The private sector of sri lanka - essay

Economic development can be defined as a process whereby the real per capita income of a country increases over a long period of time while simultaneously poverty is reduced and inequality in society is generally diminished or at least not increased. The economy of Sri Lanka grew slowly and unevenly during the last five decade largely because of the populist economic policies that failed to establish incentives needed for investment and economic growth. However, human welfare statistics are much higher than the other developing countries in the region. During the last five decade private sector contribution to the economic development of Sri Lanka is in different degree.

It is widely accepted that the participation of private sector is a basic requirement and better suited for the sustaining rapid growth. The trade liberalisation and withdrawal of state monopoly and lifting control over the institutions managed by the government have made private sector the “ Engine of Growth” in recent years. New opportunities in the country have been created by the government’s programmes for public enterprises reforms and infrastructure development. Private sector creates employment expanding labour market to poor segment of the population. Growth of the private sector contributed to strengthen the tax base of the country by which government enable to finance health, education and other basic social services vulnerable social groups.

Therefore, the role of the private sector is key to develop the country’s economy. This paper is going to examine how the private sector contributes to the economic development of Sri Lanka.

TREND OF ECONOMIC DEVELOPMENT

A study of Sri Lanka's economic development (Bruton et al 1992) indicated a basis cause of relatively slow growth over the long term has been inconsistently in the policy framework leading to wide fluctuations in annual rates of economic growth. Development outcomes in different phases since independent have reflected the policies pursued by successive governments, which in turn have been dictated by the dominant ideologies of the day and the political dynamics of Sri Lanka's electoral system of the government.

The government elected in 1977 remove barriers to liberal economic policies that had been impossible in the past and enacted new laws for comprehensive political and self sufficiency with economic reforms. Previous governments were mostly focused on import substitution and controlled economic measures. The reform package included tariff reduction, rupee devaluation, tax reforms aims at stimulating the capital market and improving tax compliance, further liberalization of financial and commodity markets and liberalization of exchange controls over the current account of the balance of payments (Dunham and Kelegama, 1995). Afterwards the successive governments adopted the liberalisation policies of the previous government with further modifications.

The Sri Lankan economy has experienced accelerated growth over the past two years despite adverse shocks such as oil price hikes and the tsunami disaster. Growth has averaged 6. 5 percent during 2005-2006, which is above the historical average of 4-5 percent during last two decades. With per-capita income rising above US$ 1350 in 2006, Sri Lanka is on a steady path to achieving status as a middle-income country.

2. 1 Agriculture

The Agriculture sector grew by 4. 7 percent contributing 11. 1 percent to the overall growth. The agriculture sector continued it recovery in 2006 benefiting from strengthening partnership between public and private sector together with favourable weather.

2. 2 Industry

The industrial sector in Sri Lanka comprises a range of large corporate firms, small and medium scale enterprises as well as micro or household business that are based on self-employment activities. The industrial sector is account for 27 percent of the GDP and employs 1. 8 million people or 24 percent of the labour force. During the last decade the average annual growth rate of the industrial sector has been 6. 2 percent. The sector comprises 78 percent of the value of Sri Lankan exports.

2. 3 Services

Contribution from the service sector was the highest at 62. 6 percent as the sector grew by 8. 3 percent during the year. The continuation of the growth momentum reflected in the sector has mainly been response to increasing consumer demand for services in the country. The continued investment on economic services and infrastructure and productivity improvements also paved the way for emergence of the services sector as the main contributor of the economic growth.

2. 4 Investment and savings

Investment expenditure increased 28 percent over 2005. In real terms it grew by 13. 4 percent and as a ratio of GDP investments improved to 28. 7

percent (26. 5 percent in 2005). Growth in private sector accelerated to 31. 7 percent in 2006. High capital expenditure was evident in the economy with the factory industry, construction and telecommunication sectors registered higher levels of investments during the year. Although in 2006 both domestic and national savings grew at high rate as a ratio of GDP it dropped marginally.

3. CURRENT SITUATION OF PRIVATE SECTOR

3. 1 Financial aspects

One of the key constraints to growth of the private sector is the lack of adequate access to finance at appropriate rates and terms. The cost of finance hampers private firms. As per the study of Asian Development Bank (ADB) and World Bank (2004) the small urban manufacturing firms pay significantly higher average interest rates (18 percent) than the large (12 percent). They also pay higher rates than rural enterprises (14. 5 percent) which benefit from subsidies from state financial institutions, especially Samurdhi bank and microfinance institutions.

Access to formal finance is especially restricted for investment purpose in rural areas. Internal resources provide biggest share of investment finance for rural enterprises while family and friends are the main external sources. Public financial institutions and Non Governmental Organisations, despite a widespread presence in rural areas provide a very modest share.

Collaterals play a vital role in the availability of finance. When needing to offer collaterals, urban manufacturing firms turned primarily to land and buildings, followed by the machinery. Land is even more important as collateral for rural enterprises. Lack of accepted collaterals pushes the investors for informal financing.

The Sri Lankan financial sector has large number of commercial banks, depository institutions (National Saving Bank), finance companies, regional rural development bank, insurance companies, a couple of pension funds and three state sponsored long term financial institutions. Rural credit schemes cater to the funding needs that these financing institutions are unable to take on. They are funded by three sources; donor agencies, government and private sector banks. Donor agencies prefer to channel their funds through the development banks operated by the private sector.

3. 2 Manufacture

Private sector industries which account for 96 percent of the output in the industry in 2006 grew by 5. 8 percent. The two sub categories of private sector industries, Board of Investors (BOI) and Non BOI grew by 5. 9 percent and 5. 6 percent respectively to the overall manufacturing industry output. Small and Medium Enterprises (SME) industries are considered as the backbone of national economy. SME is account for about 70 percent of all industrial output and 31 percent of employment.

3. 3 Service

Private sector plays a significant role in the service sector. Privatised State Owned Enterprises (SOEs) such as Sri Lankan Airlines, Sri Lanka Insurance, Sri Lanka Telecom play major role in each area. Sri Lankan Airline dominates the aviation sector, while private companies are totally involved in insurance field. Sri Lanka is moving towards a fully liberalised telecommunications market environment. At present there are 3 fixed line telephone service providers, 4 cellular phone service providers and 32 internet providers in Sri Lanka and covered 3 million subscribers of cellular phones.

The contribution of private sector to power generation is limited. Recently the private BOT (Built Owned and Transfer) and BOO (Built Owned and Operate) investment schemes in thermal power plants, incentives for exporters to import equipment and generate their own power; and concessions to foreign private firms to invest in new power generating facilities introduced to obtain private sector participation in power sector.

The private passenger service competes with the government transport services and offered a good service. The Sri Lanka railway system is entirely owned by the government. It serves primarily as a passenger train service. Like most railway companies in developing countries it is inefficient and ineffective in its operations. It suffers from poor management, regulated fare tables, is overstaffed, and has therefore come to play a gradually declining role as a transport mode. Hence, the private investors are not keen to participate in railway transport system as capital cost is in a high range.

4. ISSUES AND PERSPECTIVES

4. 1 Government Policies

4. 1. 1 Investment

The overall policy strategy has been designed to integrate the positive attributes of market based economic policies with domestic aspirations by providing the necessary support to domestic enterprises and encouraging foreign investments.

The successive governments have introduced policies to promote private investment during last three decades. The Greater Colombo Economic Commission was established in 1978 with necessary powers to offer superior regulatory, tax and administrative treatment to eligible investors, usually large ones. This organisation renamed as Board of Investors (BOI). Over the time BOI has become a powerful presence in the Sri Lankan business world. Almost all the Foreign Direct Investments (FDI) in Sri Lanka enters through the BOI " gateway". Since the initial liberalisation in the late 1970s, there has been further improvement for non-BOI investors but systematically or across the board. Sri Lanka Security Exchange expanded to attract investors.

4. 1. 2 Tax

The principal taxes that affect business in Sri Lanka are taxes on corporate profits and divided Value Added Tax (VAT) and import and excise duties. In the standard direct tax regime profits are taxed at 30 percent with reasonably rapid depreciation allowances and loss carry forward of six years. Fiscal incentives are available for approved investors for a wide range of business activities. Tax holidays, concessional income tax, zero-dividend tax & withholding tax, import duty exemptions zero duties on raw materials in export manufacturing are offered for certain periods for the foreign director investor who signed agreements with BOI.

4. 1. 3 Labour

Sri Lanka's business environment exhibit many strengths but the private sector has also to cope with an overabundance of investment-deterring labour laws. The tenor of much of the labour laws reflects a historical view that a strong role for government is need to protect workers. Sri Lanka also has industrially active and political agenda and can be confrontational. In turn, some employees almost certainly have outdated views on labour relations. Modern management practise is to regard employees as a valuable asset to be nurtured and managed in a collaborative atmosphere.

Although industrial Disputes Act includes comprehensive machinery for resolving industrial disputes, decisions are slow. With respect to the labour cost minimum wages exist for a wide range of industrial and occupational levels. Usually the actual wages paid tend to be considerably higher. Termination of employment is very strict in Sri Lanka. As per the Termination of Employment of Workmen Act an employer cannot dismiss an employee, except for serious disciplinary infractions, unless there is a prior written consent by the employee or prior written approval by the Labour Commissioner.

4. 2 Development of SME

Small and medium enterprises (SMEs) have been identified as an important strategic sector for promoting growth and social development of Sri Lanka. Over the years, SMEs have gained wide recognition as a major source of employment, income generation, poverty alleviation and regional development. The SMEs cover broad areas of economic activity such as agriculture, mining. Manufacturing, construction and service sector industries. Although SMEs encompass agriculture, manufacturing and service sector establishment, reliable data are available are available only for the manufacturing sector. Within the manufacturing sector, small and medium scale industries (SMIs) account for about 96 percent of industrial units, 36 percent of industrial employment and 20 percent of value added. However, the total contribution of SMEs to the national economy cannot be estimated due to lack of information.

One of the issues SME sector is facing lack of an overall Policy for the SME Sector. Absence of a coherent SME sector strategy or development plan and lack of private sector participation in policy formulation and administrative reform affect the sector. Further lack of monitoring and evaluation capacity to measure policy impact and compile data to serve as a basis for future policy decisions is also hindering the development of the sector. The significant number of SME firms are suffers from high transaction costs, both in starting new firms and operating existing ones. The complex incentive structure and taxes are the most serious effect for the development of the SME in terms of allocation of efficiency.

4. 3 Privatization of State-owned Enterprise (SOEs)

Privatization is a strategy or the process which transfer totally or partially an asset or enterprise which owned or controlled, either directly or regulated by the state. Privatization provides an opportunity to educate market capitalism, to build institutions and to reinforce democracy. It is a process of empowerment that makes people economic and political participants by creating opportunities for ownership and sense of involvement in society at large.

Privatization of state owned enterprises was announced as a state policy in 1987 with a view to reducing the burden on the budget due to the operations of the SOEs and improving efficiency and profitability. The necessary legal and institutional framework was established and modifies to smooth the privatization process. Privatization process has been carried out over a decade. To date about 100 public sector enterprises have been privatized, including plantation (25), manufacturing (40), financial (8) and services (20). Among the major enterprises that were privatized by 2006 were Air Lanka, Telecom, Prima Ceylon, Sri Lanka Telecom, Sri Lanka Insurance Company, Ceylon Gas Company and National Development Bank.

In 1996 independent statutory body Public Enterprises Reform Commission (PERC) established to oversee the privatization programme in a structured and systematic manner. However RERC dissolved in June 2007. The approach of the present government differs form that of the previous one. It has ruled out privatization of SOEs but has announced that it is keen on restructuring them. Restructuring of SOEs in Sri Lanka is now under the broad umbrella of the Strategic Enterprise Management Agency (SEMA).

A competitive environment needs to be created for the successful privatization programme in order to increase the economic effects of privatization. The absence of a competitive environment would mean that privatization could change firm behaviour. In other words, unless the privatized firms face competition from other private sector firms, they may be tempted to behave as monopolies. A significant impact on privatization performance can also be seen from the improvement in managerial skills and attitudes.

4. 4 Infrastructure

One of the critical component towards promote private sector is infrastructure. Sri Lanka lack sufficient quality infrastructure. Electricity supply is view by many entrepreneurs as the most serious impediment to the growth because of the poor access, high cost and unreliability. Transport also poses an important obstacle particularly for rural enterprises. The government increase investment on infrastructure and took initiatives to use private-public partnerships to develop infrastructure.

5. CONCLUSION AND RECOMMENDATIONS

The private sector in Sri Lanka has grown significantly over the past two decades as evidenced by the rising share of contribution to private sector in GDP and of the private sector in manufacturing output. However, the private sector has yet to realize its potential because of policy and institutional impediments. The Government’s broad-based reforms and its commitment for fostering economic growth, expansion of employment and improvement of living standards has created the basis for evolving a suitable enabling environment for the private sector to assume a leading role in transforming Sri Lanka’s economy.

Since current labour laws are not much favourable to the investors’ creation of labour market conditions conductive to employment and income generation activities, through harmonious relations between employers and employees is really important for development. Further the government needs to provide quality infrastructure for the development of the private sector. Private -public partnership can be used for infrastructure development. Since the SME is very important part of the economy more incentives needs to provide for the development of SME sector. Reforms should be instituted not only during their actual implementation of the privatization but in the operations of firms and markets after new policies are in place. Government must guard against replacing a public monopoly with a private one by developing effective regulatory institutions as successful privatization programme also entails a legal and modern financial system.