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THE PUBLIC SECTOR AND INDUSTRIAL DEVELOPMENT IN SRI LANKA *

by

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1.0 Scope of the Public Sector

Since the early fifties the Public Sector in Sri Lanka has expanded rapidly. In addition to the inevitable investments in the basic services sector such as railways, telecommunications, electric power where "natural monopoly" situations exist, the umbrella of the state began to cover such areas as manufacturing, trading, agriculture, plantations and, in the early seventies, even the small industries sector. The growth of the public sector and its different sub-sectors is indicated in Tables 1, 2 and 3, which give the number of Government Corporations, the capital invested therein and their contribution to the GDP. From 1970 to 1973, there was a very rapid proliferation mainly in the trading and services sub-sectors. However, the share of manufacturing remains at approximately one third, with respect to capital investment. Besides these, there are about 20 "Government business undertakings" which are former private companies acquired under the Business Acquisition Act of 1970 and about 8 joint stock companies with large government share holdings. The contribution of public enterprises to the GDP is indicated in Table 3, and it constituted about 23 per cent in 1975.

In the industrial sector, public enterprises dominate in terms of the value of production, value-added and exports. The figures for public sector in 1976 being 62.3, 64.3 and 70 per cent respectively. These figures are somewhat biased owing to the inclusion of petroleum refinery whose value of output is almost equal to that of the entire organized private sector. Also as compared to the private sector, the public sector units are substantially larger, though very much fewer in number.

Table No. 1 Number of Public Corporations *

Sector / Year	58	63	65	68	70	71	72	73	74	75
Manufacturing	12	18	20	23	24	25	27	29	29	29
Trading	1	1	2	2	2	10	12	13	13	13
Agriculture	1	1	1	1	1	1	2	4	4	4
Services & Other	14	20	22	30	35	45	51	60	60	61
Total	28	40	45	56	62	81	92	106	106	107

Source: The General Treasury

* This excludes business undertakings acquired under the Business Acquisition Act and managed by competent authorities as well as Government joint-stock companies.

Tabel No. 2 Total Capital Investment in Public Corporations *

(Rs.Million)

Sector / Year	1970	1972	1973	1974	1975	1976	1977
Industrial	1320.0	1885.4	1988.4	2346.1	2461.5	3040.6	3711.4
Trading	465.3	731.0	372.7	422.0	423.4	459.9	485.5
Services	1188.0	1796.3	1850.7	2009.5	3432.6	4621.0	6261.3
Financial	145.6	178.2	534.8	612.1	726.1	852.1	859.5

Source: Central Bank

* Investments in banks, lending institutions and public companies are excluded. Investment data are in respect of 50 corporations in 1972, 52 in 1973 and 1974, 86 in 1975, 93 in 1976 and 1977. Total investment defined as: capital + reserves + long-term liabilities - accumulated losses.

Table No. 3 Contribution to GDP. In Percentages
(At 1959 factor cost prices)

Year / Sector	60	65	70	71	75
All Public Enterprises	17.2	19.2	20.7	22.4	22.9

Source: Central Bank

In order to ascertain the reasons and motives for this expansion, it would be best to look briefly into the history of the public sector in Sri Lanka.

2.0 Historical Development of the Public Sector

2.1 Pre-war period

During the pre-world-war colonial period, manufacturing activities consisted mainly of processing the three main plantation crops - tea, rubber and coconut - for export. In addition there were a few enterprises in the private sector producing consumer items such as beer, cheap textiles, soap, soft drinks, and matches for the local markets and mining of graphite for the export market. The engineering industry was confined to a few large workshops meant primarily for machinery repair. These gradually progressed to the manufacture of some items of machinery for the tea and rubber factories. These were all privately owned. The only involvement of the Government in direct economic activity was in the railway, electric power generation, telecommunications, water supply and the production of common salt. These activities were undertaken by departments of the Government and as such were not really commercially oriented enterprises.

In the thirties a separate Ministry of Industries and Commerce was established to administer industrial projects in the public sector. The Department of Industries which thus came into existence initiated some feasibility studies and drew up plans for several projects including manufacturing of cement, plywood, ceramics and leather goods. The world economic depression in the early thirties pushed back the initiatives of this department. However, with the outbreak of the world war a wide range of essential consumer products were not available which made inevitable the commencement of some manufacturing. In a matter of one to three years, several new production units were set up by this Government department to manufacture such items as plywood, drugs, glass bottles, tanned leather, acetic acid, paper, ceramics, coir and steel re-rolling. Most of these units were using obsolete technologies and inefficient machinery, had very little technical or management expertise, and produced inferior goods. However, due to the seller's market prevailing these units were able to sell their products and were profitable. With the restoration of normal conditions and the commencement of imports, these Government-owned units were found unviable and had to be closed down.

2.2 Early fifties

During the period of the Korean war with large earnings from spiralling commodity prices, the country embarked on a welfare and consumption spree importing everything from the staple food, rice, to a pin. Food subsidies and other welfare schemes were introduced, which were to prove such a liability later on. Looking back, it has to be concluded that the country lost a good (and perhaps the only) opportunity to plan its industrial development strategy and get a head start on the path to industrialization and economic development.

In the early fifties, the Government initiated some action in the industrial field on the advice of a World Bank Mission. However, industrial development was not emphasised. The six-year investment programme (1954 1959) stated that the main objective of the industrial strategy was to reduce the state's direct involvement and to encourage the private secotr. The Industrial Research Act (1955) and the Development Finance Corporation Act (1955) were passed to provide the private sector with necessary technical and financial support. Even the Government-sponsored Corporation Act of 1955 envisaged the transfer of all Government enterprises to the private sector through their incorporation and subsequent sale of Government shares to the public. As such, in the fifties, there was ample opportunity for the private sector to enter into a wide area of large-scale industry. However, private investment was very slow and reluctant, possibly due to a combination of factors such as lack of private industrial entrepreneurship, absence of credit from a banking system mainly geared for export-import trade, and the absence of any assurance of protection from competition from imports. Consequently, the state had to intervene.

The first important venture of the state in industry was the establishment of the Kankesanturai cement works in 1950 followed by the Paranthan Chemical works. Further efforts were made to reorganise the departmentally run industries set up during the war years, particularly plywoods, ceramics and leather.

2.3 Period of rapid expansion in the public sector

In 1956, the Peoples' United Front let by Mr. S.W.R.D. Bandaranaike was elected with a landslide majority to replace the United National Party (UNP). The socialist-inclined government immediately emphasized the dominant role of the state in industrial development. Areas for investment were allocated as follows:-

(a) Basic & Strategic industries (iron, steel, cement, chemicals, fertiliser, salt & by-products, mineral sands, sugar, alcohol, rayon and plywoods were exclusively for the Public Sector.

(b) Light Consumer Goods industries (23 including, tyres, textiles, ceramics, leather, paper, light engineering etc.) for both Public and Private Sector.

(c) Small-scale Industries consisting of 82 areas reserved for the Private Sector.

The People's United Front Government gave industry high priority, allocating 20 per cent of the capital budget of the ten-year plan (1959-1968). The planners acknowledged that industrial development could be based on both manufactured goods for export as well as processing of agricultural commodities hitherto exported in an unprocessed state. However, it was concluded that it is easier to commence industrialization on the basis of the domestic market and that industrial growth tends to feed on itself. Consequently, protective tariff barriers (partly due to a deteriorating balance of payment position) as well as generous fiscal incentives were introduced. Thus came into being the strategy of import substitution.

State Industrial Corporations Act No. 49 of 1957 was introduced to supersede the previous act and had much wider powers and enabled any number of State Corporations to be started without introducing a new bill.

During the period 1956 to early sixties a large number of State Industrial Corporations emerged for the manufacture of paper, sugar, textiles, hardware, steel, tyres, flour milling, etc. Several of them were with assistance from Socialist countries such as Czeckoslovakia, Poland and USSR, with whom diplomatic relations were established for the first time.

In the early sixties, the private industrial sector too expanded greatly with a vast number of import substitution industries in the light consumer-goods category coming into operation. The entrepreneurs in these cases were mainly the former traders who found their import trade drying up. The result was that in the sixties the industrial sector expanded at a rate higher than that of the other sectors.

In 1965, the United Front Government was defeated and the UNP was returned to power once again. The unbridled expansion of the state industrial sector was curtailed, although all the projects started by the last regime (steel, tyre, flour millings, etc.) were completed. The private sector in industry was re-emphasized. By this time, the limitations of the pure import substitution strategy was becoming obvious, and the new regime introduced several measures for encouraging exports of manufactured goods (e.g. tax holidays, duty rebates, exemption from business tax and excise levies, export bonus vouchers etc.). The de-facto devaluation of the currency by introducing the FEEC scheme in 1968 further encouraged exports. The imports too were liberalized with an Open General Licence scheme (OGL). Efforts were also made to attract foreign investments.

In 1970, the United Front which included two marxist parties was elected with a sweeping majority and the pendulum swung once again very heavily towards the public sector. The Business Acquisition Act was passed in December 1970, and several hitherto existing private enterprises, including the mining of graphite, were taken over by the State. Even more significantly, the Land Reform Programme undertaken from 1972 onwards made the bulk of the most important single sector of the economy, the plantation sector, come under state ownership. Thereby, the large number of tea and rubber processing industries too passed to the state sector. The state also went heavily into trading with the establishment of State Trading Corporations and several large scale public sector industrial projects were mooted (steel melting, cotton textiles, paper, fertilizer and ceramics).

3.0 Direct State Involvement in Small-scale Industry

During the later part of 1971, the Government felt the need to shift the main thrust of development effort to the village level, since 70 per cent of the population lived in the villages. The small industries in the private sector were found to be congregating in a few urban centres, mostly in the Colombo district. Consequently, the Government felt the need to assume a direct role. The result was the establishment of Divisional Development Councils (DDCs). Practically every major village had a Development Council. The Council consisted of local government officials, the Chairmen of volutary councils, and the Secretary was an official of the Ministry of Planning & Economic Affairs. The objective was to give weightage to the rural sector in the overall development programme by establishing small-scale units of production, utilizing indigenous raw material and labour intensive technologies. The purpose was to satisfy local needs, create employment opportunities locally. Although each unit was organized on a co-operative basis almost all the money came from the Government and each unit was responsible to a DDC. These councils were in turn controlled and directed by the Regional Development Division of the Ministry of Planning and Economic Affairs. This was a major departure from the practice of government hitherto getting directly involved only in large projects, and as such is a unique "experiment".

According to Ministry (of Planning & Economic Affairs) sources, by December 1976, Rs. 45 million had been released for 1971 industrial projects, giving employment to 14,540 workers giving a figure of Rs. 3095 per worker. However, according to independent investigators the actual amount spent on the industrial projects was greatly in excess of this and the actual employment created was less than half this number. The scheme is generally considered to be a thoroguh failure due to:-

(a) Managerial and technical incompetence of the officials concernod who were mostly administrators.

(b) Incompetence and project feasibility studies.

(c) Poor quality of products which had no market prospects

(d) The common ownership (co-operative form) was found unsuitable for industrial projects.

(e) Political interference from the local MPs.

As one writer puts it "Conceptually, the whole idea had the ingredients of a true and appropriate way of rapidly diffusing the impact of development, yet what took place in practice was something quite different .... The fault lay in the way DDCs were organized and the serious shortcomings in organization and continuing malpractices. The seeds of failure and destruction were ingrained in the system itself". */

In 1975, due to internal problems the United Front broke up resulting in the virtual expulsion of the two marxist parties from the Government. The Government consisted of only the SLFP which was the party founded by Late Mr. S.W.R.D. Bandaranayake. The new Finance Minister in his Budget speech of November 1975 indicated a fresh approach to the economic problems of the country free from pure ideological constraints. He gave further incentives for private sector investments by providing foreign investment guarantees, abolishing wealth tax, lowering of income tax, abolishing ceilings on incomes. He also spelled out a more dynamic approach by the banks and threatened to close down any public sector enterprise which is mismanaged. The results, however, were somewhat different, by 1975 not a single public corporation was closed down however 3 private sector industries were taken over by the Government and run by "Competent Authorities".

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*/ An Evaluation of Development Programme under Division Development Councils in Sri Lanka - H.N. Karunatilleke - Sri Lanka Journal of Social Science - June 1978.

In July 1977, the UNP came to power again with an unprecedented majority of seats in the State Assembly. The imports were liberalized, and the state sector monopolies in trade and manufacture were removed. An element of competition was introduced into the public sector and the threat of closure for continued losses was held out. So far only one trading corporation (Weaving Supply Corporation) was liquidated and that too not because of unprofitability. Loss making corporations such as the Hardware Corporation continue to operate, while two new public enterprises were commenced. The Minister of Trade and Commerce publicly stated that "60 per cent of the economy will continue to be in the public sector".

It is thus clear that the public sector is here to stay in Sri Lanka and will probably continue to grow.

4.0 Objectives and Main Problems

It is clear that at least in the initial period, the direct involvement of the State in industry was due to the absence of any initiatives from the private sector rather than for any ideological reasons. Apparently there was both unwillingness and inability on the part of entrepreneurs. Subsequently, with the changing socio-economic environment in the country, several other motives for the State venturing directly into industrial activity or taking over private enterprises began to assume importance. These can be listed briefly as:-

Natural monopolies due to small market conditions and need for economies of scale.

Prevention of uncompetitive and anti-social practices.

Production of socially desirable goods and services.

Lack of entrepreneurial and technical ability.

Lack of foreign exchange.

Lack of domestic savings.

Need for redistribution of wealth.

Need for employment.

Need for regional development.

Desire to increase revenue.

Ideological considerations.

Personal considerations.

Although one or more of these objectives may have been predominant at the inception of a particular enterprise, these tended to be forgotten as time went by and the enterprises tended to drift along without any clear objectives or guidelines and often even worse, with conflicting objectives. Often they were buffetted by the politician, bureaucrat in the Ministry or the leadership or organized labour, whoever happened to be stronger at any period of time. During the early seventies, many individual corporations were de facto controlled by the trade union leadership with the support of the political leadership on the basis of furthering the socialist ideology. Some of the political leaders had a somewhat romantic and unrealistic concept of the worker, and an amatuerish view on industrial culture, management and discipline. This resulted in instances of serious erosion of managerial authority, credibility and effectiveness. By the mid-seventies, control was gradually taken over by the administrators of the Ministry who formed a tight circel around the Minister in charge and effectively converted the Corporations into mini-departments controlled by themselves. At one stage, the Secretary, who is the executive head of the Ministry, his two additional Secretaries, Assistant Secretaries and all the Directors of units were each a Chairman of at least one Corporation and Directors of several others, in addition to their normal full time jobs. The members of the Board were for all practical purposes appointed by them by suggesting names to the

Minister. Very few people with proven managerial experience, real expertise or strong personalities were appointed to the Boards. As expected such Boards readily acquiesced in allowing even routine operational decisions of the enterprises to be sent up for "approval" by the administrators of the Ministry, often the same individuals. This state of affairs led to severe demoralization of, especially the better class of, senior managerial and professional executives, many of whom left. There can be other times when the Minister was a strong person. He would control not only the Policy but also operations of the enterprises and certain personnel matters. Over a period of time the effect of such a situation can be devastating to an industrial organization. Divisive forces develop rightdown the line, discipline suffers, managerial efficiency declines.

Since top management is liable to change frequently and at short notice, the enterprise ceases to have self-sustaining technical and managerial continuity. The time-span of the perspectives of top management becomes short, consequently corporate and strategic planning becomes non-existent.

Table No. 4 Performance of Public Sector (Rs. Million)

Year	1970	1972	1973	1974	1975	1976	1977
Capital Investment in all Corporations	3118.9	4570.2	4746.8	5389.7	7043.6	8973.6	11,317.7
Capital Investment in Industrial Corp.	1320.0	1885.4	1988.4	2346.1	2461.5	3040.6	3,711.4
Net Profits All Corps.	10.516	313.2	321.0	687.7	482.2	367.0	670.0
Net Profits Industrial Corps.	82.3	100.4	56.6	81.9	69.5	93.1	67.7
Return on Investment All Corps. %	Loss	6.82	6.76	12.76	6.85	4.21	5.92
Return on Investments Ind.Corps.	6.24	5.32	2.85	3.49	2.82	3.06	1.82

Source: Central Bank

Table No. 4 illustrates the performance of the public sector. "Profitability" being the bottom line is the easiest to measure since neat figures are generated every year in the financial statements. If the profits were too high, they were accused of fleecing the consumer; if they were too low, they were accused of mismanagement and incompetence. Generally, it was the latter position as illustrated in Table 4. The return on total investment progressively came down to a value of 1.82 per cent in 1977, in the case of State Industrial Corporations.

The result was a much denigrated public sector with a dissatisfied public, interfering politicians, over-powering bureaucrats, demoralized and ineffective management.

There are several other shortcomings in the industrial corporations sector, such as under-utilization of capacity, poor inventory management and low labour-productivity. However, these are secondary in that they could be corrected by effective management.

In this context, it is imperative that a serious attempt be made to identify the root cause of these problems and find ways to eliminate them. While there are no doubt a large number of reasons which are specific to each individual enterprise the most frequent and fundamental causes could be identified as

(a) Lack of clear objectives and guidelines.
(b) The deficiencies in the external organizational frame-work and manner and extent of public control.

The first need is to have a clear statement of the primary objectives and explicit guidelines on policy. As indicated earlier, public enterprises can have a multiplicity of objectives since their varied activities and characteristics call for such diversity. However, it is incorrect to mix up the objectives of one with another, leading to a conflict of objectives.

The second is to have an external organizational framework which can give genuine autonomy, necessary authority and a sense of continuity to management, which is vital from a long term point of view. This is especially important in a country such as Sri Lanka due to the fact that the party system of democracy is working well and by means of the people's vote Governments have been changed regularly at every general election. This is ideal from the point of view of individual freedom and social justice. However, from the point of view of industrial management in the context of small developing countries such as Sri Lanka, it could give rise to serious problems unless the individual enterprises are uncoupled from immediate and close connections to a single supervising Ministry.

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