Economic Liberalisation Policies in Sri Lanka

International Pressures, Constraints and Supports

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Sri Lanka's development experience was long cited as evidence for the connection between 'premature welfarism' and retarded growth. Since the introduction of a liberalisation regime in 1977, initially high growth rates prompted discussion of the nation as an 'IMF success' or vindication of the 'Singapore model' of an open economy divorced from extensive state intervention both internally and at the internal-external boundary.

This article argues that the pre-1977 configuration defined a dependent welfare state which made significant progress in mediating between aggregate national poverty and individual well-being; that stagnation has been over-emphasised in critiques of the dependent welfare state; and that poor economic performance has been more a function of the dependency situation than of spending priorities internally.

Ironically, the liberalisation regime has increased dependency along some dimensions; its domestic economic performance is analytically inseparable from the extraordinary financial flows extended by important international powers. The evolution of the dependent welfare state under a philosophically laissez-faire *regime reflects in form the interaction of external carrots, sticks and exogenous shocks with domestic political limits to further reduction of the social wage and internal pressures of patronage and ordinary politics. The analysis treats primarily the period prior to disruptions of the economy caused by escalation of civil disorders.*

PUBLIC intervention in the economy is inevitably justified with reference to promotion of the general welfare; operationalising the general welfare produces significant political disputes. Sri Lanka's political-economic history divides fairly neatly into one period (from the independence in 1948 to the elections of 1977) in which the government was seen as the solution to increasing economic problems and a period from 1977 to the present in which governmental intervention in the previous three decades is seen more as the problem than as the solution. The expansion of the functional scope of government in the economy was fairly steady until 1977, resulting in a very heavily taxed, tightly regulated system. The 1977 elections were largely a referendum on perceived failures of the 'closed economy'; the champions of a liberalised 'open economy' triumphed decisively.

The argument of this paper is that despite internal and external critiques, the pre-1977 policies demonstrated concretely the possibility of significant development at very low levels of per capita income and extreme dependence. For the bottom of the income pyramid, public programmes, despite well known failings, contributed to security and well-being remarkable in comparison with other low-income nations. Post-1977 policy has not so much reduced the functional scope of government in the economy as it has curtailed certain interventions while expanding others; Sri Lanka offers a case in which the economic logic of liberalisation supports a shift in governmental priorities rather than a wholesale privatisation campaign. The most significant privatisation is not of public assets but rather of poverty and insecurity for weaker sectors of the society; responsibility for well-being of the populace has been shifted significantly from government to individuals and families in their interaction with market forces. In this important shift in priorities, international factors have been decisive: the relative success and failure of pre-1977 policies, and even their form, were dependent on structural forces in the international system—most importantly the international division of labour which was a colonial residue and shifts in the terms of trade. Likewise, the success or failure of post-1977 liberalisation policies is dependent on (in the literal sense of 'hangs from') those same international forces and more than ever on particular international actors appraising Sri Lanka's domestic policy.

IRONIES OF SRI LANKA'S EXPERIENCE AS DEVELOPMENT MODEL

Sri Lanka has received international attention disproportionate to its size both as a positive and negative model of economic development. One of the world's poorest, most vulnerable and dependent economies, classically dualistic[1] in the separation of an export-oriented plantation enclave from a large peasant subsistence sector, the nation has traditionally depended on the sale of plantation crops in international markets to earn foreign exchange for the purchase of food imports and other necessities. At independence, half the dietary staple (rice) was imported and 90 per cent of foreign exchange earnings came from three crops (tea, rubber, coconut). But unlike many poor and dependent societies, Ceylon developed an elaborate and expensive set of social welfare policies disproportionate to its per capita income. These policies were widely condemned in the official international development community as 'premature welfarism', diverting resources from investment towards social consumption and thus retarding growth. Until the 1970s, Ceylon was frequently cited as a negative development model in which welfarism and strict public regulation of the economy hindered growth; if anything is evidence of 'price distortion', it is the distribution of free food to the populace.

But in the 1970s, something very close to a 'paradigm shift' took place in development policy logic, at least at the symbolic level. The new paradigm redefined development itself, de-emphasising aggregate growth in favour of measures of social well-being, particularly for the poorest of the poor (e g, World Bank, 1975). There was, at least in theory, explicit recognition that rapid aggregate growth could produce "trickling up" and marginalisation as well as trickling down.

By alternative criteria of development, such as the meeting of 'basic needs', reduction in levels of malnutrition, disease, and inequality, Sri Lanka somewhat ironically became a positive rather than negative development model relative to most poor societies and indeed relative to many not-so-poor ones as well (World Bank, 1980a: 90; Jayawardena, 1974; Isenmen, 1980; Morris and McAlpin, 1980). For example, if one employs the criterion of the 'Physical Quality of Life Index' (composed of equally-weighted measures of literacy, infant mortality, and life expectancy), Sri Lanka in the mid-1970s ranked higher than Venezuela or Chile, with a life expectancy near that of some European countries and far greater than sub-continental neighbours India, Pakistan, Nepal, Afghanistan, and Bangladesh and a composite score, somewhat better than China (see Table 1). For a rough comparison of these data, consider that Sri Lanka's PQLI of 82, with an annual GNP per capita of about \$ 200, came closer to that of Sweden (97) or the United States (95), then to that of India (42) or Afghanistan (17). Though the PQLI is by no means unexceptionable,[2] as the aggregate measure may obscure significant differences by class, sector, gender and region and depends on often problematic and noncomparable data, the magnitudes of differences suggest important variations in policy priorities, which can be empirically verified. In the mid-1970s, Sri Lanka was allocating between 20 and 25 per cent of its budget to social security and welfare expenditures, compared to between 2 and 3 per cent for India and Pakistan (IMF, *GFSY* 1984: Vol XIII, pp 46-47). The basic needs performance of Sri Lanka, in the face of classical and severe structural dependency, raises a profound developmental point: extreme national poverty need not entail mass destitution, just as national wealth is no guarantee of well-being for the bottom of the income pyramid. The relatively effective mediation between national poverty and individual well-being in Sri Lanka was sustained by extensive public intervention in economic processes, with specific politically driven priorities.

The second irony in Sri Lanka's development experience is that just as some recognition internationally was accruing to the concrete benefits of 'premature welfarism', the accumulation of structural forces in the international economy began to erode the material base of those policies. Few nations have experienced so drastic and long-term deterioration in terms of trade as did Ceylon from the mid-1950s to 1976. The data in Table 2 illustrate the dilemma: over time, a given level of exports would purchase a declining quantity of imports. The volume of imports accordingly fell, first through severe restriction of luxury imports (automobiles, whiskey, etc), but the structure of the economy limited the amount by which imports could be cut: levels of food, medicines, intermediate goods, spare parts, fertiliser, etc, could not easily be reduced without damaging the economy or the population's welfare. The gap was met by borrowing, and debt service obligations further reduced import capacity. The debt service ratio rose from negligible levels in the 1950s to over 20 per cent (excluding short-term credits) in 1975. Though the economy was exporting substantially more in 1975 than in 1960, those exports had a purchasing power little more than one-third the smaller volume of exports in 1960.

The expansion of the public sector in terms of regulation, production and welfare was crucially conditioned by the nation's deteriorating exchange position, but two legacies of colonial rule laid the groundwork: democratic politics and an extensive public sector before independence. The plantation economy required extensive infrastructure; the colonial state owned and developed relatively advanced railways, electrical, postal, telegraphic, telephone and water supply services, and even held the monopoly for salt production. Quasi-public financial institutions serviced the commercial needs of the colony. Because of the colony's extreme dependence on imports, and strategic importance, the state established production units during World War II for plywood, quinine, drugs, leather, coir, paper, ceramics, acetic acid, glass and steel (Karunatilake, 1976). Welfare policies likewise began under colonial rule—a network for subsidised rice and flour distribution and rationing in 1942, for example. Free education (through the University level), poor relief, and subsidised or free medical care were all introduced in the late colonial period (Corea, 1975: Chapters V, VI; Wickremeratne, 1973; Gavan and Chandrasekera, 1979: 11-15; Gunatilleke, 1978; Lakshman, 1980: 17; Karunatilake, 1975; Herring, 1981). The state also took an extraordinarily active role in planning and subsidising 'colonialisation schemes' from 1935 onwards to remove the landless and land-poor from the deteriorating peasant sector to free farms in new irrigated tracts (Farmer, 1957; Herring, 1983: Chapter 5).[3]

Public institutions create clienteles: in a political democracy, distribution and expansion of spoils (jobs, contracts, services, subsidies) become objects of partisan competition for votes and means of servicing electoral machines. While remaining a colony, Ceylon received universal franchise very early (1931); though politicians could not control essential levers of state power, they could compete in patronage and promises. A wealthy plantation economy supported such predictably popular programmes as subsidised food and free farms, but as the terms of trade turned against Ceylon after independence, the economy's capacity to bear the costs was strained. Food subsidies alone claimed about 20 per cent of government expenditure (World Bank, 1953: I). When the government in 1953 attempted to reduce rice subsidies because of increasing costs during the Korean War, a well-established leftist opposition called for the 'Great Hartal' (general strike) which paralysed the nation (Wanasinghe, 1980; Wriggins, 1960: 75-76; Ponnambalam, 1981: 25). The Prime Minister resigned; the Finance Minister (currently President of Sri Lanka) lost his seat in the following elections.

As the significant foreign exchange reserves of the early 1950s dwindled and the nation's vulnerability to exogenous shocks became apparent, concern for import-substituting industrialisation naturally developed. Indigenous entrepreneurs seemed more drawn to the plantation economy and import-export trade than to risky long-term industrial development; the state took up the slack. Through both conservative and populist regimes the economic role of government increased. As current account deficits became chronic, some nationalisations were justified by the necessity of "stemming the drain of foreign exchange and the evasion of controls" (Karunatilake, 1976: 183). A similar concern for private sector

TABLE 1: PHYSICAL QUALITY OF LIFE INDEX SCORES AND GROWTH RATES FOR SUB-CONTINENTAL NATIONS AND CHINA IN THE MID-1970S

	GNP Per Capita 1977 (US $)	Literacy Rate (Per Cent)	Infant Mortality Rate (Per 1000 Live Births)	Life Expectancy at Birth (Years)	PQLI	Average Annual Growth Rate (GNP Per Capita 1960-1977)
Nepal	110	28	150	43	28	0.2
Afghanistan	190	17	205	40	17	0.2
Bangladesh	90	26	136	46	35	−0.4
Pakistan	190	24	126	51	40	3.0
India	150	36	123	49	42	1.3
Sri Lanka	200	85	37	65	82	2.0
China	390	66	45	65	75	5.1

Sources: World Bank, "World Development Report", 1979: Appendix Table I. *WDR*, 1983: Appendix C3.

TABLE 2: DETERIORATION OF INTERNATIONAL EXCHANGE POSITION, 1960-1975
Index (1970 = 100)

	1960	1965	1970	1971	1972	1973	1974	1975
Exports (Volume)	85	103	100	97	95	96	83	100
Exports (Value)	103	96	100	99	100	116	181	169
Imports (Volume)	130	84	100	88	86	77	55	68
Imports (Value)	59	71	100	107	113	149	264	309
Terms of Trade	175	135	100	93	88	78	69	55
Purchasing Power of Exports	149	138	100	90	84	75	57	55
External Long-Term Debt Outstanding (Billion Rs)	.29	.49	1.58	1.80	2.39	2.80	2.88	3.71

$$\text{Terms of Trade} = \frac{\text{Export Price Index}}{\text{Import Price Index}} \times 100$$

Source: "United Nations Statistical Yearbook", 1978, Tables on pp 492-501; CBC, *AR*, 1983, Table 36.

leakages of foreign exchange and extensive abuses (Wickremasinghe, 1974) led to the establishment of state trading corporations, tighter regulations and export-oriented public sector firms (petroleum products, for example). Fed by concern over shortages of imported consumer goods and the volatility of 'rice politics' in a highly politicised society, governments expanded state control of distribution of necessities (both goods and services) at low prices. Political elites found further nationalisations and controls attractive for narrowly partisan reasons as well in a political system very evenly balanced between the major contenders, the UNP and SLFP (which alternated in power until 1982). By 1975, roughly one-fourth of GNP was in government or public sector hands.

Adverse international pressures, in conjunction with a specific internal political configuration, thus explain intervention by the state in the economy. The freedom for policy manoeuvre was extremely limited; no regime can control international prices and an economy receiving 90 per cent of its export earnings from three plantation crops needs both breathing space and resources to diversity significantly. Moreover, as government revenues were heavily dependent on export taxes, deterioration in the terms of trade contributed significantly to burgeoning domestic budget deficits. Like many structurally similar poor nations in the mid-1970s, Sri Lanka faced an economic crisis largely external in origin (*cf* Kappagoda and Paine, 1981: 101-110): slow growth, austerity budgets, mounting internal and external debts, high unemployment.

In 1977, elections produced a virtual rout of the political forces which presided over these economic disasters and ushered in a regime openly committed to a radical redirection of national economic policy meant to resurrect long-suppressed market mechanisms and open the economy to foreign capital (*cf* Warnapala, 1979). Ironically, just as important elements in the international development community were having second thoughts about the reality of the 'equity-growth trade-off', and commending Sri Lanka for its achievements in meeting basic needs and reducing income inequality while maintaining a long-term growth rate respectable in comparison to subcontinental neighbours (*cf* Table 1), domestic political forces, with decisive international support, began dismantling the supporting ensemble of policies which had evolved over the previous three decades. In a final irony, Sri Lanka was for a time celebrated, almost certainly prematurely, as 'an IMF success', recognising the congruence of the strategy shift with the policy prescriptions of the International Monetary Fund and the sudden appearance of high growth rates after 1977.

Delegitimising 'Closed Economy'

So severe was the economic crisis of the early 1970s that there is a sense in which the complex of policies in place at the time, and the political forces associated with them, were inescapably delegitimised in popular perception. A leftist United Front government, dominated by the SLFP, came to power in 1970 with an overwhelming electoral mandate. That government inherited the accumulated consequences of the 1960s analysed above—unprecedented debts and deficits—and, more proximately important, the inability of the domestic economy to generate jobs; unemployment, especially among the educated youth, had become an explosive social issue. At least 14 per cent of the labour force was *openly* unemployed, though the level in some of the densely settled rural areas was much higher and young people were especially affected. Underemployment was severe and dissatisfaction with jobs 'inappropriate' to level of education or expectations widespread and bitter (ILO, 1971: Report, Chapter 2).

The extent to which the structural forces represented by deteriorating terms of trade and increasing budget deficits impinged on domestic economic policy is illustrated by the austerity budget of 1971. Popular opposition prevented the government from increasing the price of flour and sugar, but the price of rice was increased 25 per cent and medical subsidies reduced. N M Perera, one of Ceylon's leading Trotskyites, as Minister of Finance laconically noted:

> This has been a hard budget. It has not been a pleasant or easy task for me. Poignant memories of the past keep crowding around me. All my life I have fought to ease the burden of the poor and the humble. I am now the instrument not of easing, but of heaping additional burdens on them (in Halliday, 1975: 210).

Any regime would have faced similar, agonising and limited, options. The left protected its political constituency more than the right arguably would have, but the room for manoeuvre was narrow. Though the government continually asked for the forbearance of the poor and unemployed and promised that austerity measures were temporary, an important section of the militant left rejected both the programme and the analysis of the government. The JVP (Janatha Vimukhti Peramuna or People's Liberation Front) was already mobilising and organising in the countryside for revolution, a process accelerated by the failure of the United Front Government to produce radical structural changes (Obeysekara, 1973; Wijeweera, 1975). The Insurgency of 1971 was launched more in response to tactical problems relating to government suppression than from a well-conceived strategic position, but nevertheless succeeded in wresting large areas of the island from state control until the reinforced armed forces could regroup and, with remarkably diverse international assistance, crush the rural youths' rebellion. The Insurgency had a profound impact on Ceylonese politics, acting as a catalyst, for example, in generating a significant land reform which had not been mentioned in the coalition's Election Manifesto and in increasing the urgency of job creation (partly through continuous expansion of public sector employment) (Herring, 1983: Chapters 5, 8).

The land reform of 1972—which the Prime Minister had introduced with the stark 'we are sitting on a volcano'—was based less on rational economic principles than on the need to generate symbols of social justice, food self-sufficiency, and concern for the rural unemployed. The plantation lands appropriated by the state from indigenous owners were *by statute* to be distributed in such a way that rural youth could be provided employment with an income equivalent to that of a post usually occupied by a moderately educated person. In 1975 the foreign-owned estates were nationalised. The two land reforms together placed a great deal of prime agricultural capital in the state's hands, in marked contrast to the symbolic posturing in redistributive agrarian policy more typical of the region. Some of that land was allocated to experiments in collective and co-operative farming, particularly for groups of unemployed youth, but the major thrust was to place the core of the national economy under state control, significantly increasing resources for the ordinary politics of patronage and partisan manipulation (Herring, 1983: Chapter 5).

Food became a major crisis for the regime; the rapid escalation in international prices resulted in widespread hunger, despair, and reduced rations. Suffering and deprivation in the 1973-74 period were severe,[4] particularly among the plantation proletariat—the Tamil tea labourers. To illustrate the linkage between international structural vulnerability and regime constraints, one need only note that though rice imports were cut 12.5 per cent in 1973-74 (contributing to increased malnutrition), the rice import bill increased by 166 per cent. Likewise, the precipitous rise in costs of petroleum-based products dislocated the economy further and added to unemployment. Those factories which depended on imports of machinery, fuel and raw materials were forced to lower production or shut down (Balakrishnan, 1977: 202, 210). Between 1973 and 1974, manufacturing value declined and capacity utilisation fell to about 40 per cent. The transportation system suffered, slowing commercial activity, and rising costs increased the losses of public sector transportation operations. Paddy production suffered from bad weather, fertiliser shortages and the government's mandatory procurement policy at prices which did not keep up with inflation in costs of production—a policy strongly conditioned by the perceived political necessity of protecting mass welfare with low rice prices and the fiscal necessity of reducing producer subsidies.

Scarcity and discretionary authority predictably produce corruption, victimisation, and favouritism. The United Front regime was widely perceived to be guilty of these and other abuses of power and eventually unraveled internally (*cf* Shastri, 1985: Chapters VI, VII). But more importantly, the policies which clearly produced hardship and facilitated corruption did not seem to the public to have accomplished anything: suffering was widespread, unemployment reached 25 per cent, economic growth virtually ceased and essential goods were increasingly scarce.

Though both the external development experts and the electorate judged economic performance under the 'closed economy' in the early 1970s very harshly, it is not at all clear that alternative policies would have fared better in a small, dependent economy in the face of the extraordinarily adverse conditions—natural and economic—of the period. The economic crisis of the mid-decade was genuine, and severe, but the performance of the economy over this period was not noticeably worse than that of other poor nations, even by the narrow criterion of growth rates. This is particularly true when growth rates are compared in per capita terms; Sri Lanka's extensive social welfare system has contributed to declining rates of population growth, improving per capita performance. Moreover, measures of economic development which include some notion of physical well-being or "basic needs" decisively differentiate Sri Lanka from regional neighbours (refer back to Table 1). Even the World Bank, long critical of the Sri Lanka's heavy expenditures on education, health, and nutrition (about 10 per cent of GNP over the previous two decades) commended the results in terms of 'human development' and argued (1980a: 90) that (a) the 'trade-off' between human development and growth "has not been so sharp as is sometimes suggested" and that (b) growth rates deteriorated "for reasons generally independent of human development spending" (largely the weather and terms of trade).

Post-1977 Economic Policy: Opening 'Closed Economy'

The elections of 1977 produced a new regime and a dramatic rejection of the policies which had evolved over the previous three decades, largely as *ad hoc* efforts to alleviate the constraints and pressures of structural dependence in the context of high levels of politicisation, partisan competition and patronage expectations. The culmination had been a tightly-regulated, 'closed' economy in which the state became increasingly relevant to major economic decisions; state participation in the economy increased through nationalisation of important sectors and the proliferation of public corporations (*cf* Lakshman, 1980). Imports were strictly controlled through licensing procedures, state monopolies, and rationing of hard currency. Essential commodities were rationed and offered at subsidised prices (sometimes gratis) to guarantee a floor level of consumption. The widely-recognised result was scarcities, corruption, and black-marketeering, as well as shortages of capital and intermediate goods and spare parts which throttled growth and aggravated unemployment, particularly in the 1970s when deteriorating terms of trade aggravated already severe constraints on imports.

The erosion of social welfare coverage set in before the sweeping 1977 UNP electoral victory (140 of 168 seats), as mentioned previously. But whereas the previous government had cut subsidies reluctantly, in response to the budgetary and foreign exchange pressures, the new regime pledged to reduce subsidies on the theory that their opportunity cost in terms of competing developmental expenditures was too high. The core assumption was that the national economy had been shackled by excessive regulation, an excess of consumption expenditure over investment, and 'wasteful and complacent' public sector enterprises. Market forces were to play a greater role in allocating resources and public enterprises were to compete with the private sector. The Central Bank termed the new ensemble of policies "a sweeping departure from a tightly controlled, inward-looking, welfare-oriented economic strategy to a more liberalised, outward-looking and growth-oriented one" (CBC, *AR*, 1978: 2).

The key elements of the new policy involve powerful investment incentives to foreign and domestic capital (for details, Sri Lanka, 1979), a shift in the composition of public spending, and a liberalised international trade policy, premised on export-led growth. Employment creation is a central objective, both through encouragement of domestic and foreign capital, and through ambitious public works such as the Accelerated Mahaweli Development Scheme for bringing new tracts of irrigated land under cultivation while substantially increasing hydroelectric generating capacity.

The role of the state is by no means minimal, and indeed the public investment programme proved to be overly ambitious; but the state is to play a smaller role in regulation, commerce, and production, and a greater role in developing infrastructure. The initiatives are by any measure bold, and clearly captured the imagination of the external development establishment. Fiscal logic suggests that the very boldness itself is dependent on international support; if tax incentives are given business and yet the government increases infrastructural investment when budget deficits are already large and chronic, additional financial resources on a large scale must be found externally. Likewise, relaxing import controls can be expected to put pressure on the balance of payments.

International factors in the new strategy thus become critical; external support in material terms has arguably been a necessary condition for the liberalisation initiatives. The international development community has provided resources to tide the regime over the potentially rocky re-adjustment period. The dynamics are familiar. Following a sharp devaluation of the rupee in November of 1977, the IMF announced support for "the comprehensive programme of economic reform . . . in support of which the present stand-by arrangement (of SDR 93 million) has been approved" (*IMF Survey*, 6: 23, 1977). IMF approval is an important signal in international financial and development communities, and the regime quickly took advantage of its new status.

In pursuit of the new strategy's emphasis on external investment capital and foreign loans, the Finance Minister visited groups of investors and officials of aid-giving nations and agencies across the globe. In the first full year of the new regime, official loan commitments more than doubled the 1977 level, in marked contrast to the experience of other South Asian nations at the same time. These official loans carried a grant element of 64.8 per cent (World Bank, 1980c: I, 191). The *net* flow from all lenders increased from $ 48 million in 1977 to $ 175.9 million in 1979 (Ibid: I, 102). The Finance Minister was thus able to boast in his Budget speech for 1981 that "due to the confidence placed by the international community in our new economic policies, we have been able to obtain greater volume of foreign aid and foreign assistance *per capita* than perhaps any other third world country" (Sri Lanka, 1980a: 2). As importantly, considering previous national experience with debt difficulties, the Minister noted that more than a third of the assistance was in the form of outright grants, the balance as long-term loans "at minimal interest". Given current 'aid-weariness', Sri Lanka was indeed successful by its announced criterion of foreign-assisted development, and the Minister acknowledged the direct connection to the new economic policy: "Without the courageous and imaginative steps we took . . ., nothing would have moved, nothing would have happened" (Sri Lanka, 1980c: 2).

The marked increase in the level of international grants has allowed the economy to run unprecedented balance of trade deficits (a consequence of import liberalisation and deteriorating terms of trade). The burden of amortisation claims on export earnings was reduced not only through increases in the level of outright grants, but also by the substitution of long-term subsidised loans and IMF drawings for high-interest suppliers' credits and commercial loans. The lengthening of the debt service structure was especially evident in 1979 when approximately 70 per cent of the long-term loans contracted, accounting for 74 per cent of loan volume, allowed a grace period of ten years or more (CBC, *RE*, 1979: 185). The position was further alleviated by the outright remission of debts equalling Rs 804 million in 1979.

The effect of international factors in facilitating a higher level of imports and, indirectly, exports (since the import component of intermediate goods is over 75 per cent) extends beyond the balance of payments. Domestic capabilities of the government in so dependent an economy are in large part a function of levels and terms of international trade (for analysis of the effects of the Great Depression and Second World War in this regard, see Corea, 1975). The tax revenues foregone through the incentives for capital had to be made up from other sources. Taxes on individual and corporate income and profits fell from 17.5 per cent of total revenues in 1976 to 9.8 per cent in 1978. Similar decreases occurred in the share of taxes on property, net wealth, estates, inheritance and gifts (IMF, 1980: 511). Indirect taxes thus increased, and in 1979 taxes on international trade amounted to 55 per cent of total revenues. Without strong international support, current account deficits would necessarily curtail the level of such trade and thus force very hard political and fiscal choices on the regime.

Both internally and externally, the new

strategy was initially hailed as a remarkable success. Such claims are based on relatively high growth rates since 1977 and require considerable qualification. First, the new strategy was launched in an unusually auspicious economic situation; the terms of trade, which had deteriorated since 1960, showed a 35 per cent improvement in 1976, 31 per cent in 1977; tea prices experienced an unprecedented rise of 80 per cent, contributing to an unprecedented current account surplus of Rs 1,259 million. Gross National Product grew at a rate of 8.2 per cent in 1978, a very high rate by historical standards, then slowed to 6.2 per cent in 1979, 5.5 per cent in 1980, 3.9 per cent in 1981, 5 per cent in 1982, and 4.9 per cent in 1983. The rate of growth in real national income has been significantly less, however, because of subsequent deterioration in the terms of trade (see Table 3). Moreover, as foreign nationals claimed larger interest, profit and dividend factor payments, GNP growth rates have diverged from GDP growth rates. Nevertheless, the acceleration of economic activity was significant; the more important question is whether the growth rates represent self-sustaining processes or simply reflect the effect of a large influx of external resources into a very small economy, combined with initially favourable terms of trade and the short-term explosion of pent-up demand once the restrictions on imports were lifted.

The import liberalisation policy, by removing constraints on imported intermediate goods, certainly contributed to growth in the manufacturing sector, but simultaneously contributed to wiping out the current account surplus very quickly. In 1978, the balance of trade deficit was one of the largest in Sri Lanka's history—and that deficit was dwarfed by the 1979 deficit, which in turn doubled in 1980, and increased further in 1982. As the data in Table 3 indicate, in 1977 and 1978 the movement of terms of trade in Sri Lanka's favour (which began in 1976) peaked; import liberalisation produced large balance of trade deficits over time as prices of imported goods increased much more rapidly than prices of exports. The resultant current account deficits were covered by dependence on foreign funding.

It is fair to say that domestic political elites read the international acclaim and support as *carte blanche* for a very ambitious development programme. This was not to be the case. The 1980 Budget deficit amounted to more than 26 per cent of GDP and was accompanied by a rate of inflation of at least 30 per cent. Officials of the World Bank and the IMF told the government that financial indiscipline was becoming a serious problem. The consortium of donors meeting in Paris in July 1980 was critical of the ambitious public works, particularly housing construction and water supply schemes. The external pressure was to cut the current account and budget deficits and to raise more resources internally. The Finance Minister predictably responded that "external factors beyond our control" were responsible and that cuts in the investment programme would dampen the enthusiasm the government had worked so hard to instill among investors (*AWSJW*, 6/6/81; 7/20/81). In the 1981 Budget some of the more ambitious development projects had to be cut; but a share of the remaining deficit was still covered by international assistance. The foreign contribution to financing of the net cash budget deficit in 1976 was 32.5 per cent; in 1980, 70.4 per cent (CBC, *RE*, 1979: Table 10.1). The Public Investment Programme of the Ministry of Finance and Planning, 1980-1984, projected a strategy in which net external inflows would be greater than domestic sources, constituting 54 per cent of total public investment over the five-year period (Sri Lanka, 1980b).

This familiar pattern was repeated in meetings with the Aid Sri Lanka Consortium and IMF in the summers of 1982 and 1983; 'belt-tightening' is urged, the government pleads domestic constraints and blames external factors, and compromises are made. In 1982, the government was particularly unwilling to cut expenditures because of the upcoming Presidential elections (*cf* Samarasinghe, 1983). In 1983, the IMF took an especially dim view of budget and current account deficits and urged the traditional remedies: devaluation and cuts in subsidies to mass consumption. The Finance Minister answered that new capital expenditure projects had been totally suspended and that construction on the Mahaweli project was vital for reducing food import costs (and thus balance of payments pressure). There was reluctance to cut health, education and welfare subsidies further, as the nation's remarkable records in these areas "are our pride and we cannot afford to throw them away" *FEER*, 6/23/83). As to devaluation, the Minister pleaded: "We have only so much to export and any further devaluation can only make imports more expensive", fuelling inflation.

TABLE 3: BALANCE OF TRADE AND TERMS OF TRADE UNDER LIBERALISATION REGIME

Year	Exports (Value Rs mln)	Imports (Value Rs mln)	Balance of Trade (Rs mln)	Export Prices (Index 1978 = 100)	Import Prices (Index 1978 = 100)	Terms of Trade 1978 = 100
1960	1,832	1,960	– 128	17	9	185
1975	3,968	5,196	– 1,228	29	49	58
1976	4,840	4,901	– 61	34	44	78
1977	6,569	6,061	+ 508	55	54	102
1978	13,193	15,099	– 1,096	100	100	100
1979	15,282	22,602	– 7,320	109	152	72
1980	17,595	33,942	– 16,347	126	217	58
1981	21,043	36,582	– 15,539	129	282	46
1982	21,454	41,946	– 20,492	119	309	38
1983	25,096	45,553	– 20,457	165	375	44

Source: Central Bank of Ceylon, *RE*, 1983 (Appendix Table 18; Table 1. 41); CBC, *AR*, 1983 (Appendix Tables 67, 64).

Despite initial international enthusiasm for the new policies, there are already signs of what may develop into serious problems. At the most general theoretical level, there is evidence that massive foreign inflows may produce something like a 'hot-house' effect in third world economies, generating significant short-term growth but depressing long-term growth prospects (for a review and empirical analysis, *cf* Bornshier, *et al*, 1978; Bornshier, 1980). Since the foreign exchange problem has been a persistent obstacle to economic development in Sri Lanka, the question of profit repatriation, debt servicing, and other outflows becomes critical. Samarasinghe (1980:14) estimates that net foreign exchange earnings from the Export Promotion Zone are one-third of gross earnings and would be even lower if repatriation of profits and royalties, etc, were calculated. The net deficit in national accounts for investment payments increased from Rs 10 million in 1977 to Rs 98 million in 1979 (CBC, *RE*, 1979: Appendix Table 83), and increased further to Rs 432 million in 1980, Rs 1,712 million in 1981, Rs 1,969 million in 1982, and Rs 3,218 million in 1983 (*AR*, 1982, and 1983, Table 25). At the same time, hard currency debts have quadrupled since 1977 and will eventually have to be serviced.

It is unlikely that the international community can be counted on repeatedly to make the type of concessions which greeted the new strategy initially. Vulnerability to global recession, protectionism and terms of trade shifts remain the primary determinants of domestic success. Indeed, empirically the economy is more vulnerable to exogenous shocks under the liberalised regime than under the closed economy (Jayatissa, 1982). Simply from shifts in the terms of trade, Sri Lanka lost 7 per cent of its real national income in 1982 and 8 per cent in 1983. The global depression in primary commodity prices significantly affected government revenues (and thus budget deficits and international approval of the regime): as a striking example, rubber export *volume* increased by 17 per cent in 1982, but export *earnings* fell by 20 per cent and export *duty revenues* fell by 47 per cent. Coconuts experienced a similar, less drastic, decline (CBC, *AR*, 1982: 5).

No amount of external pressure on Sri Lanka can produce policies which effectively counter this type of systemic shocks. The IMF has noted that the sharp deterioration in terms of trade from 1980-1983 increased the current account deficit from 5.5 per cent of GDP to 16 per cent (*IMF Survey*, 9/19/83). To cover these growing deficits, the government has resorted to more extensive commercial borrowing: the debt service ratio has risen accordingly. When short-term debt obligations and IMF transactions are included, the debt service ratio reached 15.2 per cent in 1982 and 17.5 per cent in the first half of 1983 (CBC, *AR*, 1982: 104: CBC, 1984: 21). While not high by contemporary third world standards, the debt service ratio eventually crept above the historic high experienced during the 'oil shock' period of 1973-74, well over 20 per cent. Nevertheless, debt service obligations have been kept to manageable levels, in part because of favourable external flows that depend on special treatment which remains both curious as to its causes and uncertain in its continuity.

Privatisation, Entitlements, and Discretionary Boons

Despite an economic philosophy which emphasises the magic of the market and the disutility of state intervention in economic activity, government policy to-date has not dismantled the large public sector, nor has 'simulated privatisation' in the sense of forcing market efficiency criteria on public sector firms through competition played a major role. The state has not, for example, reversed the two land reforms which put the largest plantations in the public sector; about two-thirds of the tea acreage and one-third of the rubber remains public. Public corporations still run airports, provide insurance, manage hotels, produce traditional medicines, deal in fish, sell milk, fly tourists, build houses, transport people and monopolise the airways, among other things. Public sector industrial corporations include steel, petroleum products, textiles, fertilisers, tyres, salt, dairy products, distilleries, oils and fats, timber and plywood, paper, cement and ceramics. More than 60 per cent of industrial production is by the public sector (CBC, *RE*, 1982: 430). Setting the index of public sector industrial production for 1977 at 100, a fairly steady increase was evident through 1982 (index = 124.6), with the only significant declines in food, beverages, and tobacco.

Public sector firms vary in profitability, with no clear trend since the new policies took form. The rate of growth in production in public sector enterprises has been considerably lower than in the private sector. One irony is that import liberalisation—a key component in the strategy—has hurt badly the National Textile Corporation and the National Paper Corporation (CBC, *RE*, 1982: 62), adding to the troublesome budget deficit. Of course, the profitability of some public sector firms has been adversely affected by the terms of trade (e g, plantation industries, petroleum products).

Actual transfer of productive assets from the public sector to the private sector has been minimal—a few textile mills, some agricultural land—but the regime has significantly reduced the publc sphere in terms of exclusivity. Trading monopolies, both international and domestic, have been broken, a transnational venture for flour milling has been arranged, foreign banks were permitted (and invited) to establish branches (21 as of 1982), and bus transport was opened to the private sector. It is in field of regulation that the state has most significantly withdrawn from economic activity, especially in the Export Promotion Zone, where a kind of frontier *laissez-faire* attitude prevails; not only are long-established legal protections of labour in abeyance, but even data collection and monitoring are accorded very low priority.

Food policy has been central to both domestic politics narrowly conceived and to conflicts between Sri Lankan regimes and important international actors. A fundamental change in food policy was effected in June 1978 when the general subsidy of food consumption was restricted to households earning less than Rs 3,000 per year. Approximately 7.72 million people—about half the population—claimed to be eligible. Further targeting accompanied a revision of the programme from a ration provision to a food stamp programme limited to those with incomes less than Rs 300 (then US $ 12) per month. About half the population remains on the rolls, despite international pressures to reduce the subsidy and domestic talk of further restrictions of coverage.

The regime undercut the effect of the subsidy in any event by refusing to revise the purchasing power by indexing either the income criterion or the stamp values to counter inflation. Between the inception of the programme and July 1981, the purchasing power of a typical family's food stamps had been cut in half (Sri Lanka, 1981: Table 3). Subsequent inflation cut the benefits in real terms even further. An evaluation by the Food and Nutrition Policy Planning Division of the Ministry of Plan Implementation found that the effect of policy changes has been a deterioration of the nutritional status of pre-school children and in increase in the number of cases of serious malnutrition (Sri Lanka, 1981: 30; compare Sahn, 1983; Edirisinghe, 1985). That study concluded that the food stamp system, although cheaper, put more families at risk nutritionally than the older ration system. Although the cereal self-sufficiency ratio continues to improve, the rural and urban poor remain vulnerable to malnutrition, though it must be stressed that even the restricted food subsidy scheme is a significant protection by regional standards.

The pressure on the government to reduce welfare expenditures has been partially successful; food subsidies, which were roughly 14 per cent of government spending in 1979, and 6 per cent of GDP, declined to 7 per cent of expenditures and 2 per cent of GDP by 1981. But the regime has found it more difficult to cut public consumption in favour of investment than anticipated. Despite significant reduction in entitlement coverage under the food stamp programme in 1979, the gross food subsidy bill continued to increase because of higher import prices for wheat, flour, and rice (CBC, *RE*, 1979, Appendix Table 93). The politics of food have been turbulent in Sri Lanka; attempts to cut subsidies have been met with predictably powerful opposition, frequently forcing back-tracking in policy (Ponnambalam, 1981: 25, 32, 48, 62, 78-79). The importance of these facts is that the social and political effects of austerity programmes typically advocated by the IMF have been deflected by the extraordinary international support for making Sri Lanka a showcase of export-led growth, liberal economic policy, and openness to foreign capital. It is, however, an open question how well the services related to the physical quality of life will survive in the face of persistent and powerful external demands for greater fiscal discipline.

Income inequality has inevitably entered discussions of the liberalisation programme. The widely-discussed reduction of income inequality between 1963 and 1973 is a matter of considerable empirical dispute (Jayawardena, 1974; E L H Lee, 1976; 1977; Dahanayake, 1979; Lakshman, 1980). The dispute largely turns on the validity of the Consumer Finance Surveys conducted by the Central Bank in 1953, 1963, 1973, and 1978-79 and 1981-82). *If* these surveys accurately reflect real income inequality (which is problematic because of reporting biases at the upper end and arguable evaluations of income in kind), data from the 1981-82 CFS indicate increased inequality between 1973 and 1981-82; indeed, the Gini coefficient, which had fallen to 0.41 in 1973, and was precisely the same in 1978 as in 1963 (0.49), increased 0.52, the highest level since the surveys began in 1953. Given the increases in property income after 1977, and tax concessions to capital, income inequality after taxes and before subsidies has almost certainly increased (compare Lakshman, 1980; Samarasinghe, 1980). Moreover, the real value of the most important consumer subsidies has been significantly eroded. Likewise, the management of public sector enterprises has historically had a purposive redistributive impact (Lakshman, 1980: 22) which is now contrary to official policy.

Whatever the reality of apparent changes in income equality, inequalities in *consumption* were kept very low by the pre-1977 policies of subsidisation and rationing of essential consumer items and severe restrictions on luxury imports and high tax rates on the wealthy. Relaxation of controls has produced a flood of luxury consumer items after 1977—electric food processors, Danish hams, Scotch whiskey, smoked herring, stereo components, television sets, automobiles and so forth—in a society in which per capita income is still near $ 300 per annum. Though the share of consumer goods in total imports has remained fairly constant, luxury items make a striking impression on the visitor accustomed to the old Sri Lanka. To take but one item, imported passenger vehicles which cost only Rs 18 million in 1975 rose to a cost of Rs 563 million in 1979 (CBC, *RE*, 1979: Table 7.13). Although availability of all imported items has improved since liberalisation, the effect has been most noticeable in goods which can be purchased only by the very wealthy.

Though the government has taken a decidedly *laissez-faire* position with regard to certain economic dynamics, the role of the state is still large. Sri Lanka has traditionally been one of the most heavily taxed poor nations. Government revenue as a percentage of GDP was 26.5 per cent in 1978, compared to 11 per cent in India, 12 per cent in Pakistan; government *expenditure* was 40.9 per cent of GDP (CBC, *ESS*, 1979: Table 2.1). By 1982, government revenues were down to 19.5 per cent of GDP, but spending remained near the 40 per cent level (38.7) (Sri Lanka, 1983: Table 74). The gap between the two figures indicates the lack of financial discipline which concerns the IMF.

While the current regime was cutting some areas of public consumption, it expanded others. In 1979 a National Housing Development Authority was established to construct 100,000 living units before 1983. The programme was later expanded to a target of 1,000,000 units, through both direct construction and 'aided self-help' programmes. An 'Electrical Housing Programme' undertook direct construction of 155 houses per electorate. Not surprisingly, international opinion of the IMF variety was hostile to both the diversion of investment funds from capital formation and to the interest subsidies to 'aided' home builders. Nevertheless, the plan was attractive to USAID, which contributed heavily, and is tailor-made for servicing regime patronage interests. Not only can significant boons be selectively allocated, but ruling politicians gain attractive opportunities for skimming operations. Likewise, the massive Mahaveli (river valley) development programmes provided ample opportunities for patronage, ranging from lucrative contracts to free irrigated land for farmers.

The public investment programme has been ambitious, but is not meant to increase the public sector's share of final goods production. Rather, as the Financial Minister stated in July, 1984, "public investment is to be viewed basically as a means of providing the infrastructure facilities necessary to support private entrepreneurship" (*CDN* 28-7-94). Accordingly, capital transfers to public corporations have been heavily dominated by the Mahaveli Development Authority (irrigation, electric power), which has consumed between 50 and 70 per cent of the total annual transfers; by the National Housing Development Authority; and (more recently) by the National Water Supply and Drainage Board and Air Ports Development Authority (CBC, *AR*, 1983: Appendix Table 35). Public capital expenditures as a percentage of total public expenditure increased from 21 per cent in 1971-72 to 38 per cent in 1978 and to 43 per cent in 1982 (CBC, *RE*, 1982: 250), though budget deficits continue to put pressure on capital spending and it is widely acknowledged in Sri Lanka that the rapid expansion of capital spending has produced considerable waste and corruption.

Despite cuts in some programmes, the net thrust of the new policies was to increase the share of investment in GDP. Gross domestic investment increased from an annual average share of GDP of 16 per cent for the 1970-77 period, to an annual average of 27.7 per cent for the 1978-83 period (see Table 4). Coupled with cuts in taxes to offer incentives to private and foreign capital, the ambitious public investment programme inevitably inflated budget deficits. Table 4 presents a summary. Budget deficits reached 26.1 per cent of GDP in 1980, 22.1 per cent in 1982, contributing to mounting public debt, though the significant grant element in foreign assistance enabled the regime to escape a debilitating debt service burden. Table 5 presents a summary. Still, by 1984, interest on the public debt—domestic and foreign—was the largest single expense in the budget, exceeding capital transfers, salaries, and subsidies and grants (*ER*, 9:8, 1983: 116). Foreign financing has typically covered 50 per cent of the annual deficits since 1977. To understand how crucial is international support for continuation of the current policies, we may note that while the share of public investment more than doubled as a percentage of GDP in the 1978-82 period, compared to 1970-77 averages, international assistance (grants, loans) almost quadrupled as a percentage of GDP (Table 4).

The 'financial discipline' which the IMF repeatedly urges thus presents difficult dilemmas to the regime. Withdrawal of subsidies and high rates of inflation are more tolerable politically in a boom economy than in a period of declining growth rates. Economic expansion is heavily dependent on the incentives granted capital, as well as on the continued enthusiasm of external sources of hard currency. The import component of industrial raw materials hovers around 80 per cent; unless the terms of trade show dramatic improvement, continued production expansion and provision of essential consumption items are likely to remain dependent on the 'confidence of the international community' of which the Finance Minister speaks. That confidence in turn depends heavily on assessments of the IMF and thus on the degree of tolerance of that organisation for fiscal indiscipline and economic heterodoxy. In crudest terms, financial discipline is likely to involve some mix of reducing business incentives (jeopardising further investment), reducing public developmental expenditures (jeopardising employment and growth), and reducing the social wage, directly or indirectly (threatening both social peace and improvement of the 'physical quality of life' for the bulk of the population). The resultant policy mix will reflect the regime's perception of the tolerance levels of foreign and domestic capital, domestic classes, and the international development establishment.

International Factors in 'Opening' and 'Closing' Economy

In a political economy so dependent as that of Ceylon/Sri Lanka; analysis of domestic policy shifts of necessity incorporates extensive attention to external forces. It need not be emphasised that domestic elites (selectively) benefited greatly from the 'closed' economy: the regulatory interstices and public economic activities allowed windfall profits, bribes, influence peddling, political patronage and partisan advantage to various sections of dominant classes. The 'open economy' continues many of these political advantages, while subjecting entrepreneurs to greater risk with wider opportunities. It is easy to understand in political terms why the public sector has remained large. Moreover, for elites, liberalisation and cuts in the social wage are a small price to pay for concessional hard currency flows which have averaged roughly 13 per cent of GDP from 1978 to 1983 (almost four times the average for 1970-77). Domestic elites' interests may be served by a variety of policy packages; the focus of this piece has been on external forces and actors which have shaped the policy environment—the complex of opportunities, pressures and constraints—which has influenced domestic policy choices. Restricted choice is, of course, a core element of dependency.

The roots of social welfare policies, and the potential to finance them, are found in the late colonial experience—the development of a wealthy plantation export sector, early popular representative political forms, and the development of infrastructure to service the plantation economy. The structuration of the national political economy during the colonial period simultaneously opened important opportunities for social welfare

Table 4: International Support for the Liberalisation Regime: Savings and Investment
(Percentages of GDP, current market prices)

Year	Gross Domestic Investment	Public Investment	Foreign Savings
1970	18.9	8.2	4.8
1977	14.4	7.2	3.6
Annual Average 1970-1977	16.0	7.7	3.3
1978	20	11.9	4.5
1983	29	15.5	12.5
Annual Average 1978-1983	27.7	16.7	12.7

Source: Sri Lanka, 1984, Ministry of Finance and Planning, "Public Investment, 1984-88".

Table 5: Budget Deficits, Foreign Finance and Public Debt Under Liberalisation Regime
(*Rs million*)

Year	Budget Deficit	Foreign Finance Contribution to Covering Deficit	Public Debt Outstanding
1976	3,576	1,326	15,621
1977	3,074	1,779	22,434
1978	7,165	4,454	27,746
1979	8,791	4,237	31,512
1980	16,274	6,735	46,779
1981	14,866	8,208	58,659
1982	20,091	8,794	71,250
1983	23,385	14,024*	98,380**
1984	(16,543)*	12,312*	NA
1985	NA	14,100***	NA

Notes: ** Provisional.
*** Approved estimate.
Source: CBC, *AR*, 1983: Table 28.

development and left that potential vulnerable to external forces in the global economy. The development of a tightly-regulated, "closed" economy was a response to that vulnerability given the domestic political necessity of protecting the mass public from immiseration through exogenous shocks. The stategies of the first three decades of independence did not alter the structural vulnerability of the economy and resulted in a genuine economic cul-de-sac of high unemployment, internal and external deficits, scarcities, slow growth and austerity budgets when international economic forces produced unrelenting pressures over time. It was the realignment of domestic political forces, strongly influenced by the inability of ruling elites to cope with international economic forces, which allowed international actors to play a decisive role in supporting a fundamental shift in development strategy after 1977.

It is ironic that the current regime speaks of a shift from a 'closed' to an 'open' economy. Even in its tightly-regulated incarnation, the Sri Lankan economy was in a critical sense open; the ineffectual 'closing' of the economy was in part a response to that vulnerability. Whatever the validity of Cameron's (1978) argument concerning the contribution of openness of economy to expansion of the public sector in advanced industrial societies, the connections and mechanisms in the case of Sri Lanka are clear. Given a closely competitive political system, openness created the foreign exchange reserves and budgetary flexibility for the welfare state when export prices were buoyant; when the terms of trade deteriorated, openness was manifest as vulnerability, and domestic political pressures led to expansion of the welfare state and regulatory apparatus to protect the domestic population from externally-induced immiseration. The IMF's argument that the resources spent on public consumption could have been better spent on investment may be true but was politically irrelevant. The comparative developmental records of regional neighbours which took the other path (Table 1) do not, however, support the argument that national policies were disastrous.

Effects of liberalisation on the mass public have been ambivalent, but heavily mediated by external forces. Unemployment has been cut, fed by an aid-driven expansion, but international donors demand higher taxes and spending cuts. Inequality increased and the social wage has been deeply cut. Attracting foreign capital to create more employment depends on advertisements of a docile, inexpensive labour force, stripped of traditional legislative protections in the Export Promotion Zone; moreover, the regime has demonstrated a very tough attitude toward organised labour. Reductions of inequalities of income and wealth are contrary to the incentives for accumulation on which the strategy depends; the regime resurrects as justification the Kuznets hypothesis, contending that inequalities inevitably grow in the early stages of growth, then subside. The continuation of food subsidies for half the population and the introduction of a minimal unemployment dole mark the persistence of what we may term the dependent welfare state, representing functional requisites for maintaining low wage rates and social peace, both of which are selling points in the competition to attract foreign capital.

The dismantling after 1977 of the state's direct intervention in and regulation of production and exchange, while supported domestically by dominant classes and by mass discontent with previous policies, was a necessary condition for the extraordinary international support the new regime has received, and such support was a necessary condition for sustaining the policy changes. The policy changes themselves create the conditions for future dependence on those same international actors and thus restrict the range of domestic policy options. The social consumption role of the dependent welfare state is in theory de-emphasised, with international approval (and pressure), though there remain tactical domestic political difficulties in a complete retreat; moreover, persistent international vulnerability (food and fuel prices, for example) introduces constraints on reducing the fiscal burden of welfare policies despite reductions in their coverage. To date, the maintenance of a regime committed to dismantling the *internal* welfare state has depended on Sri Lanka's status as an international welfare case. As a result, whether or not the liberalisation regime's policies produce rapid growth without immiseration of the weakest sectors, or rapid growth at all, is heavily dependent on decisions made outside Sri Lanka, as well as on structural forces which, to date, have been largely kept off the global policy agenda.

Abbreviations

AWSJW	Asian Wall Street Journal Weekly (New York)
ARTI	Agrarian Research and Training Institute (Colombo)
CBC	Central Bank of Ceylon (Colombo)
AR	Annual Report
RE	Review of the Economy
ESS	Economic and Social Statistics of Sri Lanka
CDN	Ceylon Daily News (Colombo)
ER	Economic Review (People's Bank, Colombo)
FEER	Far Eastern Economic Review
ILO	International Labour Office (Geneva)
IMF	International Monetary Fund (Washington, DC)
GFSY	Government Financial Statistics Yearbook

Notes

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1 The conventional use of 'dualism' to characterise the Ceylonese economy has been challenged by Bandarage (1983); see Herring (forthcoming). Though Bandarage's work rightly stresses the complex interaction between plantation economy and village society historically, the notion of a dualistic economy need not, and should not, be taken to preclude certain interactive effects, but rather the disarticulation of sectors as stressed in the dependency literature.

2 For a critical discussion, see Hicks and Streeten (1979). The inclusion and weighting of literacy is particularly problematic in the PQLI because of the different real advantages implied by different kinds of literacy in different economic and cultural contexts; with regard to Sri Lanka on this point, see Ann Mattis (1978). On the inadequacy of traditional measures, and a defence of the PQLI, Morris (1979). On the persistence of severe poverty in Sri Lanka despite the impressive aggregate indicators, Marga, 1981; Isenman, 1980; Lee, 1976; Pieris, 1982; Richards and Gooneratne, 1980. For an empirical analysis of the relationship between PQLI and income in 116 societies, along with a defence of the basic needs measure, see Moon and Dixon (1985).

3 The colonisation schemes have contributed not only to improving the PQLI (via transfer of the landless and land-poor to new subsistence farms) but also to improving the cereal self-sufficiency ratio dramatically by opening up highly productive tracts and to reduction of the potential for agrarian discontent, by making landed proprietors of large sections of the most marginal agrarian classes. An excellent review is Moore (forthcoming). Because of the spatial spread of colonisation schemes, land policy has added to tensions in the current social upheaval, as Sinhalese peasants populate areas traditionally considered to be Tamil turf.

4 E L H Lee (1976) documents deterioration of real wages in the estate sector as well as in urban areas. Gunatilleke (1978: 48-51) discusses the sources which led him to report widespread malnutrition in Sri Lanka in the mid-1970s. Nutrition data presented by Gavan and Chandrasekera (1979: Table 7) indicate serious malnutrition effects, especially in the estate sector. The available nutrition-data of a systematic sort relate to a period after the most severe stage of the food crisis. Paul Isenmen (1980: 244) presents data and analysis to link an increase in mortality, particularly on the estates, to the food crisis in 1974. *Cf* Marga, 1981; Sahn, 1983. On Sri Lanka's international food situation, ARTI, 1976.

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