased rapidly over the years. With the establishment of the flour milling complex, Sri Lanka stopped importing wheat flour and commenced importing wheat grain instead. Therefore these factors contributed to a change in the import structure over the years.

In addition, after the liberalisation of imports, there was an increased demand from the private sector for capital imports for expansion of the installed industrial capacity and also for intermediate goods as raw materials for industries so established, essentially for exports but also for the domestic market.

Terms of Trade

The expression 'Terms of Trade' is used to indicate the ratio of export prices to import prices. Over the years Sri Lanka's terms of trade behaved adversely to Sri Lanka. In simple terms it says that prices of exports increased at a lower rate than the prices of imports. When this happens continuously, the stock of exports that needs to be sold to purchase a given amount of imports will increase continuously. A simple example will explain this more clearly. If the price of tea increases at five per cent annually and prices of tractors increases at ten per cent, then the amount of tea needed to pay for a tractor will increase continuously.

When a country is faced with this problem on a continuing basis, it becomes a serious problem which needs remedial action. However, there is little that a small country such as Sri Lanka could do to alleviate this problem. Small countries are price takers in the export market as well as in the import market. The only long term solution would be to move away from low growth commodities to other high growth commodities or other products.

After 1956, Sri Lanka experienced a continuous decline in the terms of trade. This tendency has not improved inspite of Sri Lanka shifting successfully to be a producer of industrial exports. Increases in prices of Sri Lanka's exports have not kept pace with sharp increases in prices of imports. Even during the period after 1985 when the major share of Sri Lanka's exports consisted of labour intensive industrial products, the terms of trade for Sri Lanka has deteriorated continuously due to the sharp increases in import prices which over shadowed marginal increases in export prices. Therefore, Sri Lanka continues to bear the burden of a declining terms of trade inspite of the substantial development achieved in expanding its export base. This is a problem that a country such as Sri Lanka has to live with, as there is no global initiative at the moment to attempt at alleviating this problem. Steps taken in the past by organisations such as the UNCTAD have ended in failure due mainly to lack of cooperation from developed countries.

THE DIRECTIONS OF TRADE

The directions of a country's trade would depend on many factors. It would depend on the type of goods that are produced in the country and the pattern of demand for these goods from the rest of the world. It would also depend on the type of goods required by the country and the countries that are able and willing to sell these goods to them and the policies, regulations and other arrangements, if any, that regulates the country's trade with the rest of the world. If conscious decisions have been taken to discourage or to encourage trade within a particular region, these would be reflected in the directions of trade. In addition to these factors, there are other factors such as sepecial trading arrangements which results in trade being encouraged with a particular region. For example, Sri Lanka's external transactions at the time of independence were mainly with the UK. Sri Lanka was a member of the 'Sterling Area' which included countries whose currencies were directly linked to the Pound Sterling of the UK. Therefore, Sri Lanka's trade during that time was leaning towards the UK and other members of the Sterling, area. However, with the weakning of the Sterling, most countries linked their currencies to other stronger currencies such as US Dollar and as a result, the Sterling area gradually lost its importance. The UK Pound was devalued twice in 1949 and 1967 and a major share of external transactions got shifted from Sterling to Dollars. Sri Lanka's transactions too shifted from Sterling to Dollars over time.

In addition, the existance of bilateral trade arrangements affects the direction of trade. In the 1950s, there were difficulties in obtaining markets for rubber and problems in importing rice regularly to Sri Lanka. As a result, China and Sri Lanka signed a bilateral trade agreement in terms of which Sri Lanka sold rubber to China and imported rice. Trade was contracted with no regular payments in foreign currency. Records were maintained by Central Banks of the respective countries and settlements were made at the end of each year by payments in foreign currency. The advantage of these agreements to countries with insufficient foreign exchange for day to day transactions would be the ability to import their requirements without having to depend on export earnings. At that time, the belief was that these arrangements would benefit developing countries specially when trade is between two developing countries. In addition to the agreement with China, Sri Lanka had many other agreements of this nature with many countries in the Eastern Europe. It was considered useful for Sri Lanka as well as for the countries in Eastern Europe to conduct trade in terms of these agreements. Therefore, a substantial share of import-export trade in Sri Lanka was carried out by way of these agreements. However since 1977, in a liberalised trade regime these agreements did not have any role to play and were cancelled one after another in the early 80s. It may be mentioned that international organisations such as the IMF and the GATT too discourage the continuation of these bilateral arrangements.

Table V

Sri Lanka's Direction of Trade-Selected Countries 1949-1959
Imports & Exports

Percentage Shares

	Imports			Exports		
	1949	1954	1959	1949	1954	1959
North America	8.1	3.5	8.8	16.1	10.8	17.4
of which						
USA	7.1	2.6	7.7	11.5	6.8	11.4
Europe	25.8	33.9	39.6	47.6	38.0	50.6
of which						
UK	18.0	21.0	26.7	33.7	28.7	33.5
Africa	7.7	2.9	1.0	11.4	11.2	8.1
Asia & Oceania	56.6	58.1	50.6	23.8	39.2	23.2
of which						
Australia	9.9	7.6	5.4	8.4	9.9	7.4
Burma	14.9	9.0	7.4	—	0.5	0.1
China	0.2	11.4	8.4	0.2	12.6	5.4
India	14.9	13.7	13.8	2.2	4.2	3.7
Japan	1.8	5.5	8.3	0.4	0.8	2.9
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Donald R. Snodgrass, Ceylon: An Export Economy in Transition – The Economic Growth Centre – Yale University – Illinois – 1966

Therefore changes in the direction of trade from independence to date were results of interaction of the factors indicated above. Changes in trade patterns discussed in the earlier section have also resulted in changes in the directions of trade. Therefore, it will be necessary to examine the changes in the direction of trade and to discuss the reasons for same.

As we know, Sri Lanka at the time of independence was an exporter of tea, rubber and coconut. At that time Sri Lanka and India had not developed fully their auction centres and teas were sold in Colombo and other auction centres in India accounted only for a small share of world exports. However, this situation changed over the years. In addition, the importance of tea in the export structure diminished along with the expansion of other exports. The Colombo auction centre also became the main auction centre for tea. Presently the volume of tea traded in Colombo is larger than the volume of tea traded in London. This was an indirect result of Sri Lanka getting new buyers for their tea. As a result of the rapid expansion of incomes in countries in the Middle East such as Iraq, Iran and Saudi Arabia after the oil boom, the demand for tea from these countries expanded rapidly. These countries, in addition, preferred to purchase their teas in Colombo or Calcutta rather than in London. In addition, Pakistan too commenced the purchase of tea from Sri Lanka after the separation of Bangladesh from Pakistan in the 1970's. At the moment, middle eastern countries which include Iran and Egypt purchase nearly two thirds of all Sri Lanka's tea

TABLE VI

Sri Lanka's Directions of Trade - Selected Countries 1980 - 1990
Imports and Exports

Percentage Shares

	Imports		Exports	
	1980	1990	1980	1990
(1) Industrial Countries of which	45.0	38.9	48.7	59.1
USA	4.3	7.7	10.9	24.8
UK	9.4	5.4	7.2	5.8
Japan	12.6	12.0	3.1	5.1
Germany	3.4	3.1	5.2	6.3
Australia	1.9	1.6	10.7	1.2
(2) Developing countries of which	27.3	58.6	33.5	33.5
Singapore	4.4	3.8	1.1	2.5
India	4.6	4.3	3.2	1.0
China	2.4	4.5	4.8	0.2
Iran	5.3	8.2	3.1	3.2
(3) Other Countries	27.6	2.4	17.6	7.3
(4) Total	100.0	100.0	100.0	100.0

Source: Central Bank of Sri Lanka - Annual Reports Various Years exports. The United Kingdom which was the major buyer in the past, buys only 5% of our teas. Total tea purchased by EEC inclusive of teas purchased by the United Kingdom amounts to 12%. Countries such as Japan, the USA, Australia, Russia and Pakistan are the major buyers. The decline in the importance of tea in Sri Lanka's export structure and the movement towards new markets have resulted in a sharp change in the direction of tea exports.

In the case of rubber, bilateral trade agreements played a vital role in the 1950's and the major share of rubber was purchased by China. In addition to China, there were other Eastern European countries which purchased rubber through bilateral trade agreements. However, after the discontinuation of the bilateral trade agreements there was a sharp change in the direction of trade in rubber. The share of rubber sold to China declined from 50% of total rubber exports in 1970 and 30% in 1980 to 4% in 1991. Major buyers of rubber in 1991 were the European Economic Community, Pakistan, Japan and the USA.

In the case of coconut products there was no sharp change in the direction of trade. The United Kingdom and the European Economic Community continued to be the major buyers of desiccated coconut. In the case of coconut oil and copra major buyers were countries such as China, India, Pakistan and also countries in the Eastern Europe.

With the expansion of industrial exports which expanded rapidly in the eighties there was a sharp change in the direction of trade. As most of the industrial products were exported to developed countries, the USA became the major trading partner for exports while exports of other countries in Europe too increased. However, it should be noted that even in 50's Sri Lanka exported a major share of its exports to Europe. However, the composition was different while exports in 1950's consisted of primary products, exports in the 1980's consisted mainly of labour intensive industrial goods and less of primary products such as tea or rubber. Changes in the directions of trade over the years are indicated in Tables V and VI.

In the case of imports too, a similar change occurred in the direction of trade resulting mainly from the changes in the composition of trade as explained in the earlier section. In the early fifties the major trading partners were the UK for various items of capital equipment, Australia and Burma for imports of rice and flour and India for various items of subsidiary foods. China also became a major importer after signing of the China - Sri Lanka trade agreement.

However, by 1991 this pattern has changed radically as a result partly of changes in the composition and also the availability of new supply sources for Sri Lanka. Japan has become the major trading partner in imports while other newly industrialised countries such as South Korea, Taiwan, Hongkong and Singapore have become regular suppliers of capital and intermediate goods. In addition, suppliers of oil such as Iran, Saudi Arabia and Iraq are major sources of imports.

Therefore it can be seen that there has been substantial shifts in the direction of trade in exports as well as in imports due to the changes in the composition as well as the availability of new supply sources.

PERSPECTIVES FOR THE FUTURE

Discussions in the earlier sections have shown that foreign trade has played a key role in the growth and development of the Sri Lankan economy. Inspite of many problems, Sri Lanka has managed to generate a continuous growth of more than moderate proportions, partly due to the role of foreign trade. Even though other sectors of the economy have contributed towards attaining these levels of growth, the continuation of these rates of gowth over the years was due to Sri Lanka's ability to shift from its position as at independence of being an exporter of primary products to an exporter of labour intensive manufactured goods. In achieving these levels of growth, the appropriateness of the policy mix particularly in the nineteen eighties played a leading role. Sri Lanka's shift towards more outward oriented policies with an emphasis on export promotion, the liberalisation of the economy and the steps taken to achieve budgetary discipline by curtailing expenditure and divesting commercial activities of the government played an important role.

In the future too, it is clear that foreign trade will play a leading role in the growth and development of the economy. Being a small country with a limited domestic market, Sri Lanka cannot depend on the expansion of its home market for future economic expansion. In the past, such inward oriented policies failed partly due to these reasons. Therefore, in order to expand rapidly and to reach the levels of economic growth achieved by other economies with similar characteristics, it would be necessary to depend on export expansion.

In its programme of economic expansion, there are four areas that can be identified as those where future growth should be concentrated. The expansion of industrial goods exports in Sri Lanka has been concentrated on labour intensive goods with a low value added. It may be necessary in the future to move along a technological spectrum towards high value added items. Many countries which developed their economies on the basis of export expansion have successfully moved along these lines, Singapore is a good example. It may be possible to move on to other labour intensive products such as electrical goods and electronics and also garments with high value added.

There is a possibility of increasing the level of value added of goods that are exported by producing locally, at least some of the intermediate goods that are imported at the moment. For a small country such as Sri Lanka, this could turn out to be a more difficult task than for a large country such as India or China because of market limitations and because these industries would tend to be more capital intensive than the finished products exported at the moment.

There are possibilities of developing exportable products with the use of agricultural products that are exported at the moment in semi processed form.

Tea, rubber, coconut and other minor agricultural crops that are exported in raw form can be processed further. Even though Sri Lanka is one of the two main exporters of tea in the world, the major share of the tea is still exported in bulk. Exporting tea for the retail market after blending would result in increases in the value added. In the same manner many minor agricultural crops can be further processed for export. In addition, rubber being an industrial raw material can be a base for the production for the export market. One good sign is the local use of nearly 20 per cent of local production of rubber for domestic industry. These industries can be geared to the export market. There can be many possibilities of this nature. However, industries need not necessarily be based on local raw materials if they are heavily labour intensive. In the recent past, Sri Lanka has successfully developed an export industry for polishing and cutting of diamonds imported from abroad. There can be many more such possibilities which can make use of the abundant labour available in the economy.

Therefore in the future, attempts should be made to diversify the export base on the lines indicated above in order to maintain the momentum gathered in the recent past.

Countries that have achieved rapid economic growth in the recent past based on the expansion of the export of manufactured goods are named Newly Industrialised Countries. South Korea, Taiwan, Hongkong and Singapore are classified in this category. A question is raised as to when Sri Lanka can achieve this status, Even though NIC status has not been clearly defined it is noted that Sri Lanka's per capita income is well below all these countries and are below two other Asian countries Thailand and Malaysia that are achieving rapid economic growth based on the export of manufactured products. However we could be certain that Sri Lanka will become a middle income economy in the World Bank's definition in the near future being the first South Asian economy to do so. However inter country comparisons of per capita income are being subject to question and therefore, such comparisons should be made with care. What is necessary is to achieve a rapid rate of growth and development of the economy which is reflected in marked increases in the standards of living of the population.

In the recent past, there has been a tendency for regionalisation of foreign trade. The European Economic Community is moving towards a Monetary Union. While the USA, Canada and Mexico have signed an agreement for further integrating their trade regimes. The ASEAN in the South East Asia too is moving to further its trade relations. In this sphere, South Asia is lagging behind. It is only in the recent past that the SAARC countries have initiated discussions, for increased trade relations. The existing level of trade within the SAARC region is only a minute part of world trade. All countries in South Asia are countries with low per capita incomes and the intra regional markets for products of the region are limited. In addition, it is stated that economies are competitive in the world market and there is little complementarity or possibilities of supplying the needs of each other. This is due to the fact that in the past many countries were producing similar types of primary products. Even in the present context many countries seem to compete with each other in the manufacture and export of industrial products. Inspite of these short comings there could still be a potential for developing complementarity along with the economic development among the more technologically developed countries on the one hand and the others in order that intra regional trade be increased. However as indicated earlier the success of such strategies will depend on the level of co-operation that can be achieved among the countries in the region.

Even if regional cooperation in trade does not play a leading role in South Asia in the near future it is clear that in the case of Sri Lanka foreign trade would play the leading role in the growth and the development of the economy.

EPILOGUE

In the belief that this paper is meant for persons with no background knowledge in economics, a conscious effort has been made to avoid footnotes and other bibliographical references to economic literature in the text. However, any person who wishes to study further problems discussed in this paper is referred to publications indicated below:-

Historical references to economic development can be found in any book on history of Sri Lanka specially the university volumes. A good source on economic development prior to independence is Snodgrass, Donald. R "Ceylon - An Export Economy in Transition," Illinois: Richard D Irwin, 1966.

Basic concepts in International Trade Theory can be found in any text book on International Trade. Some of which are:

1. Heller, H. Robert
   "International Trade Theory and Empirical Evidence". New Jersey: Prentice-Hall Inc., 1968. 189p.
2. Kindleberger, Charles. P,
   "Foreign Trade and National Economy". New Haven: Yale University Press, 1967. 262p.
3. Sodersten, B'o'
   "International Economics". London: Macmillan, 1970. 554p.

A detailed discussion on the "Centre-Periphery Theorem" is found in "International Economics and Development, Essays in honour of Raul Prebisch edited by Luis Eugenio di Marco, New York:

Academic Press, 1972. 515p. A discussion on pros and Cons inward looking strategy and outward looking strategy can be found in special conference series on "Foreign Trade Regimes and Economic Development" (12 volumes.) Those volumes are part of a series of studies resulting from a National Bureau of Economic Research Project, directed by Jagdish N Bhagwati and Anne O Krueger. The series includes ten country studies and two synthesis volumes by Bhagwati and Krueger. The World Development Report for the year 1989 published by the world Bank has as its main topic Foreign Trade in Economic Development and gives very useful insight into benefits of export led growth strategies.

The information on strategies followed in different periods in Sri Lanka can be found in the Development Plans published in different periods by the Government. The Ten-Year Plan published in 1958 highlighted the advantages of inward looking strategies. The Five-Year Plan 1972-76 highlights the importance of export led growth. The public investment programme prepared on a Six year rolling plan basis from 1978 onwards and published annually indicates various development strategies followed from 1978 onwards.

The best statistical source for foreign trade in Sri Lanka is the Annual Report of the Central Bank of Sri Lanka published from 1950 onwards.

Any reader who wishes to refer to global trade statistics is referred to "Handbook of International Trade and Development Statistics" published by the UNCTAD.

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