PRIVATIZATION IN SRI LANKA

by

KASUN DISSANAYAKE

M.B.A., University of Peradeniya, Sri Lanka, 2010

A REPORT

submitted in partial fulfillment of the requirements for the degree

MASTER OF ARTS

Department of Economics
College of Arts and Sciences

KANSAS STATE UNIVERSITY
Manhattan, Kansas

2012

Approved by:

Major Professor
Yang-Ming Chang

Abstract

This report examines the role of the privatization in Sri Lanka and assesses its effectiveness. The focus was given for the evolution of privatization and how socio-political factors such as rent-seeking, inconsistency policy making, market competition, political uncertainty and role of supporting institutions have affected the privatization process. After the independence in 1948, several reforms have been taken place in Sri Lanka. In 1977, a market oriented policy package which brought huge amount of foreign aids into the country was introduced. Further the privatization in Sri Lanka can be addressed as: Sporadic attempt, Systematic approach and Structured approach. The appointment of short-term governments and changing of the leadership has always been a hurdle for a successful privatization in Sri Lanka. In order to establish a successful privatization, it requires having the changing of ownership from public sector to private sector, creating a competitive market environment and forming a proper institutional framework. Unfortunately, due to less emphasis was given to the latter two factors: the privatization has always given undesirable outcomes. In the whole history of privatization in Sri Lanka, the highest value for Foreign Direct Investment (FDI) was recorded in 2008. It is clear that the reason for the FDI value escalation in 2008 is the improved confidence of foreign investors by addressing security concerns. In conclusion, it is time to investigate whether the current regulatory model is the most appropriate arrangement for the prevailing economic, social and cultural circumstances in Sri Lanka.

Key Words: Privatization, Telecommunication, Regulation, Rent-Seeking, Foreign Direct Investment

Table of Contents

List of Figures

List of Tables

Acknowledgements

I would like to express the deepest appreciation to my committee chair, Professor Yang-Ming Chang, who demonstrated his genius in the field of Economics in his teaching and encouraged me to do the research by providing the necessary guidance. Without his excellent guidance, this report would not have been possible.

I would also like to express my sincere appreciation to Professor Dong Li, the Graduate Coordinator, and Professor Wayne Nafziger for serving as committee members.

At last but not least, I would like to give my heart full of thank to Dr. Ganga Hettiarachchi, for offering me a Graduate Research Assistantship during my Master's study.

Chapter 1 Introduction

As a result of the transition of command based economies to market based economies, Sri Lanka has opened its doors to economic liberalization in 1977. Economic liberalization is surrounded by number of aspects such as institutional reforms, removal of barricades to market entry and establishing proper institutional system. In other words, it facilitates to close down the firms that fall into the inefficient category and also revolutionize the firms which need the change of ownership. (Balasooriya et al., 2007).

Under liberalization, privatization was one of the most prominent things that affected Sri Lanka in the mid-1980s. Privatization was adopted as to bring down the fiscal and administrative pressure of state-owned entities and to gear up the expansion private-owned entities as well as to encourage the government responsibility.

The basic principles to establish a successful privatization process includes the change in ownership from public sector to private, bringing forward policies to create a competitive market environment and establish a proper institutional framework to carry out the process (Balasooriya et al., 2007). With reference to (Commander et al., 1999) the strategies that are focused to create attractive market mechanisms and adjusted legal protocols to facilitate the entry, exit, taxation and other aspects would enhance the process of privatization.

According to (Smith and Trebilcock, 2001) even though liberalization and privatization are different in concepts, those two tend to overlap especially, in developing countries. In addition to that privatization has turned out to be a vital policy in terms of easing state's fiscal pressure. However, there are some arguments and controversies about developing State Owned Enterprises (SOE) without the support of privatization (Balasooriya et al., 2007).

The economic liberalization in 1977 was the most defining moment in Sri Lankan history, even though many efforts have been put to development activities since independence in 1948. The second wave of reforms in 1980's pushed this further to get involved private sector in economic activities. It was recommended that change of ownership, creation of market competition and establishment of institutional framework would definitely make the ground to reap the harvest of privatization. It would also ease the pressure of the financial burden of the government. Not only those mentioned above, but also the pressure from the international Aid Agencies such as World bank and IMF pushed forward the initial stages of reform of SOEs (Balasooriya et al., 2008).

After the economic liberalization in 1977, like any other aid dependent country, Sri Lanka have also accepted the five-itemed liberalization package namely, trade liberalization, devaluation of exchange rate, policy implementation for drawing FDI and boosting private sector, to put an end to price controls and engagement in massive public investment program. Sri Lanka forced its mindset towards the privatization of SOEs and as a result 98 out of three hundred SOEs were privatized and also 17 were shut down under public enterprises reform program by end of 2005 (Balasooriya et al., 2008).

This report examines and analyses privatization in Sri Lanka. Under that I explain three dimensions of privatization, namely, change ownership from public sector to private sector, competition and establishment of proper intuitional framework in Sri Lankan context. The analysis is based on secondary data and mainly focuses on the extent to which the prevailing socio-political culture of the country has affected the above mentioned dimensions of privatization.

Chapter 2 Government failure, benefits and stakeholders of privatization

Government failure is the market failure due to inefficiency of public sector. Government failure occurs when the government intervention to the economy causes more inefficiency of allocation of goods and resources than the absence of its intervention.

For example, when additional taxes are imposed on goods and services in order to generate more revenue to the government, prices will be increased exponentially. As a result, it changes the efficient market operation such as altering the consumer behavior by leaning them towards substitutes etc. In addition, when there is a rise in tax on income, it creates a dissatisfaction of a worker to work hard because a considerable amount of money will be deducted as tax from his/her monthly income.

Another example for the government failure is the excessive bureaucracy prevailing in public sector. This happens in the public sector, when Principle-Agent Problem take place which tells you that one party (principle) hires another party (agent) to execute some obligations that are in the best interest of the principle not for the agent. The government should appoint some authorities to resolve this Principle-Agent Problem and need to make sure that the public sector organizations are functioning properly.

Since there is a huge state intervention, all most all the economic actions happened with the influence of the government. This leads to less focus of the government to create the opportunity to make betterment to the people in the country. Also government uses lots of resources to develop public sector. People started criticizing the government's actions as they realized that outcomes of the actions would not be favored to them.

The above phenomenon is very significant in developing countries, since the intervention of the government on economic activities is high. The people in developing countries anticipate more payments of welfare benefits such as unemployment benefits and free treatments for their poor health conditions to maintain a good quality of life; the government failure is relatively more intense.

To minimize the adverse outcome of the government failure, privatization has been implemented. By implementing a market based economy with less government influence, the government is capable of paying more focus attention to increase living quality of the people through providing efficient services. Further, Privatization limit the government responsibility of investing on public enterprises and thereby government burrowing. Another advantage of privatization is the establishment of stability and the sustainability of the private sector in the long run which strengthen the country's economy. Furthermore, through competition among the private enterprises, the economic diversity increases which creates more diverse employment opportunities within the country.

For the privatization to be effective in long run and to be socially responsible, it is important to analyze the situation with regards to all the stakeholders and their involvement and values. Figure1-1 illustrates the stakeholders of privatization in the outer circle. The major stake holder of privatization process is the government. Interest of government is mainly on fiscal impact. In addition to that, government is also concern about social and political impact.

As another key stakeholder, private companies benefit by increasing opportunities for expanding their products and market. A main threat that they face is increasing competition. Employees are another important stakeholder category. More often, they undergo the feeling of job insecurity and forced to work in a completely different work environment. Especially technology inflow is high in private sector compared to the public sector which makes the necessity of the workers to be trained and adopted to those new technologies. In short run, this situation may cause dissatisfaction with this changing process and the government itself. Another important stakeholder that plays a significant role in making successful privatization is International aid agencies. They get opportunities to invest in the county under more flexible regulations, proper institutional framework and attractive market. In general, stakeholders of privatization are numerous and the interactions among them are complex.

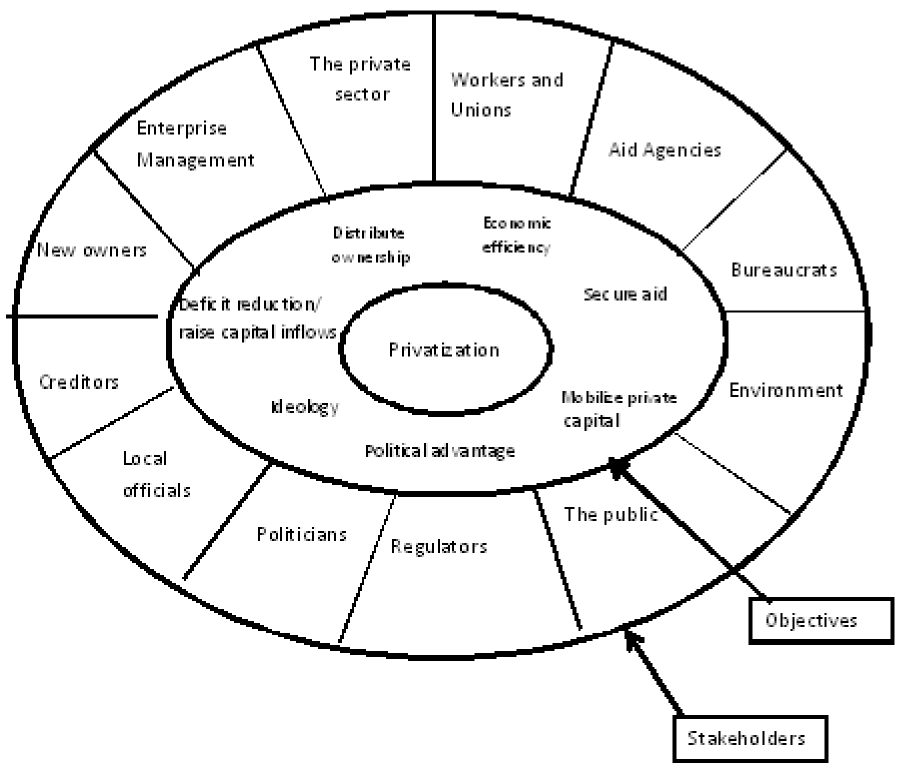

Figure 2.1 Objectives and stakeholders of privatization

(Source: Piesse (undated) and modified by Balasooriya et al. (2012))

Chapter 3 Privatization in developing countries

By the knocks of worldwide reform waves in early 1980's, privatization has found its access point to step into the economies. Especially, the developing countries have embraced privatization with intention of encouraging the private sector participation in economic activities that the government had previously been performed. In addition to that, they were more focused on fixing economic issues such as the growing foreign debt which is a serious economic concern and increasing inflation which will tremendously reduce purchasing power of money and rapid increments of current balance of payments deficits. Privatization was significantly contributed to find a way out for these problems, by promoting private sector more and more into the economic activities. To get accomplished, number of strategies were introduced for each above mentioned problems such as to improve the current account balance by promoting exports and limit imports or both, improve capital account balance by increasing cash inflows in terms of private foreign direct investments, borrowings from foreign governments, borrowings from foreign commercial banks, borrowings from multilateral firms or International Aid Agencies such as IMF and World Bank.

The inefficiency and the lack of ability of SOE's to get along with the varying economic conditions was a high concern in this privatization process. By experiencing this, most of the state owned organizations such as gas, telecommunication and distributions have been taken under private sector in most of the developing countries. For example most of the projects of the telecommunication industry have been entered into the privatization process in third world countries such as Ghana, Congo and Ivory Coast.

The primary and secondary objectives of privatization process with regards to developing countries have been listed in flowing tables.

Table 3.1 Economy related primary and secondary objectives of privatization in developing countries and related reforms.

Primary Objective	**Secondary objectives**	**Reforms**
Raise revenue	Reduce budget deficit	Transfer of ownership of SOE’s to private sector
Increase efficiency	Reduce public sector borrowing requirements (PSBR) Increase competition Eliminate state interventions Encourage private capital Attract private management practices Increase productivity and growth Adopt private management practices Induce better budgetary management Improve management in the public	Management contracts Contracting out Encourage employee buyouts Restructuring existing SOEs by adopting private sector management styles Introduction of performance indicators Better use of resouces Cutting costs Adopting a component

	sector organizations Elevate efficiency of assets currently owned by the state through market discipline Develop domestic share market Induce technology transfer and modernization	competition policy regime Establish truly independent regulatory regime Lifting barriers to foreign direct investments (FDI) Establish good governance practices Encourage joint ventures, public and private partnerships (PPPS)

Source: Developed in association with Hodge (2000) and Balasooriya et al., (2008).

Table 3.2 Political related primary and secondary objectives of Privatization in developing countries and related reforms.

Primary Objective	**Secondary objectives**	**Reforms**
Secure eligibility for aid	Win the political agendas Reward political loyalists Release the state burden of subsidizing and keeping afloat loss-making SOEs Respond to the globally prevailing ideology Reduce trade union power	Strengthen policy making capacity of the center of organizations Ensure greater accountability and transparency Raising labor discipline Raising labor discipline

Source: Developed in association with Hodge (2000) and Balasooriya et al., (2008).

Table 3.3 Society related primary and secondary objectives of Privatization in developing countries and related reforms.

Primary Objective	**Secondary objectives**	**Reforms**
Consumer sovereignty	Provide better consumer services through cheaper prices and better services Spread the ownership of shares to wider spectrum	Greater concern on competition and rivalry Induce quality standards Introduce broader reforms Create awareness about existing facilities and mechanisms
Encouraging wider participation from academic elite	To create more market oriented economy	Ensure ownership transformation hands into experts

Source: Developed in association with Hodge (2000) and Balasooriya et al., (2008).

Chapter 4 Significant reforms in Sri Lanka

Sri Lanka is a South Asian county located the Indian Ocean. It is an Island with the extent of 65,610 km2. According to the 2012 census, the total population in this country is 20.3 million and the population density is 323/km2 (Department of Census and Statistics, Sri Lanka, 2012). It has been estimated that the population growth rate in Sri Lanka is approximately 0.7%. Sri Lanka was ruled by British Empire for 133 years which was ended on 4th February 1948 as a result of a peaceful political movement.

From 1948 to 1957 the United National Party (UNP) governed the country. In this period, the government implemented open economy policy to encourage the growth of private sector. Government intervention for foreign trade and exchange controls were very little. However, in the late 1950's, direct government influence on economic activities began and increased in 1960's. The government policies restricted imports and foreign trade. Banking and insurance companies were controlled by the government. Also the government more focused on implementing import substitution industrialization policies. In 1965 the UNP was reelected and adopted policies that encourage foreign aid for the industries.

From 1970 to 1977 the Sri Lanka Freedom Party (SLFP) took over and maintained highly regulated and controlled economy which was targeted to achieve self-sufficiency. However, this political behavior on country's economy was not solely decided by the SLFP government. The government was forced to do so by the associated parties: Lanka Sama-Samaja Party (LSSP) and Communist Party (CP). During this period, the state owned industries were developed and created new employment and training opportunities in the state industries.

Again, in 1977, UNP was elected with vast majority of votes which enable amendment of constitution. By creating executive presidency, the government centralized the decision making in the country. This introduced market oriented policy package to the county's economy in 1977 which completely turned the country's economic activities. Foreign aids were remarkably increased. Remittance from Middle-east workers contributes to counties revenue immensely. All these lead rapid economic growth in the country. However, much attention was not given for privatization, mainly because of the fact that government supporters expect the government to create state employment opportunities.

In 1994, SLFP implemented privatization as a main program in the development. However, due to the feedback of workers and trade unionist several privatized companies were again taken to government control under Public Enterprises Rehabilitation act. This act was withdrawn later, considering the fact that this can discourage investors.

Since then, no major reforms for economic policies were done, although UNP and SLFP were elected time to time. Today, Sri Lanka has the most liberated economy in South Asian region.

Chapter 5 Privatization in Sri Lanka

Embracing the economic liberalization in 1997, Sri Lanka couldn't reap the harvest as expected due to government failure. Sri Lanka was opened its door to privatization before any country in the South Asian region. Since this country has high literacy rate, low infant mortality rate and long life expectancy, many experts believed that Sri Lanka would become a developed country in a little period of time. Further, some believed that Sri Lanka would end up among the Four Asian Tigers which are namely, Hong Kong, Singapore, South Korea and Taiwan. Those are the countries whose demonstrated an exponential growth within short time period and became role models to other developing countries. Having said that, Sri Lanka couldn't reach to developed state yet.

At the time of establishing privatization in, there was evident of a bubble inefficient SOE's Sri Lanka. To maintain these inefficient SOE's the government had to allocate 30 to 35 percent from annual budget and this was estimated for 10 to12 percent of GDP (Kelegema, 1993). At the same time the government had to spend large amount of national defense activities as North-East ethnic war was on the verge of expanding its wings. With all these burdens government could bear the pressure of maintaining these inefficient SOE's no further. Also the government had involved in massive investment programs such as building the parliamentary complex other gigantic projects instead of reducing their burden and creating better market mechanisms which are the tools in marketing when used together can achieve the overall marketing goal. Even though the prime objective of privatization was to create a market based economy which means production, distribution, pricing and investment decisions are made by the private sector owners of the factors of production based upon their own and their customer's interests rather than upon promoting some overreaching macro-economic plan.

Eventually, though the reform program was failed, the politicians were able to provide ample job opportunities to their political loyalists. To settle down the budget deficit the government had to seek for support from International Aid Agencies (IAAs) such as IMF and World Bank.

The progress of the privatization process can be discussed in three unique stages: sporadic attempt, systematic approach and structured approach. These three stages are discussed below, relating to Sri Lanka.

Stages of Privatization

Sporadic attempt

At this stage, the government had started sudden reform programs to entitle for foreign aids without creating the necessary groundwork for establishing a successful privatization plan. As pointed out earlier, changing of ownerships from public sector to private sector, creating a completive market and establishing a proper institutional framework are the mandatory conditions for implanting privatization. Without these conditions the government pretended that they are fully prepared for privatization to IAAs. When the government was about to initiating the privatization program there were huge protests from the employees of the SOEs because the most of the employees were appointed by the ministers as they were their political supporters. Even though the process of changing ownership from public to private sector was able to get done without going through number of agencies, the politicians handed over them back to their families, relatives and friends.

The US Aids provided us the required technical know-how at this point, but without the necessary political backing for this the entire program was ended up with a tragedy.

Systematic Approach

This was the second stage which was brought to light during the regime of President Ransinghe Premadasa in late 1980s. Two types of acts brought forward such as Conversion of Government Owned Business-Units (GOBUs) in to Public Corporations Act No. 22 of 1987 and the Conversion of Public Corporations or GOBUs into Public Companies Act No. 23 of 1987. According to (Kelegama, 1993), the government brought these acts with the intention of transforming the selected organizations and GOBUs into public companies. The government had approach the community with a very defensive strategy which was using the word "peoplization" rather "privatization". According to (Balasooriya et al., 2008), this name change was done by the government to bring down the objections of members of trade unions and to convince the general public that this policy for them. Some actions have been taken to omit public utilities such as Electricity, Water and Petroleum from the privatization process.

Structured approach

At this state the People's Align (PA) government required to establish a transparent privatization program which will create a win-win situation for both the economy of this country and people. Under this phase the government invited for competitive bids or tenders which helps to force its suppliers to compete and the buyer will get better value for money at the end and also this will diminish the favoritism and corruption. Employee company buyouts also have been taken place which creates more advantageous such as when employee company buyout occurs that motivates employees to strive for the success of the company because each employee now has a big interest in keeping the business doing well.

With that intention, the government established the Public Enterprise Reform Commission (PERC) in 1996. Under this approach 98 public sector firms have been privatized and 17 public enterprises have been liquidated but 7 firms have been unsuccessful because new owners have left the firms and the government had to take them under their custody. Initially, this seemed to be a very successful phase of privatization because the Treasury was able to generate 46.2 billion (Knight-John, 2004). Sectors such as Telecommunication and Gas have been taken under privatization at this phase.

Even though, there was some vagueness in some parts of this approach, apparently, this can be named as merely a structured approach. The government was failed in making a list of public enterprises which were supposed to be privatized after initial years of this stage. The best example is that the major two public banks in Sri Lanka, namely, Bank of Ceylon and People's Bank still haven't been privatized yet.

Thigh people believed that this approach would bring prosperity to the economy from privatization, in terms of solidifying the key role that private sector playing in the economy, bringing financial well-being and put efficiency to a high level in the industrial sector, eventually nothing was accomplished.

Rent seeking behavior

Rent seeking can be defined as spending resources to redistribute wealth among different groups without creating wealth with use of social the political power and influence or the corrupt interactions between the government and business such as a politician who accepts bribes from a firm to influence the decision of which firm will do the business with government. This stands in contrast with profit seeking in which the wealth is created.

After receiving the independence from British in 1948, Sri Lanka focused its mind set towards more nationalized and patriotic economic policies. In order to put forward this strategy the government used number of SOE's to create a state monopoly.

The government wanted support and the acceptance of the general public for these strategies. They convinced people that these transformations would bring prosperity to the country in terms of creating jobs, setting up standards to control prices on important commodities, establishing a proper and equal distributional system.

After some years most of the SOEs were running on loss and fell in to the unprofitable category due to following factors.

Overstaffing - Labor is the largest expenditure for most of the public sector organizations. An organization should employ an accurate and manageable amount of employees with the necessary skills and competencies. If an organization is overstaffed by unproductive and inefficient workers, that will be a waste of money for that organization. In the Sri Lankan context, the job appointments have been given to large number of people by minister since they are political supports.

Corruption- A series of political events and influences have awakened Sri Lankans to gross mismanagement and rampant corruption within nearly every organization and to the political leadership's indifference to what is effectively national theft.

Unproductive procurement systems - The requirements which have to be met by the logistics functions vary significantly between industries and businesses. Supply side logistics, distribution logistics, after market logistics all follow different arrangements and serve different market requirements.

The economic liberalization in 1977 was able to bring a change to these unproductive and unsteady financial conditions of the government. After some years of liberalization, SOE sector founds its own way to for rent-seeking and compensate the political patronage by providing job opportunities to political supporters rather than putting forward strategies to develop the economy.

According to (Balasooriya et al., 2008) these SOEs became more unprofitable as well as more unmanageable and undependable and the government's contribution to them from its annual budget was 10 percent of GDP. Further their research finding says that the International Aid Agencies (IAAs) who closely observed these malpractices from the very beginning and expressed their dissatisfaction and the aids were received by government to stabilize the a privatization process in the country and create the well-being of the economy.

Though privatization was formally introduced as one of significant national policy in 1987 in order to reduce the state burden and improving the efficiency of industry, didn't work out well due to the rent-seeking activities.

During the time of second wave of liberalization, the newly elected UNP government focused more to establish institutional structures which mean that the definite manner of arrangement that was produced by origination's complex structure of mutually connected elements and good governance activities. They paid their attention on these factors because of the issues that they had come across regarding transparency and trustworthiness of policies during the first wave of liberalization (Balasooriya et al., 2008). Anyhow, the activity of rent-seeking wasn't able stop from resurfacing even in this period because it was very much infiltrated the whole socio-political system.

Competition

Competition can be defined as the rivalry for supremacy. It is worthwhile to discuss why competition is beneficial to the whole economy and the consumers who are relying on it. Strong competition is the hub of the wheel of the healthy economic transactions. When there is a vigorous competition firms compete with each other to provide best deals of goods and services to consumers. As a result, not only the consumer will be able to get a best deal but also will get a stronger more economy. The potential gains from increased market competition can be listed as follows:

- Consumers will get goods and services at lower prices
- Ability to develop production methods and minimize costs with the improvement of technology.
- More differentiated products to consumers
- A faster track for both innovation and invention
- Better quality products on the market

The overall outcome of increase market completion would be economic well-being to the consumers.

Inconsistency in policy making

Most experts have identified that the inconsistency in government policies are responsible for a slow growth and development of a country. Sri Lanka had realized that private sector should play a major role in order to have a sustainable and solid economic growth get binding with competition.

After a decade from the economic liberalization, the government passed Fair Trading Commission Act of 1987 in the Parliament and established Fair Trade Commission (FTC).

According to (Balasooriya et al., 2007) the primary objectives of the FTC can be listed as follows;

- Bring policies to control monopolies, mergers and any fraudulent or dishonest trade practices that are prohibited by statue.
- To help to implement a national price policy

After sixteen years of time from the establishment of FTC, the government brought forward Consumer Protection Act (CPA) of 1987 and established Consumer Affairs Authority (CAA) by replacing FTC. The vision of CAA was “A well protected consumer within a disciplined business culture” and the mission statement was “To safeguard consumer’s rights and interests through consumer empowerment, regulation of trade and promotion of healthy competition”

The main responsibilities of CAA were to carry out both the functions of FTC and Department of Internal Trade (DIT), (Balasooriya et al., 2007). The government had realized that the formation of CAA was important focus on number of important concerns about the privatization program. According to (Indraratna, 2004; Knight-John, 2004), the adequate authority to interact with monopoly and merger events has not been awarded to CAA by the Act.

Some experts stated that there was no great need for a competition law since the economy is small and requires a higher level of expertise to implement it. There seemed to have an issue of providing the necessary funds to maintain institutions. An IAA representative had pointed out the non-existence of a competition law was a major loophole in legal system in Sri Lanka (Balasooriya et al., 2007).

Role of supporting institutions

It is a mandatory requirement to get the continuous support from supporting institutions, in order to create competitive market mechanisms. These supporting institutions should have a nationwide well-spread network that would provide interrupted guidance and assistance for the firms to strengthening the market conditions.

In Sri Lanka, the FTC's involvement was restricted for certain issues, especially for the complaints that they received by consumers (Balasooriya et al., 2007). According to (Kelegama, 2002), the involvements of the FTC were unproductive due to various reasons such as insufficient workforce, lack of knowledge, lack of resources and involving in the complicated, time-taking tasks. Similarly, the CAA wasn't able to demonstrate their capability and accountability to administer the competition and consumer complaints in an effective manner. There was a power struggle between the Chairman and the Director General which has made huge impact on service that the consumers expected from CAA. The appointments of both these positions at CAA were done by directly or indirectly by the Minister. The Chairman of CAA was directly chosen by the Minister. On the other hand, the Director General was chosen by the Authority with the permission and the printed approval of the Minister (Balasooriya et al., 2007). Due to the enormous political interference, the consumers weren't able to get the best service from these institutions.

Regulation

Regulations are the principle or rules based on and meant to carry a certain piece of legislation. When considering the service privatization, the government should become role model by providing the necessary guidance and direction to firms. In addition to that, the state involvement in this regards is mandatory as to provide necessary support in terms of stimulating market competition and take full advantage of efficacy in the economy. According to (Samarajiva, 2002) the government can establish a legal system through regulations to safeguard the consumers and shareholders from any market failure situation. Thus, most of the privatized service sector firms who were carrying their tasks under the public monopoly category emerged as a self-governing regulator. The prime objective of bringing up a change from public monopoly to self-governing, to become solely sovereign from the government and continuing its business in a unbiased way. As a result, this would definitely bring effectiveness and in excellent performance of the privatized industry.

The following factors can be identified as the limitations for establishing of a proper regulatory system carry out an effective market oriented strategy in Sri Lanka.

Political uncertainty and inconsistency in policy direction

Political instability spreads economic uncertainty and also gives birth to the corruption and inefficient administration which eventually giving a big blow on poor people of a country. On the other hand, consistency in policies would ensure the economic welfare.

In Sri Lankan context, there was an unsettled policy making environment in between 1994 to 2004. This was worsen off more because when the executive and the legislature controlled by two opposing parties. The executive powers have been delegated to the President of Sri Lanka from its constitution. Further the executive presidency has the power to decide whether he’s going to hold another election after a year of newly elected government.

These short term governments and unsettlement between the executive and the legislature have hindered the development of the reform program. On the other hand, the issues, conflicts and disagreements within government parties have pushed the process and the pace of policy making process to a more sluggish stage (World Bank, 2000).

At this point, the key economic threats such as rising debt burden, surge in global oil prices, and downfall of exports have been adversely affected inflation. Unfortunately, due to the ongoing political and administrative turmoil it seems that these economic issues are not on government's priority agenda.

Trade union power

An organization whose membership consists of workers and union leaders, united to protect and promote their common interests. They search for through collective bargaining with employers to:

- Protect and improve the real incomes of their fellows
- Improve jobs security
- Protect employees against unfair dismissal and other issues relating to employment rules and regulations.
- Request for better working conditions
- Provide a great deal of other work-related facilities such as support for people appealing compensation for injuries sustained in a job.

There are around 1600 trade unions in Sri Lanka and can be classified into three sections;

1. Trade Unions within public sector
2. Trade Unions with some various relationships with political
3. Trade Unions with that are not under any political influences

According to many experts most of the trade unions in Sri Lanka, belongs to the second category, which have relationships with political parties. According to (Kelegama , 1993), there are 42 labor laws and various standard court verdicts, when setting up trade unions of SOEs when they go under the process of privatization. Privatization often consists with so called labor cutback or belt-tightening process, it seems to be a burning issue from the point of employees. Further, most of the politicians take the advantage of trade unions for their personal welfare (Balasooriya et al., 2007). Due to this, the effects of reforms seem to be self-conscious. The prime example to demonstrate the trade union power is that the incident that strong protests emerged from trade unions avoided passing of the Electricity Reform Act 2002. If the trade unions did not object this Act seven companies could have been established by unwrapping the traditional Ceylon Electricity Board (CEB), (Balasooriya et al., 2007).

According to (Salih, 1998) Regulation has always been difficult because of trade unions bargaining power was raised over time due to the following reasons:

- The economy wasn’t not healthy and moving fast enough to promptly enroll retrenched labor
- Trade Unions realized that benefits and insecurity experienced due to retrenchment have increased over time
- Trade Unions were mindful enough to refrain from rent-seekers

As the government is concern about revenue generation by speeding privatization process, trade unions bargaining power increases. Government tends to provide quick solutions to labor issues, considering attracting private investors. Mostly labor requests are to improve their income and work facilities on which government has to finance additional amounts.

Chapter 6 Foreign Direct Investments in Sri Lanka

Foreign Direct Investment (FDI) is a part and partial of the privatization. FDI refers to a direct investment of foreign assets into a domestic organization. There are number of advantageous from FDI to a home country.

- Trade - FDI can open its doors wide range of opportunities in the exchanging of goods and services in terms of imports and exports.
- Technology transfer – with FDI the home country invites the introduction to world-class technology and technical expertise to their current work process.
- Increased competition – FDI increases the competition of the market of the home country because if other companies want to stay in the market, they have to perform their best.
- Development of the Human Capital – with the FDI, the home country gets the universally valued skills to perform certain tasks.
- Employment opportunities – FDI creates more job opportunities by funding various industrial divisions across the country.

In the Sri Lankan context, the enormous infrastructure development is going on, with the support of FDI in order to achieve a high and sustainable economic progress in the long term. Further, FDI helps to increase the economic efficiency along with production capability of the economy. The prime objectives of the economic infrastructure development program in 2010 were to develop the road system, water supply, ports and aviation, hospitals, housing and transport.

The following table categorized the major sectors which are relying on FDI in Sri Lanka.

Table 6.1Key sectors for investments and their growth in Sri Lanka

Sector	Sub Sector	Growth
Tourism and Leisure	Hotels / Resorts / Villas, Higher-end restaurants, Leisure / Entertainment and Theme Parks Tourist transport: Domestic and International Sea & Air transport Meeting Incentive Convention and Exhibition: MICE Domestic and International Air transport / Water-based transport Skill Development: Hotel / Hospitality Training Institutes	**Tourists arrivals:** Increment of 46% in 2010 than 2009. **Earnings:** Increment of 42% (US$ 501 million) in 2010 than 2009.
Infrastructure	Housing and Property Development, Shopping & Office Complex, Hospital Services and Medical Services, Warehousing & Logistic Services, Exhibition Centers, Industrial Parks, Construction of Highways and Railways	**Value addition:** Increment of 9.3% in 2010 than 2009. **Cement availability:** Increment of 18.1% (US$ 501 million) in 2010 than 2009.
Knowledge Services	IT Software Development, Knowledge Processing Outsourcing / Business Processing Outsourcing Industry IT and IT Enabled Services IT Training Sectors.	**Estimated target of Export revenues :** US$ 1 billion **Estimated Employment:** 100,000 by 2015

Utilities	Power & Energy Telecommunications and related services Ports development Radio & Television Broadcasting Distribution of Petroleum related products such as LPG & LNG Recycling of waste	**Power and Energy sector:** 2517 MW in 2010 and is forecasted to increase up to 5306 MW by the 2020.
Apparels	Apparel manufacturing Textile and Fabric Manufacturing Garment Accessories Garment related services such as Garment washing, Textile testing, Screen printing etc.	**Garments:** Exports to USA increased by 5.5% to US$ 1,678 million in 2010.
Export Manufacturing	Rubber, PVC Products Cement, Minerals, Metal, Transport Equipment ,Gem & Jewelry, Electrical & Electronics, Ceramic, Paper, Leather, Chemicals, Pharmaceutical, Boats, Food, Tea, Wood, Coir	**National industrial exports** Generates over 25%
Export Services	Shipping services, Other marine services (shipping services, crew exchange etc) Printing services, Management consulting, Aviation Services, Automation services, Other export services	**Sector growth** Increment of 8% in 2010 than in 2009
Agriculture	Cultivation and processing of fruits, vegetables, herbal and spices	Contributes 12% to the GDP of the country, 25% of total

	Deep Sea Fishing & rearing processing of fish Animal husbandry projects. Horticulture / Floriculture	export earnings and 30% of national employment in the year 2010.
Education	Branch campuses of leading Foreign Universities Higher Educational Institutes Hospitality / Tourism / Hotel Management Design Development Engineering, Nursing, Maritime Training	15 - State universities 6 - Post Graduate Institutes 9 - Other degree granting universities. The capacity of the state university system is limited and not more than 17% of the 120,000 students who qualify for university education can gain admissions to these Universities. **Targets:** To become the most preferred country for higher education in the Asian subcontinent by 2020. Enroll 50,000 foreign students into proposed private universities.

Source: Board of Investment, Sri Lanka (2012)

Privatization-related FDI has been a bright spot, accounting for a least one-third of FDI in the 1990s (United Nations, 2003). The largest 20 foreign investors in Sri Lanka started operating in the 1990s (Table 6-2). They are making a huge modification in telecommunications, power, ports, and other areas of services and manufacturing.

Table 6.2 Top twenty foreign investments.

Rank	Enterprise	Product	Home country	Cumulative investment as at end 2002 ($ million)	Ownership status
1	Sri Lanka Telecom (1997)	Fixed-line telecom	Japan	236	Joint venture
2	Lanka Bell (1997)	Wireless telecom network	Singapore and United Kingdom	148	Joint venture
3	Colombo Power (2000)	Barge-mounted power plant	Japan	141	Wholly-owned
4	Lanka Cellular (1993)	Cellular phone services	Singapore	141	Joint venture
5	South Asia Gateway Terminals (1999)	Port services	Australia and United Kingdom	131	Joint venture
6	JAIC Lanka (1997)	Apartments	Japan	127	Wholly owned
7	Overseas Realty (1996)	Property development	Hong Kong and Singapore	119	Joint venture
8	Kabool Lanka (1990)	Yarn	Republic of Korea	118	Wholly owned
9	MTN Networks (1995)	Cellular phone network	British Virgin Islands and Finland	117	Joint venture
10	AES Kelanitissa (Pvt) Ltd. (1999)	Power generation	United States	107	Joint venture

11	Shell (1995)	Gas	Netherlands	103	Joint venture
12	Ansell Lanka (1990)	Surgical gloves	Australia	96	Wholly owned
13	Air Lanka (1998)	Airline	United Arab Emirates	77	Joint venture
14	Prima Ceylon Ltd. (2001)	Food processing	Singapore	70	Joint venture
15	Asia Power (1998)	Power generation	United Kingdom	64	Wholly owned
16	Suntel (1996)	Wireless telecom network	Sweden	50	Joint venture
17	Colombo Dockyard	Port services	Japan	43	Joint venture
18	Ace Power Generation (1999)	Utility	Finland and United Kingdom	33	Joint venture
19	Orient Lanka (1996)	Trading	United Kingdom	31	Wholly owned
20	North Pole Lanka (Pte) Ltd. (1992)	PVC manufacture	Korea	27	Wholly owned

Source: Board of Investment, Sri Lanka (2003) (as amended by UNCTAD).

The latest value for FDI in Sri Lanka was $300 million in 2011. It was a decline of $178 million where FDI, net inflows for 2010 was $478 million. Over the past 41 years, the value of FDI net inflows has recorded highest value for $752 million in 2008. It reflects a 24% growth in the year compared to 2007 (Figure 6-1).

The reason for the height recorded value for FDI inflows in 2008 was the improved confidence of foreign investors on the country’s growth potential with the increased national safety.

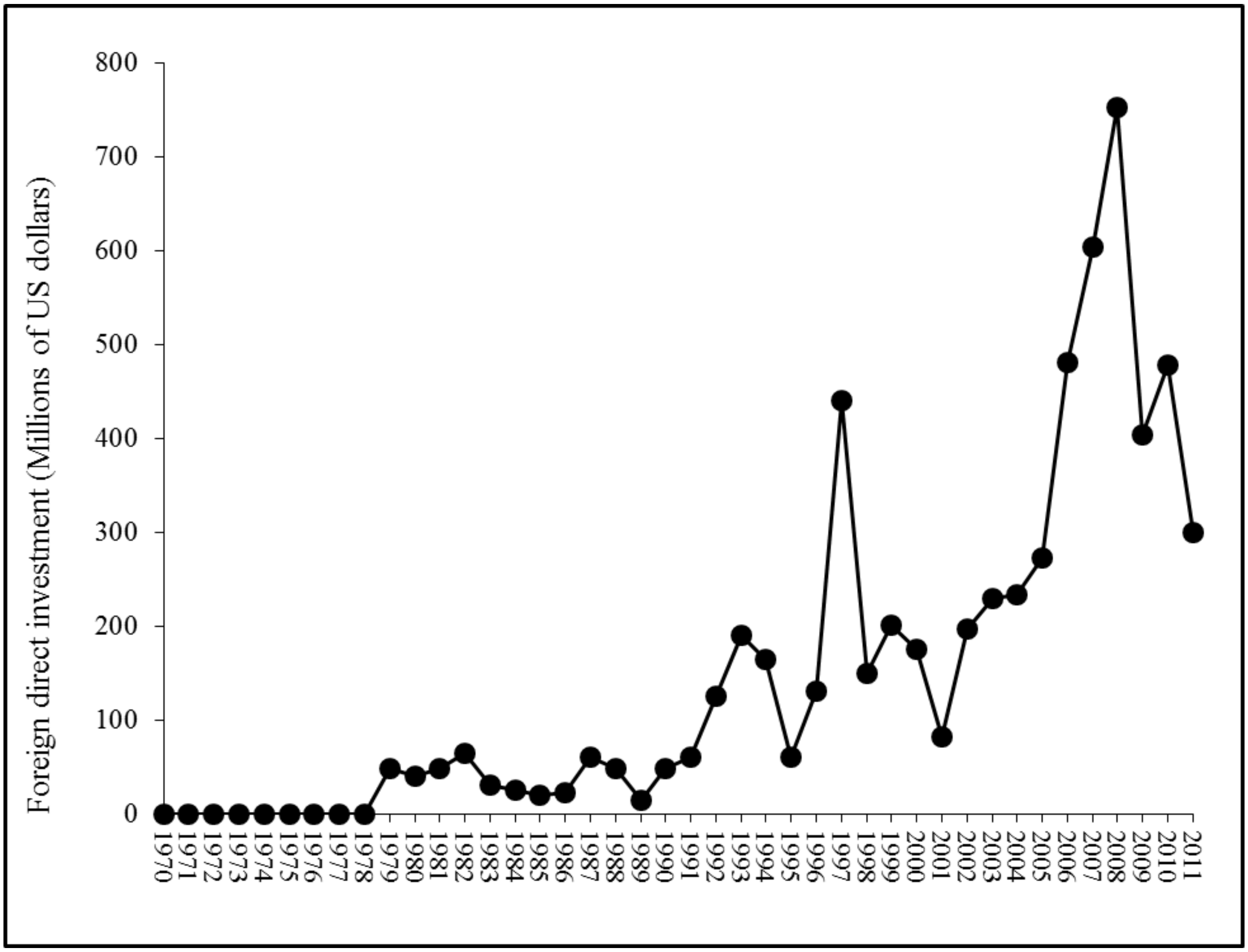

Figure 6.1 Foreign direct investments in Sri Lanka

Source: UNCTAD, World Investment Reports

Chapter 7 Outcomes of privatization Sri Lanka

In order to achieve a healthy economy through privatization, not only change of ownership, but also creating a competitive market and establishment of proper institutional framework is necessary. In the absence of competitive market, one or few companies get exclusive rights over controlling prices. This situation may wipe out the product completely from the market if the product is a non-essential commodity. On the other hand if this situation takes place with regards to an essential commodity creates a pressure on the consumers. Regulatory bodies are responsible to maintain the quality, prices and standard to protect the consumers.

Nevertheless, the main drawback of privatization in Sri Lanka is giving utmost priority to change the ownership but lack of emphasis on both creating a competitive market and proper institutional frame work. Two good examples are Sri Lanka Telecom (SLT) and Colombo Gas Company.

SLT has been privatized in 1996 and stepped in to operate in a different business climate. Not only the privatization but also the partial deregulation was providing the background support for this new change. The market rivalry was putting the pressure on SLT's market share and business margins. At this point, there was a strong call from shareholders to generate more profits.

As a company they had realized the change should be done to its organizational culture. This change brought forward by the company to entice the workers and make them satisfied with the job with the intension of achieving efficiency, effectiveness, market sensitivity and customer oriented service delivery.

Under this privatization process, SLT has taken number of significant steps to reach the above mention goals as follows:

- Introduction of Voluntary Retirement Scheme in 2003, to fix the problem of overstaffing.
- Introduction of 5S concept and Kaizen techniques to promote efficiency.
- Introduction of latest IT technologies to the organization to compete aggressively in the market.
- Introduction of quality training programs to its workers to provide a better service to the customers.

All these strategies, they put forward under privatization of SLT, was able to create a more competitive market (Balasooriya et al., 2007). Further, their research finding suggests that SLT achieved greater success and operating in the market with lower prices, improved value added services and a great variety of selection to customers. According to statistics Fixed-line telephones per 100 persons has increased from 0.7 in 1991 to 6.3 in 2005. (Balasooriya et al., 2006a; CBSL, 2006b).

The telecommunication industry showed remarkable progress due to increased competition among key performers especially in the mobile market segment. It was backing more than 7 percent of annual GDP (CBSL, 2006b). In addition, telecommunication industry was regulated under Telecommunication Regulatory Commission (TRC) which has numerous responsibilities to govern the telecommunication sector in Sri Lanka: processing applications for licenses, tariff regulation, monitoring and ensuring compliance with the act (Sri Lanka Telecommunications Act, No. 25 of 1991) and holding inquiries for consumer complaints and advertising on variety of telecommunication services.

The Colombo Gas Company is privatized in 1997. The most notable point is that, there was no regulatory body. Thus, all the privileges have been awarded to this monopoly supplier. Due to this fact, customers had to go through a tough time because of price escalations. For example, the price of 1 kg of gas was Sri Lankan Rupees (SLRs) 20 in 1995 (before privatization). This was raised to SLRs 74 in 2006.

Under given situation, unlike gas industry, telecommunication services achieve a significant success by privatization, since it was operated under a competitive market and regulatory frame work.

Chapter 8 Conclusion

With the market liberalization that stepped into Sri Lanka in 1977, privatization has been playing a major role as a means of moving SOEs from state ownership to private ownership. According to Economic experts, privatization improves economic efficiency, increases competitiveness and retains the consistency of the private sector growth in developing countries. We claim that the most important prerequisite for establishing a successful privatization program is the creation of proper and active institutional framework to support the three dimensions of the privatization namely, the change of ownership, creation of competition and proper regulation. Looking at the Sri Lankan context, discloses that under the existing socio-political background, this matter falls to unsatisfactory category. Since there wasn't proper and well organized approach with selected institutions at the beginning has resulted non-market transfers of SOEs. These were occurred according to the preferences of politicians of those times. Most of the organizations have been highly influenced by politicians in terms of appointments and participation of the operations decision making process. Organizational mangers or heads who were incompetence and inexperienced should be responsible for not carrying out the required institutional tasks. Similarly, the appointment of short term governments which heads towards the frequently changing leadership positions of these organizations has worsen-off the implementation of the reforms. Thus, we claim that the implementation of reforms should require extreme care of prevailing socio-political climate of Sri Lanka.

References

Balasooriya, A.F., Alam, Q. and Coghill, K. (2007), "Ownership, competition and regulation under privatization policy: the Sri Lankan experience", International Review of Administrative Sciences, Vol. 73, pp. 611-627.

Balasooriya, A.F., Alam, Q. and Coghill, K. (2008), "Market-based reforms and privatization in Sri Lanka", *International Journal of Public Sector Management*, Vol. 21, Iss: 1 , pp. 58-73.

CBSL (2005), Annual Report of Central Bank of Sri Lanka, Central Bank of Sri Lanka, Colombo.

Commander, S., Dutz, M. and Stern, N. (1999) 'Restructuring in Transition Economies: Ownership, Competition and Regulation', Annual World Bank Conference on Development Economics

Indraratna, S. (2004), "Consumer affairs authority act in the overall context of competition policy", in Kelegama, S. (Ed.), *Economic Policy in Sri Lanka: Issues and Debates,* Sage Publications, New Delhi, pp. 349-62.

Invest in Sri Lanka: Key Sectors For Investment
http://www.investsrilanka.com/key_sectors_for_investment/introduction.html
.

Kelegama, S. (1993*), Privatization in Sri Lanka*: *The Experience during the Early Years of Implementation,* Sri Lanka Economic Association, Colombo.

Knight-John, M. (2004), "Privatization and regulation", in Kelegama, S. (Ed.), *Economic Policy in Sri Lanka: Issues and Debates*, Sage Publications, New Delhi, pp. 363-78.

Samarajiva R. and Dokeniya, A. (2004), "Regulation and investment: Sri Lanka case study", *Stimulating Investment in Network Development: Roles for Regulators- Report on the World Dialogue on Regulation*, Regulateonline Org Kgs, Lyngby, p. 141-75.

Smith, D.A.C. and Trebilcock, M.J. (2001), "State-owned enterprises in less developed countries: privatization and alternative reform strategies", *European Journal of Law and Economics*, Vol. 12 No. 3, pp. 217-52.

United Nations (2003), *Investment policy review Sri Lanka*, United Nations conference on trade and development, UNCTAD/ITE/IPC/2003/8.