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Master's Degree Program in International Studies(International Area Studies)

**Strategic Industrial Policies for
Economic Development in Sri Lanka
(Lessons from South Korea)**

August, 2015

Seoul National University

Master's Degree Program in International Studies(International Area Studies)

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June, 2015

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DEDICATION

This dissertation is dedicated to my loving parents

for their unconditional love and

to

My ever loving husband, Chamikara Silva

who consistently encourage me to accomplish this task.

ABSTRACT

During 1960s Sri Lanka and Korea were earmarked almost similar positions in terms of economic, social and political conditions. However Korea gained a rapid economic development by introduction and implementation of new policies in their industrialization process while Sri Lanka was right away from its path. Therefore, this study investigates the industrial policies adopted by Sri Lanka since its independence and examines the impact and relevance of those policies and identifies the weaknesses and failures during implementation and also tries to compare with strategic industrial policies that Korea has experimented in its rapid industrial development process. This study considered the development plans setup by Korea during its development process. In here, I have developed a conceptual framework to address the issues I found in my investigations of industrial policy adoptions of Sri Lanka. Finally the study itself express certain suggestions which Sri Lanka needs to be improved to gain a rapid improvement through industrial development by learning lessons from the strategic industrial policies adopted by Korea.

Key words: Industrial Policies, Import Substitution Industrialization, Export led Industrialization, Sri Lanka, Korea, Development plans, Economic development.

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ABBREVIATIONS AND ACRONYMS

NICs	Newly Industrialized Countries
ISI	Import Substitution Industrialization
OECD	Organization for Economic Cooperation and Development
UN	United Nations
CBSL	Central Bank of Sri Lanka
IMF	International Monetary Fund
GDP	Gross Domestic Products
CISIR	Ceylon Institute of Scientific and Industrial Research
IDB	Industrial Development Board
FDI	Foreign Direct Investment
MOFP	Ministry of Finance and Planning
SMEs	Small and Medium Enterprises
LDCs	Less Developed Countries
HCI	Heavy and Chemical Industries
R&D	Research and Development
IT	Information Technology
FTZ	Free Trade Zones
WB	World Bank

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CHAPTER ONE

Introduction

1.1 Background of the study

Economic development has been more conversational topic especially in developing countries. Although there is no universal accepted method or strategy to achieve economic development, each country adopts different ways of their own. Economic development can be defined as a progress in an economy or the qualitative measure of it. It usually refers to the adoption of new technologies, transition from agriculture-based into industry-based economy and general improvements in living standards.

Economic growth is necessary condition for development and in this process, *industrialization* made leading role. Industrialization is a socio-economic process through which a society will change from pre-industrialization into industrialization (Abdullah.2009). This is mainly a part of wide modernization process through development of new technological and production methods. Falokun and Ayodele define;

industrialization involves developing the economy from its presently low state to a more efficient system of mass production of goods and services in order to improve that quality of life and standard of life of the citizenry. The historical facts reveal that all the developed countries of the world broke the vicious circle of underdevelopment by industrialization. When we study the pathway of economic development of developed countries such as United States, European economies and East Asian economies, we can see it clearly.

Therefore industrialization is a well accepted strategy for developing countries which are waiting for development of their economies if they can manage industrialization process properly. In my study, I would like to examine industrialization of Sri Lanka which had experience more than six decades but still couldn't achieve industrialized status. In here, I wish to investigate and in turn to adopt South Korean industrial experience as a bench mark of Sri Lanka industrial policy.

Sri Lanka was colonized by the British for nearly 150 years and then obtained independence in 1948 with strong publicly funded programmes that had been initiated during colonial rule and then extended until early 1950s by the post-colonial governments. These

initiatives provided literacy, basic health care and key staple foods to the population enabling the country to maintain and build on relatively healthy social indicators it inherited from the colonial era. Therefore, despite its low income level, Sri Lanka enjoys a reputation for having social and other human welfare indicators comparable to economies with much higher income in the region.

In this sense, Sri Lanka ranked as one of the most prosperous and developed Asian countries in the immediate post-independence era. Also Sri Lanka had a vibrant democracy, an open economy with strong commodity exports such as tea, rubber and coconut products and a high level of education, proper physical infrastructure and governance structures. With the independence, Sri Lanka has experienced different industrial strategies undertaken by different political parties from time to time but there were no considerable improvement of the industrial sector as envisaged.

Although Sri Lanka was considered to be a prosperous country in some social development indicators (life expectancy 75.1 yrs, Literacy level 95.6%, Per capita income USD 2922- Central Bank Report, 2012), still it couldn't achieve industrialized status. In 1950s and following years,

Sri Lanka adopted some industrial strategies parallel to East Asian countries such as South Korea, Taiwan, Singapore and Hongkong, to boost economic development, but Sri Lanka has not been succeeded. East Asian countries have successfully achieved industrialized status even though they had to face some difficulties on the way to their industrial process while Sri Lanka was still lag behind them.

1.2 Purpose of the Study

In Sri Lanka, industrialization was first emphasized as a national policy in 1950s when the government adopted a policy of imports substitution (IS). Since then Sri Lanka has been followed IS policy considerably long period of time when compared with other Asian countries. However this strategy did not accelerate the economic efficiency or economic growth of the country.

Hence, Sri Lanka moved away from IS trade in 1977 and economy was open to international market. Broad economic reforms were undertaken in 1977 and it resulted to increase industrial activities rapidly. The manufacturing sector grew rapidly at average rate of 8.25% per year during the period of 1977-1997 (CBSL). During the period from 1978–2001, the annual growth of industrial production grew; nevertheless, the

growth rate has declined somewhat after two three years. Therefore, it seems that there was no continuous improvement in industrial sector although it had experimented different industrial policies for a long period of time. Moreover, in the manufacturing exports, it has also been fluctuated since 1972 to 2009.

In terms of social development, Sri Lanka was well ahead of some developing nations however, it is more than six decades since the industrial reforms were implemented, still it couldn't achieve industrialized status. Therefore, it is useful to examine the reasons behind the lag or failure of Industrial development in Sri Lanka in terms of economic, social and political context. Then to investigate what lessons can learn from South Korea's industrial development experience in the context of Sri Lanka's industrial development.

The study will reflect on the South Korean industrial policies as a benchmark whilst synonymously examining and investigating the context of industrial policy development in Sri Lanka. The study further examines why there was a lag in terms of the degree and scope of its applicability to boost the Sri Lankan Industrial development. In this process I intend to achieve following objectives;

1. To briefly investigate the industrial policy revolution in Sri Lanka since Independence up-to-date and identify the impact and relevance of them for economic development in Sri Lanka.
2. To examine related problems of implementing the Sri Lankan industrial policies in terms of economic, social and political context.
3. To investigate and in turn adopt the Korean Industrial policy experience as a benchmark for Sri Lanka industry policy.

1.3 Research Problem

I would raise my research questions as follows;

- What types of industrial policies have been followed by Sri Lanka since independence up to date?
- What extents have these industrial policies affected to the economic development in Sri Lanka?
- What obstacles country had faced when implementing these industrial policies?

- How to use lessons learnt from the Korean industrial development in terms of social, political and economic context in Sri Lanka?

1.4 Research Methodology

The study will be carried out using qualitative method. The data that is used in the study consists of secondary sources and will be collected from; Reviewing previous research work done by various researchers and institutions, Reviewing the policy papers done by various institutions in Sri Lanka and South Korea, Findings from previous studies, The review of the economy (annually published by MOFP in Sri Lanka), CBSL reports, Publications of Senses and Statistics Department of Sri Lanka, previous dissertations and Web publications.

Further, this study explores the different tracks of industrial policies in Sri Lanka and South Korea. The initial part of the study investigates the industrial policies adopted in Sri Lanka since independence. Large extent follows a descriptive approach, through the policies to find there affect to the economy. The need to better understand the causes for strategies implemented by the different actors in the process of the policy-making led to a more explanatory and exploratory approach, as I got a wider knowledge on the industrial sector. Further, I hope to

discuss the literature on industrial policy in order to set the conceptual framework for the analysis of industrial policy in the context of Sri Lankan economy. I intend to use descriptive statistical tools like bar charts, tables etc. to analyze the figures both countries earn in their industrial development.

1.5 Structure of the Thesis

The study consists of 6 chapters.

First Chapter provides basic introduction of the study. It includes background of the study, purpose of the study, Research problem, methodology and structure of the thesis.

Second Chapter provides review of literature related to study field. It describes industrial policy in various aspects, what define industrial development, how industrialization works in the economic development, which strategy works better for developing countries; IS industrial policy or export led industrial policy? And government intervention and Opposing views of industrial development policy.

Third Chapter explains overview of Industrial Policy in Sri Lanka. In here it describes the socio economic overview of the economy, industrial development history of Sri Lanka since 1950s mainly

focusing its development plans. Also describes, current environment of industrial sector, critical issues in industrial development policy in Sri Lanka.

Fourth Chapter undertakes brief analyses of development experience in South Korea since 1950s. Mainly it focuses on seven five year development plans undertaken by South Korea from 1962 to 1997 giving more concern with industrial development strategies.

Fifth Chapter analyzes the industrialization and industrial policies adopted by Sri Lanka since independence in comparison with South Korea industrial policies in contemporary period to identify the weaknesses and failures of implementing the policies.

Sixth Chapter provides findings and conclusion of the study. In here I would like to conclude my work by giving major findings and lessons learned.

CHAPTER TWO

Overview of the Literature

2.1 Introduction

This chapter provides a brief review of the previous research work done by various researchers and institutions, with regard to the economic growth through industrialization. In here I used published case studies and some grey literature for my study. There are plenty of research articles for East Asian Miracle of industrialization. But, I found that there is a lack of previous articles related to industrial development of Sri Lanka. I hope to create a conceptual frame work after studying literature for the formulation of strategic industrial policies in the conditions currently being faced by Sri Lanka.

2.2 Industrial Policy through various aspects

From the theoretical point of view there are good grounds for believing that industrial policy can play an important role in promoting development. Some high or higher-middle income-countries like South Korea, Taiwan, Singapore and Brazil are often mentioned as examples of countries that successfully used industrial policies to catch up with

the rich countries. In general, Industrial Policy plan of a country can define as its official strategic effort to encourage the growth and development of its manufacturing sector. In this process the government should intervene aimed at improving the competitiveness and capabilities of domestic firms and promoting structural transformation. A country's infrastructure such as transportation, telecommunications and energy industry are considered as major parts of the manufacturing sector that usually has a key role in industrial policy. Now let's see some case studies, how industrial policy strategies helped those countries to carry out their economies towards economic development.

Sandesara, J.S. (1991) from his study of India's New Industrial Policy (NIP), he first asked a question of "What are the sources of increase in efficiency and production, as could be gleaned from the NIP?". He carried out his study keeping this question in his mind and found that the purpose of the NIP was raising industrial efficiency to the international level which accelerates industrial growth. And also he pointed out that the India's industrial policy and planning has a mix of economic and social objectives which are; the economic objective is

growth and social objectives are in the spheres of small industry, regional balance, concentration etc.

He further says that the NIP relates to industrial licensing policy, foreign investment, foreign technology agreements, public sector policy and Monopolies and Restrictive Trade Practices (MRTP) Act etc. He emphasized that the NIP is growth- promoting, mainly through improvement in efficiency of industrial production, even as it contains little to promote social objectives it may be expected eventually to sub serve almost all of the social objectives as well, except with regard to the objective of faster expansion of the public sector relative to the private sector. In his study he examined during the period of NIP adjustment, production may not only respond to the NIP within one or two years, but it may even slow down and subsequent period, industrial growth may be expected to accelerate in a sustained manner.

When considering the South Korean industrial policy, Westphal, Larry E (1990) says that, the Korean industrial policy has had two proximate objectives. When allocating resource, neutral policies had been used for well established industries to encourage export while non neutral policies have used for infant industries. He further says that, the Korea's

export performance thus attests to the speed at which Korean firms have acquired increasingly more diverse and more sophisticated industrial capabilities. They quickly established a position among the world's most competitive suppliers of many skill and technology intensive products.

In Korea's industrial process, the mass trading companies, the *chaebol* were the government's vehicle for undertaking the activities needed to strengthen Korea's export marketing capabilities. In their role as producers, they were the chief agents for implementing the central thrust of government planning in the mid-to late 1970s, which was to develop heavy industry (p.8). Also Westphal thoroughly emphasized that Korea achieved its rapid growth and also maintained international competitiveness because Korea maintained wide variety of industries as well as strong overall performance of its industrial sector (p.14). However he emphasised that there were mistakes and weaknesses of selective interventions to the industries and this caused dramatic deterioration in Korea's industrial performance at the end of 1970s.

According to Ajit Singh (1994) in his study of Asian Economic successes and Latin American failures in 1980s, he has emphasized four factors that affected to failure of Latin Americas industry policy.

They are; (i) misallocated foreign borrowings; (ii) Followed IS for long period and economies were not opened to foreign competition. (iii) State had full of corruption and mismanagement. (iv) Followed incorrect policies such as inappropriate exchange rates which led to capital flight which in turn greatly deepened the debt crises.

Generally we can say that industrial policy can sometimes work, but sometimes does not work. What distinguishes these cases? As we see earlier, an obvious difference is the type of industrial policy adopted in different cases/countries was very different. In Latin American countries came in the form of ISI with domestic markets closed to international competition while in South Korea and Taiwan, the model was instead export based with incentives created to induce the development of export industries. On the other hand Stalin in Soviet Union had an industrial policy according to his socialist ideology. Therefore it is clear that different economies had variation in adoption and success in different industrial policies.

2.3 What define Industrial Development?

Industrial development can be regarded as a heartbeat of every successful economy. It includes production of outputs to outside world in a large scale. In this process country uses technology, human

resources and physical capital because of that production level increases and also economic performance of the country increases. In the meanwhile unemployment decreases while foreign investors willing to invest in the country because all the economic variables are favourable for investment. As a result of that, BOP of the nation becomes favourable. In the long run GDP increase as all the macro economic variables make good performance of the country's economy. On the other hand industrial development involves extensive technology-based development of the manufacturing system of the economy. It could be seen as a "deliberate and sustained application and combination of suitable technology, management techniques and other resources to move the economy from the traditional low level of production to a more automated and efficient system of mass production of goods and services"(Ayodele and Falokun, 2003).

2.4 Industrialization for Economic Development

According to Paul Rosenstein Rodan(1961)in his "big push theory" emphasized the importance of industrialization for less developed countries. This theory is a concept in development economics or welfare economics emphasizes that a firm's decision whether to industrialize or not depends on its expectation of how other firms will

respond. There are two assumptions; an economy of scale and oligopolistic market structure and explains when industrialization would happen.

And also he further emphasized the large scale programme of industrialization advocated by this model requires huge investments which are beyond the means of the private sector. According to the theory the role of the government is critical for investment in social overhead capital. The idea behind this theory is that a big push or big and comprehensive investment package can be helpful to bring economic development. In other words, it can be explained as “you cannot do anything until you can do everything”. Accordingly, it seems that South Korea’s industrialization was one of the more relevance examples to prove Rodan’s theory.

Bae, Kyuhan.(1989)studied how has labour strategy been worked for industrialization in South Korea. He emphasized that the Korea is also a case of a dependent country that became industrialized and raised its standard of living even while it was dependent upon industrialized countries. He emphasised that Korea could easily achieve this success because of Korea's promotion strategy which depended heavily upon its

labour strategy. Moreover, he says Korea's method of dealing with the labour might reveal useful lessons for other developing countries as an industrialization strategy.

He further says, Korea was heavily depend on foreign capital, technology and trades and then gain economic growth combining them with Korean diligence, productivity, and low labour cost. Also it is known that the Korean government has played a leading role and those entrepreneurs and workers did their best to respond to a government agenda. Bae however, emphasized, Korea's strategy is not the best or even a good answer when addressing the problems of industrialization in the third world.

Different leaders had followed different ways when promoting industrializations. As an example, the way that Joseph Stalin promoted industrialization in the Soviet Union in the 1930s was completely different to the way that General Park Chung Hee did in South Korea in the 1960s. Therefore, it is clear that countries which achieved economic development have succeeded using industrialization even it was not implemented in similar pattern. On the other hand improving productivity performance is critical for rapid industrialization and

economic growth in any economy. One can say that the main goal of industrialization is to increase output using the more mechanized system of production. There are ample evidence that industrialization is the central theme of economic development and growth.

2.5 Import Substitution Industrial Policies (ISI)

In 1950s most of the developing countries have been adopted IS Strategies for their industries aiming economic development based on two scholars, Singer and Prebisch thesis. This thesis explains a formula for chronic economic problems such as unemployment, foreign exchange difficulties, lower economic growth etc and to resolve these issues government has to follow some kind of strict controls and also public ownership. Following this idea, most of the developing countries have adopted IS policy for accelerate their economies towards rapid development. However, there were plenty of cases which showed that this policy has not considerably contributed for development of those countries economy as they expected. The advocates point out that most developing countries that followed inward oriented policies under the IS strategy, mostly in Latin America, had poor economic achievements (Balassa, 1980). Not only that in the context of Sri Lankan experience,

1950s Sri Lanka adopted IS Strategy but it was not much helped to Sri Lanka's economic development while economy was backward for several decades.

An IS strategy was not properly worked in South Korea as well. It helped for some extent but not at all. South Korea's economy was started rapid development while experiencing both IS strategy to protect domestic industries and export oriented policy for expanding its products to the international market. When studying about the African region, the first strategy of industrialization adopted by Africa was introduction of ISI and it was started in the mid 1960s – late 1970s (UNIDO, 2006) after independence. They thought that ISI would enhance the domestic production of intermediate and capital goods needed by the home consumer goods industry. The ISI had much government support and protection of infant domestic industries from foreign competition. Though, during the period 1970-1980, the share of African manufacturing in GDP increased, the ISI did not achieve the desired expectations for diverse reasons ranging from high foreign exchange demand, neglect of agriculture and lack of capacity by domestic industries to compete in the foreign markets. (Ibbih JM,Gaiya BA-2013)

2.6 Export oriented Industrial Policies for Developing Countries

The economic growth is a complex process, which depends on many variables such as both human and physical accumulation, trade, price fluctuations, political conditions and income distribution, and even more on geographical characteristics etc. Economists believe that to gear the economic growth, export expansion made important role. There are some studies done by scholars that export led industrial policy help for developing countries to develop their economies. Let's discuss whether it is true or not by studying some cases.

Asif Dowla(1997)in his study of Bangladesh Export Processing Zones(EPZ), he found that an important development in the world economy in the 1970s and 1980s was the proliferation of EPZs, designated specialized industrial estates that produce mainly for export. In this process allow raw materials entering duty free in to country and finished goods leaving the country without tax. In Bangladesh, the first EPZ in Chittagong has been successful in generating employment and foreign exchange earnings, and the successes of the zone have led the government to make plans to open another EPZ on the other parts of the country. But he identified some difficulties such as Bangladesh has

small size of market and it has to compete with India and China to attract big multinationals. Also there was backlashes like the Chittagong EPZ has not turned out to be a vehicle for diffusion of technology because of poor backward linkages with the local economy.

In his study he noted that Bangladesh must make a hard decision whether to pursue the strategy of free trade enclaves despite attempts to liberalize the rest of the economy. The total cost of setting up an EPZ is quite significant for a country like Bangladesh, and to minimize costs and lessen the burden on the economy, the government should encourage privately managed commercial EPZ estates. Several investor groups from South Korea, Malaysia, and Japan have expressed interest in establishing industrial estates in Chittagong, and he says the government should allow private sector to open EPZs as well. He concluded his decision like, unless Bangladesh is able to institute a proper democratic tradition with a responsible opposition, EPZs might remain the best way to attract foreign direct investment into Bangladesh.

Emilio J. Medina-Smith(2001)has selected Costra Rica for his study to examine and test the Export Led Growth Hypothesis(ELGH). In 1980s, many developing countries stimulated export-led orientation because

most of them had to rely on multilateral organizations to implement adjustment and stabilization programmes to correct imbalances in their basic macroeconomic indicators as most of the countries were greatly affected by the debt crisis of the early 1980s. In here the main strategy was to encourage a free market through policies that relied heavily on the export promotion approach as one of the most suitable and trustworthy mechanisms.

Owusu J. Henry (2001) studied Ghana's wood processing industry after implementing Structural Adjustment Program (SAP) that is a package of market based economic reforms to arouse its ailing economy, in the early 1980s. He found that subsequently, there has been a dramatic expansion in the production and export of processed wood after Ghana adopted the SAP program. This expansion proves the validity of the proponents' argument as they employ the principle of comparative advantage, and use foreign loans to operationalise their export-oriented production process. It supports the view that the production process in developing economies becomes more efficient through competition. In this Ghana case processing wood for export was a good choice as this industry was based on natural resource which they can easily access.

2.7 Government Interventions

There is increasing evidence that governments have played an active supporting role in almost every case of successful latecomer industrialization. This can be applied to the USA, Germany and Japan in their early development and also it does the NIC of Asia as well. There are several studies in the literature that government's active role for adopting industrial policies for economic development.

Park, Yung Chul(1990) says that, although South Korea and Taiwan share common structural characteristics and export-led industrialization, role of the government differed in this two countries. Also government acted with private sectors in different ways like Korean government has been collaborative and coercive with private sector while Taiwan has been supportive with private sector. Therefore Park emphasized that there is no ideal model for role of government in development context and the success or failure of export-led strategies did not seem relate with policy activism. He further says that initial conditions, structural and institutional characteristics have been more important than the strategies or development ideologies in shaping the role of government in Korea.

Another Important lesson he showed in his study was that government should adjust with the economic changes. If government policies are inflexible with changing economic environment, it could be a cause of government's failure as it was in the case of Korea in the 1970s and in the 1980s in Taiwan.

Yoo, Iiho(2008) in his study focused on what lessons can get from Korea's economic development. In his study he mentioned the leadership with the vision on the market economy and the government which supports that efficiently is the minimum requirement for the development. However, he emphasised no country can achieve fast growth by just following Korean steps because of two reasons ;(i) Different in each country's economic, social and political environment (ii) there are strategies that couldn't contribute and strategies which were important factors of growth became causes of problem later. It should be reminded that the market oriented approach has been the basis for all these development strategies. Therefore, Yoo emphasized "it requires much caution and discretion when a country tries to adopt Koran Strategies of Development".

According to Wilson Perea and Analisa Primi in their book named "Theory and Practice of industrial policy- Evidence from the Latin

American experience” they emphasized that an in industrial policy, as in other policy areas, the State might play different roles. They stated four types of State interventions in support of industrial development; (i) As a regulator, by creating fiscal incentives or subsidies to support industrial sectors, (ii) As a producer, participating directly in economic activity, (iii) As a consumer, ensuring a market for strategic industries and economic activities through public procurement programs.(iv) As a financial agent and investor, influencing the credit market and promoting the allocation of public and private financial resources to industrial projects.

2.8 Opposing views of Industrial Development Policy

There are sufficient empirical evidence to prove both industrial policy success and failure. Literature has revealed that most of the empirical evidence on the effectiveness of industrial policies comes from the countries of the OECD and NIC in Asia. Industrialization in these countries builds on political systems with relatively well established rules and regulations, reasonable administrative capabilities, and a substantial degree of private sector activity. Much less empirical literature is available in case of low and lower-middle-income countries

because in these countries, they often have weak government and low capital accumulation.

According to Tilman Altenburg in his book named “Industrial policy in developing countries”, he has taken seven low and lower middle income countries named Egypt, Ethiopia, Mozambique, Namibia ,Syrian Arab Republic, Tunisia and Vietnam as case studies to analyze the potentials and risks of industrial policy during 2009 and early 2010. In his study, he confirmed that industrial policies may be implemented successfully even in low-income countries with weak institutions while identifying number of failed policies or at least raised doubts about cost-effectiveness.

By observing both negative and positive observations of his study, he extracted seven key lessons for industrial policy in low and lower-middle income countries. Briefly they can be mentioned as follows;

1. The political leaders must have the firm will to pursue a national project of productive transformation.
2. The above transformation projects need to build on existing comparative advantages and define incremental upgrading pathways.

3. The transformation should balance economic, social and environmental objectives.
4. Industrial policy is devised as a collaborative process of experimental learning.
5. The focus of industrial policy should shift from promoting established firms in traditional industries to supporting innovative ideas and encouraging experimentation.
6. The strengthening of linkages between firms and segments of the business community is crucial.
7. The international trade and investment links should be gradually increased.

He further says that, if governments bear the above lessons in mind, they can significantly accelerate upgrading and diversification of their economies. Beyond these general lessons, a good deal of trial-and-error learning is needed to find the most appropriate industrialization pathway for each particular country.

Though the situation is perhaps less bad in Latin America with even a few successes, particularly in Brazil, it is again generally true that government stimulation of industry in Latin America has not been a success. Most government protection and subsidization of industry did

not create internationally competitive firms it rather led to uncompetitive monopolies or oligopolies producing poor quality goods for protected domestic markets.

According to Rhys Jenkins (1991), he analyses the industrial performance of two East Asian (South Korea and Taiwan) and three Latin America (Argentina, Brazil and Mexico) NIC for his study. He argues that the better performance in East Asia is not due simply to differences in trade orientation or the degree of state intervention, but rather to the effectiveness of intervention. Rapid industrial accumulation in the East Asian NICs reflected not only the attractiveness of such investment, but was also, at least in part, a consequence of the closing off of opportunities for non-productive investment (ILO, 1988: 42). Land reform limited the opportunities for large-scale investment in land, while public ownership of the banking system meant that financial investment was less attractive. Also capital flight too appears to have been less of a problem in East Asia than in Latin America (World Bank, 1985).

Moreover he explains the key to the superior industrial performance of the East Asian NICs does not lie in the general superiority of export-oriented industrialization strategies over IS or of market oriented

policies over state intervention as some writers have suggested. It is rather the ability of the state to direct the accumulation process in the direction which is required by capitalist development at particular points in time which is crucial. Further he highlighted that specific historical experience and the international context gave rise to such states in East Asia but not in Latin America in the post war period.

Some of the best example for unsuccessful industry policy comes from Sub-Saharan Africa. After independence many African countries adopted different types of industry policy; Ghana and Zambia had very ambitious five year plans which were often led by the public sector. Unfortunately, these countries couldn't generate internationally competitive industry because of inefficiency of those industries. It is clear and widely accepted that industrial policy may work well in countries with strong meritocratic public services and political checks and balances.

There is debate on how can industry policy be used in Sri Lanka. How can Korea's industrial experience be replicated in Sri Lanka development context to achieve industrial development? I found that there are limited analytical studies in Sri Lanka in this area.

CHAPTER THREE

Industrial Policy in Sri Lanka

3.1. Current Socio-Economic Overview

Sri Lanka is an island located in the Indian Ocean to the south of India. The area of the land is 65,610 Km². Sri Lanka is considered to be South Asia's outlier in terms of the incidence of absolute poverty and severe deprivation. It was ranked 92 among 187 countries in the UN Human Development Index in 2012 that was 0.715. Sri Lanka has a population of about 21 million; 51.5% of whom are women and 48.5% of whom are men. The population growth rate is 0.9% in year 2012. The life expectancy at birth is 75.1 years (2012) and literacy rate is 95.6 % (2012). The per capita income is USD 2,922(2012).The GDP growth rate in 2012 is 6.3% and the rate of unemployment is 4.0% in 2012(CBSL-2013). The IMF classified Sri Lanka as a middle income country in 2010("Mahinda Chinthana" development framework-2006-2016).

Sri Lankan economy is basically dominated by agricultural sector which consist 29.7 % (2013) of the population. Also the agricultural

sector is responsible for 10.8 % (2013) of the value of Gross Domestic Product (GDP). It is the main source of livelihood of the rural population which accounts for 70% of the total population. The industrial sector employs 26.2% (2013) of the work force and generates 31.1% of the GDP (2013)(CBSL Annual report-2013). It seems that, although agricultural sector dominated in the economy, industrial sector is the major contributor of the GDP.

In the export earnings of Sri Lanka, industrial goods have great share comparing with agricultural output. Among the industrial goods, textile & garments sector viewed as potential one while among the agricultural sector, tea is recognized as the potential as an export item (Economic and social statistics of Sri Lanka, 2012). Sri Lanka's other major industrial exports are rubber products, gems, diamonds & jewellery etc. The Other agricultural exports are spices, coconuts, sea foods and in recent times foliage plants and flowers are also being exported. On the other hand, the tourism industry plays a major role in the country's economy with around recorded 400,000 tourist arrivals every year.

When consider the imports, fuel imports has been the highest while textile articles and chemical products are become second and third respectively under the category of intermediate goods, in the import

composition. Under the importation of consumer goods, foods and beverages make higher amounts among others while, under the investments goods, machinery and equipments makes higher amounts while building materials and transport equipments comes second and third in the composition of imports.

3.2 Industrial Development History of Sri Lanka

3.2.1 Before Independence

British captured Sri Lanka in 1815 and ruled more than 150 years. They changed the system from agriculture economy to plantation market economy aiming to provide raw material for their Motherland but not inclined to engage itself directly in the promotion of industrial development in Sri Lanka. They established factories for processing tea, rubber and coconut and few allied industries such as brewery, textile mill, some small scale industries to produce paper, soap, plywood etc.

In 1931, the British granted Sri Lanka limited self-rule and this new policy reforms established the Bureau of Industrial and Commerce recognizing importance of orderly development of domestic resources. The efforts were also made in 1935 to develop the economy by developing agricultural sector for the local food production and

planning of minor industries to meet local demand for manufactured goods using local resources. In 1938, Department of Industries and Commerce was established for the purpose of preparing planned development of industrial activities.

The industrial policy of the government has changed considerably between 1939 and 1946. The government had taken steps to establish factories producing essential manufactured goods using indigenous raw materials such as coir, plywood (Sriyani Dias-1987). And also steel rolling and glass factories were set up by the government during this period. By 1948, Sri Lanka's major manufacturing concerns comprised a number of government sponsored factories such as Steel, Plywood. Sugar, Ceramics, Hardware, Textiles etc, and a few privately- owned (British firms) factories such as tea (factory), rubber (factory), Petroleum etc.

3.2.2 Period from 1948 to 1956

The government of Sri Lanka has initiated active steps to develop the industrial sector with the attainment of political independence in 1948. The major objective of the first six year plan (1948-53) was to reduce the dependence of the country on imports and diversify the economy by giving priority to domestic industries. However, most of the factories

which already setup were difficulties under conditions of normal competition from cheaper and high quality foreign imports and this led to closure of most of these plants. In this planed period, cement project was the only one that has succeeded while other factories such as manufacture of paper, textile, iron and steel, fertilizer and vegetable oil remained at preliminary stage.

To overcome these issues, government has introduced legislation “The industrial product act no.18” in 1948. By 1954 government pronouncement were placing less emphasized on state- run industrial enterprises while new policy was stressed private enterprises giving them initial support from the government. Under this new policy, private sector was recognized as partners in industrialization. In 1955, the Ceylon Institute of Scientific and Industrial Research (CISIR) and Development Finance Corporation were setup to foster private enterprises. However, it was unable to find whether it was helped to foster private sector or any support to the countries industrial development.

The next six year plan (1954-60) was formulated by the government, because of the first plan has not been succeeded as expected. The purpose of new plan was, ensuring “Properly co-ordinated planning and

supervision of government capital investment programmes.”The major transaction implemented in new plan was, to transfer government enterprises to the private sector and encourage foreign companies to invest in Sri Lanka. However, the Plan had very little impact on actual investment allocations because during this time commodity prices plummeted and there was a political debate on national priorities. Therefore, before much work could be started under this plan, the government changed in 1956.

3.2.3. Import substitution Industrialization 1956-1965

The export sector which was implemented during colonial period began to suffer due to deterioration in the terms of trade especially in the late 1950s. Therefore, the food self sufficiency and industrialization thus emerged as priorities in all economic planning programs. The new government formulated a long term plan covering ten year period (1959-1968) with include of IS strategy for their industrial development while continuing plantation crops export realizing that the only strategy for economic development was “Import Substitution”, as many other developing countries did during this period. The government categorized all the industries in to three groups; (a) Basic heavy industries such as iron, steel, chemical, cement, fertilizer, mineral sands

and salt which were exclusively under the public sector, (b) Other heavy industries such as textile, tyres and tubes, ceramics, vegetable oil refinery and glass which were under both government and private sector, (c) light consumer goods under private sector. This was the most ambitious analysis of the economy and projection of planning that had yet been officially published. This plan sought to increase the role of industry in the economy. Under IS strategy, government adopted protectionist system; promoted products to the domestic market, protection of domestic assembling industries and many financial policies such as licensing, high tariffs, quotas, quantitative controls on luxury goods and foreign exchange and extensive intervention in industrial management etc. This period seemed Sri Lanka's end of classical export economy and moved towards state led industrialization. It is somewhat similar with the experience of contemporary less developed country of South Korea.

Unfortunately, the plan failed to achieve its targets as the Prime Minister was assassinated in 1959 and hence it was abandoned, at its beginning and translated in to three year development action programme (1961/62-1963/64). This plan recommended shifting less capital intensive and more labour intensive investment. In 1961, import

licensing and quota system were introduced for several semi essential consumer items controlling other imports. Restriction of imports, on the one hand, was crippled as more than 60% of the imports represented essential consumer items. Although government tried to promote domestic private industries by doing so, yet the private sector in the island was at its infant stages and was not in a position to undertake massive industries. The government although announced several policy packages to attract foreign direct investment. But a restricted and a controlled economic regime never attracted the foreign investors in investing in Sri Lanka.

Moreover, a highly controlled economy coupled with a feeble private sector created a supply gap in the economy which made the state take up the role as a producer in the economy. This made the government to get directly involved in the industry by expanding the allocation of economic resources to state owned industries and for the setting up of public sector industrial corporations. The government established and expanded large number of state owned enterprises in industry for the production of a wide range of goods such as paper, cement, steel, hardware, petroleum products, fertilizers, tyres and textiles. As a result

of this improvement in the industry sector, the economy grew 4.8% per year, during the second half of 1960s (Central Bank of Sri Lanka).

However, this plan failed to achieve set targets because, with the exchange and price crunch of end 1961 and plan became increasingly out of touch with the changing economic situation.

3.2.4 Export oriented Industrialization 1966-1977

However, the government has given greater emphasis upon agricultural sector than industrial development between 1965 and 1969 encouraging agro based processing industries based on domestic raw materials and indigenous technology. Hence, development of public sector industry which was already underway was collapsed. In the meantime, government has taken steps to encourage small and medium scale industries and the Industrial Development Board (IDB) was setup in 1966 to provide facilitate to those industries.

In 1970, a new government came in to power and formulated a new five year plan and the key element of this plan, (1972-1976) was “new export sector based on industrial production” and has taken number of steps to encourage export oriented industrialization. It envisaged rapid growth in agriculture, not only in the traditional crops of rice, tea, rubber, and coconut, but in such minor crops as sunflower, manioc,

cotton, cashew, pineapple, and cocoa. This plan proved to be based on overly optimistic assumptions, and it soon ceased and in 1975 it was replaced by a Two-Year Plan that placed even greater emphasis on agricultural growth and less on industrial development.

Since all the above efforts had failed and the industrial growth had become increasingly dependent on the foreign exchange earning of traditional exports which were themselves suffering from both instability and stagnation in this period.

3.2.5 Outward looking strategy from 1977

In 1977, new government came in to power adopted an outward looking strategy by move away from IS trade policy which was lasted for a long time. Under this new economic liberalization, set of reforms has been introduced by the new government which can be listed as follows;

- Steps were taken to devalue the rupee by 100%.
- Allowed unlimited importation of items to the country with only a limited list of items on specific licensing.
- Promotion of private enterprise including Foreign Direct Investment (FDI).
- Limits on expansion of the public sector industry and steps were taken to privatize existing government institutions.

Its first Five-Year Plan (1978-83) included an ambitious public investment program to be financed largely by overseas grants and loans. Its immediate objective was to reduce unemployment, which had risen during the tenure of the previous government. The government has taken measures to promote export oriented industrialization through introducing export incentive schemes, financial assistance schemes, fiscal and tariff concessions and import liberalization policy etc.

Following with the liberalization, annual average rate of growth which stood at 2.9% during 1970-1977 increased up to 6.8% and the manufacturing sector started to play a key role in the economy in terms of generating high levels of production, foreign exchange earnings and employment. When considering export composition, the apparel and clothing industry surpassed tea which was the main export item from Sri Lanka to Britain since colonization period. Then apparel became the country's largest export item and foreign exchange earner in 1986 and accounted for more than 52% of total export of the economy (Rupa Deerasinghe- Challenges, prospects and strategies for the garment industry in SL.p33). However, Sri Lanka couldn't maintain its economic growth in the following years and as a result, it suffered from

low growth again in 1987-89 period mainly owing to the insurgency in these years.

There was a serious issue Sri Lanka has been facing specially after the 1977 is debt crisis. As Sri Lanka was largely depends on overseas loans, problem of high public debt and interest payment for them is a one of the major problem. It caused high fiscal deficit and declining government revenue and rising cost of borrowings as well. Meanwhile, the Industrial Policy Statement of 1987 by the MOFP speaks of the vulnerability of the economy due to dependence on a 'narrow range of agricultural exports' and identifies a clear need for industrialization. Early 1988 government owned industries showed 60% industrial outputs. Even though, most of the Stated Owned co-operations had faced troubles due to the inefficient management, insufficient technical planning, over staffing and defective of pricing policy in the beginning of market base economy in that period. As a result, some of industries transferred to private control enterprises.

Subsequently, the government was enacted Industrial Promotion act No 46 of 1990 to facilitate industry sector of Sri Lanka. The act allowed establishing a commission and advisory committee and to set up

regional committees mainly to facilitate in every matters of industries. During this period, industrial growth in private sector became prominent dominating textiles, food and beverages, wood products, rubber and plastics, and other consumer goods as main products while industries such as oil refining, and electric power generation were continuously remained under state control.

The new government was elected in December 2001 with the new slogan of '*Regaining Sri Lanka*' programme. Under this program, the new administration approached to shifting commercial resources to the private sector, through privatization as a resolution of loss making enterprises to be accelerated. Accordingly, at its beginning, considerable amount of manufacturing companies were privatized including Lanka Lubricants, Colombo Gas Company, Ceylon Steel Corporation, and Sri Lanka's flour mill (Annual Reports of Ministry of Industry and Commerce). Even though, records shows that the relative share of manufacturing sector in GDP in this period remained slightly declined resulting from the negative growth of -1.5% in 2001 due to the political instability in the economy. However, there were big controversies among political parties while implementing this program.

As a result, this programme couldn't continue because of government has changed.

3.3 Current environment of Industrial sector in Sri Lanka

At present, industrial sector in Sri Lanka comprises a range of large corporate firms, SMEs as well as micro or house hold businesses that are based on self employment activities. SMEs are considered as the back born of national economy because it account for about 70% of all industrial establishments and 31% of total employment (Development framework -2006-2016). The Industrial development under “Mahinda Chinthana” policy frame work described economic perspectives as, *“national economic policy will be formulated by integrating the positive attributes of the free market economy with domestic aspirations in order to ensure a modern and balanced approach where domestic enterprises can be supported while encouraging foreign investment”*(Mahinda Chintana 2005, p 39). Industrial sector has focused to enhance its contribution to reach the GDP value; US\$ 98 billion in 2016 under this policy frame work.

The growth in the industry sector in 2012 was 10.3% and it was the highest growth recorded during the past 33 years in value added terms.

In 2013 it was decreased up to 9.9%. During the last decade the average annual growth rate of the industrial sector has been 6.2% and sector comprises 78% of the value of Sri Lankan export. The textile and garment sector accounts for the largest share of manufacturing activities and export generates more than USD 3 billion in export earnings per year amounting to on half of the country's export earnings (Central Bank of Sri Lanka, Annual report).

The industry sector growth was largely pushed by factory industry and construction activities. Recently, the government extended its support to industrialists through the fiscal policy measures and other programmes aimed at enhancing value addition of export orientation, import substitution and SME development. Also essential constructions such as new highway roads, new air port, harbours, rail way, and telecommunication system directly involve with the development of industrial sector has been given priority.

Sri Lanka's industry sector has been categorized according to the main activities as follows;

- Mining and quarrying
- Manufacturing – Processing (Tea, Rubber, Coconut)

Factory industry

Cottage industry

- Electricity, Gas, Water
- Construction

Mining and quarrying

Sri Lanka has various minerals like ball clay, calcite, dolomite, gemstone, graphite, mica mineral sand, phosphate, silica sand etc which can be used in industries such as cement, gem & jewelry, ceramic products, glassware petroleum products, parts of aircrafts etc. The category accounted for 2.8% of the GDP in 2012. The gems and semiprecious stones are among the leading export mineral commodities. (CBSL 2012, Sri Lanka Customs).

Manufacturing – Processing (Tea, Rubber, Coconut), Factory industry, Cottage industry

The manufacturing sector is often the major contributor to GDP and attractor of policy makers in the country and also the largest sub sector of the industry sector.

Generation and Distribution of electricity, Gas, Water

This includes generation, transmission and distribution of electric energy and collection, purification and distribution of water for sale to household, Industrial, commercial or other users.

Construction

The construction sector accounts for the majority of the total investment as country is marching towards an economic expansion after the end of the 30 years war. This sector GDP stood at USD 1.9 billion in 2012.

Out of Sri Lanka's total revenue in respect of export structure in 2013, 80% of export earnings were derived from eight product sectors. Textile & Garments and tea contributed high value of 43% and 15% respectively while other 6 sectors contributed to the rest. The Central Bank report in year 2013 says "The current industrial policy of the government is focused on the creation of a globally competitive and knowledge based manufacturing industry sector, with the maximization of value addition in exports". These objectives are expected to be achieved by making the micro economic environment conducive to rapid industrial growth, encouraging private sector participation, promoting direct, foreign investment, facilitating the expansion of SME's, and promoting regional industrialization.

In the last decade the economy has witnessed significant contributions from other sectors like industrial exports, and the IT sector. There has been a steady growth in revenue from the software companies of Sri Lanka over the last few years with many US and European companies

outsourcing their software developments to Sri Lankan organizations. The government has taken the strategic policies to rise up the economic growth through the export oriented business development in the Sri Lanka specially in the year of 2013.

3.4 Critical issues in industrial development in Sri Lanka

As discussed earlier, Inward looking policy has not been helped with the problems which were hanging Sri Lanka's economy while it was further worsened. Athukorala(1980)says that, Sri Lanka's manufacturing industries had high level of import dependence. The manufacturing sector relies on imports for most of its raw materials. And a significant share of private consumption is also met out of imports. It is this high degree of import dependence that has made the economy vulnerable to the changes in the international market.

As Sri Lankan garments depend on few major buyers, like USA, Europe and UK their reactions were highly effected to the export volume of the garments. Other important issue is reducing quota which Sri Lanka received mainly from the USA because of other competitors. Therefore, new markets have to be explored in addition to diversify the

exports products as to obtain better export performance as well as for higher revenue.

Under market liberalize policy, the world market was fully opened to Sri Lanka and allowed almost all kind of products to import and because of this, domestic production was collapsed. This affected badly to countries local manufacturing industries. Sri Lanka is still experiencing it although it make burden to external trade of the country.

The privatization of the government owned industry is another debatable issue. These industries losses due to political interference, mismanagement and corruption and the answer is restructuring, not privatization. This was a major debate in the industrial sector in Sri Lanka.

The tea industry of Sri Lanka has not performed well in the competitive global tea market in the recent past as well as at present as it did in the earlier period. Sri Lanka was one of the best countries for export tea to the world market in the past. However, the position Sri Lanka had for the tea those days were significantly loosened although Sri Lanka has potential for improves this sector by value adding the tea products. Tea has long been the main sources of its foreign exchange earnings. Records show that the Productivity of the tea sector has been falling for

a long period of time due to harsh macroeconomic policies adopted which paralyzed the tea sector and ended with a gradual loss of competitiveness to other producers in Asia and Africa.

It is well known that the industrial facilities often severely pollute the air, water, and land. What should also be understood is that a further extension of past patterns is not the inevitable consequence of industrialization. Rather, such problems reflect inefficient technologies or wasteful processes, as well as carelessness and lack of appropriate legal and economic policies.

Most of the investors do not intend to establish an industry in Sri Lanka owing to the bribery and corruption involved by the politicians at different stages on the part of obtaining various approvals needed by the Government Institutions which compel the Investors to take away such investments out of the country.

It seems that the Banks being reluctant to lend to industries specially SMEs with inadequate collateral and unproven records because banks nowadays more interest for pawing, consumer loan, vehicle loan rather than giving loan for industries because they can earn more profit by giving loans for other purposes rather than industry sectors.

In Sri Lanka to open a new industry takes long period of time and during the process since purchasing a land and until starting an industry there are various kind of documents one have to prepare and for this documentary process it has many difficulties and also many laws, rules and regulations introduced by the government, to follow. Therefore, prospective investors hesitate to start new industries even though they are interested to start an industry. Manufacturing investors frustrate of all these ineffective processes.

Also in Sri Lanka, chargers for electricity is very high compared with other countries. One can say that Sri Lanka experience some of the most costly electricity rates in Asia. As we know that electricity is very essential for industries.

Above facts can be mentioned as critical issues which Sri Lankan industrial sector have been facing. Still these issues are visible in the industrial sector.

CHAPTER FOUR

Industrial Development Experience of Korea

4.1 Introduction

South Korea has some kind of similarities with Sri Lanka in terms of historical background, economic characteristics, socio political aspects, land size and also both have an experience under a colonial rule as well. From their independence both countries have somewhat similar initial conditions such as both were typical LDCs with dualistic, resources poor, labour abandon economies. Not only that both have long history under different trade policy regime (Agalewatte, 2004). Therefore in my study I have selected South Korea and its industrial policies to asses as a bench mark for Sri Lanka industrial policy. To examine and investigate the context of industrial policy development in Sri Lanka it is noteworthy to understand Korean style industry policy and its implication for past decades. Therefore this chapter examines how South Korea gained economic development and what are the major factors behind this remarkable transformation of Korean Economy.

4.2 Overview of Korea's Economic Performance

South Korea was one of the poorest countries in the world in 1953 because it was paralyzed after Korean War during the period of 1950-1953 through the mass destruction of industrial facilities and the massive inflows of refugees from the North. In that period Korea depended heavily on U.S. aids and assistance because Korea had no strengths to stand itself as it was suffered with many structural problems such as low economic growth, poverty, lack of infrastructure etc. Korea has used this aid to meet the basic needs of the population as well as to finance the rehabilitation of the economy.

In this period economic policy was mainly focused on import substitution and most important thing was the massive investment on education. This was helped later to establish a well educated labour force in South Korea which acts as back born of its labour intensive industries which developed from the early 1960s. South Korea was lucky because, in this period some facts have given favourable support to facilitate South Korea's miracle rise as in 1965, Korea's relationship with Japan was normalized, supplying materials for the Vietnam War, the Middle East construction boom in the 1970s, oil prices of the world market was low, cheap US dollar, and low interest rates in the late

1980s etc. These entire incidences facilitated for South Korea's rapid rise (Song (1990), p.1).

Korea continued its rapid growth during the 1970s despite the two oil crises, and by the late 1980s had joined the group of highest income developing countries. By the mid 1980s Korea had become a country with a trade surplus and mature debtor nation, it became self sufficient in terms of its domestic financial requirements, and foreign debt also started to decrease gradually. Exports were the engine of growth driven by an outward- looking development strategy pursued from the early 1960s.

At present South Korea is the world's leading producer of Displays and Memory Semiconductors and also the second largest as a Shipbuilding producer. The chaebols, Korean conglomerates such as Hyundai, Samsung and Daewoo and LG, play an important role in the Korean economy. Korea has become the 7th largest exporting country and considered to be having the 13th largest economy in 2010.

4.3 Growth Pattern and its Main Features

It is important to identify the key characteristics of its growth process by studying general overview of policies as well as industrial policies.

These characteristics can be summarized as follows;

First, despite economic conditions were not favourable; Korea placed great emphasis on education immediately after got independence in 1945, because Korea's greatest resource was its people. During the 1950s, educational facilities were greatly expanded. It helped in the subsequent period of industrialization towards economic growth of Korea with highly educated people.

Second, in the process of economic growth Korea initiated land reform before the outbreak of Korean War in 1950. The main aim of the land reform was to reduce the concentration of land ownership by redistributing land between landlords and tenants to increase land productivity and to improve the income of tenant farmers. In 1945, all Korean farmers owned only 13.8% of land while 51.6% of farmers owned no land at all. After the land reform, the situation was reversed in that 71.6% of farmers became full owner whereas tenant farmers accounted for only 5.2% of all farmers in 1964(Sung Hwan Ban,1980, p. 286). This was one of major factors behind Korea's rapid industrial development with a relatively good income distribution in the 1960s and 1970s when compared with other neighbouring countries.

Third, the strong government intervention in resources allocation was considered indispensable for economic development. President Park Hung Hee in his political vision was of a government-led development strategy, which could be better carried out through development planning. In order to design the development planning and carry it out effectively, he set up a planning agency called the Economic Planning Board (EPB) in 1961. Korea's development plan until the early 1980s was very much target oriented, specifying not only macroeconomic targets, but also sectoral targets to be achieved during the plan period.

Fourth, Korea's rapid industrial transformation was mostly affected by the economic bureaucracy who formulated and implemented policies. It certainly played an important role in the emergence of the Korean developmental state. Consequently, the Korean developmental state has been described as a state where "bureaucrats rule while politicians reign"(Luis Mah,2011).

Fifth, By the 1970s, focus was given to the development of import substituting strategic policy for heavy and chemical industries (HCIs), as well as maintaining the export growth of light manufactured industries and the development of new heavy goods exports.

Sixth, South Korea has a long history of relatively consistent and stable macroeconomic policies. The government always tried to intervene any time to control macroeconomic variables such as Inflation, Investment, savings, exchange rates, interest rates etc. Therefore, South Korea could have maintained their economy consistently stable.

Seventh, the basic theme of the President Park Chung Hee government was “exports first”, or “nation building through export promotion”. Larger Korean firms were assigned annual export targets by officials in the Ministry of Trade and Industry, and were seen by these firms as virtual orders or assigned missions. If they succeeded in fulfilling their export goals they obtained numerous benefits reserved for exporters, including preferential credit and loans, administrative support, tax and other benefits.

Eighth, social infrastructure facilities and industrial parks are complementary for economic development. Korean government had given priority to infrastructure development by formulating four regional development plans in 1960s.

Nineth, it was most advantage for economic growth, the capacity of entrepreneurs and policy makers to adjust rapidly and flexibly to external shocks. South Korea has successfully faced for oil crises,

financial crises etc. It seems that Korea could have faced any economic difficulties by suddenly adjusting them in a proper manner.

Tenth, domestic investment exceeded domestic savings. It borrowed heavily to finance the foreign debt. Therefore South Korea could have reduced amount of their high debt.

4.4 Road to Industrial Growth

4.4.1 Import Substitution Strategy

Many developing countries have adopted IS policy as a strategy for industrialization in 1950s and 1960s. Korea adopted this policy first in 1950s, but by implementing this strategy it could not achieved targeted economic growth. In this period most industries in Korea were non-durable consumer goods industries such as food and textiles, therefore import substitution took place mainly in those industries. Also there were key business success such as access to foreign exchange, the securing from the government of subsidies of various types, and quantitative restrictions on imports etc. However corruption and favouritism for some businessman were aroused when access to government controlled foreign exchange, bank credit, and foreign assistance. In 1962, however again import substitution strategy was adopted aiming of protecting in heavy and chemical industries.

4.4.2 Export Based Industrialization Strategy

By the mid-1960s, the government leaders and technocrats apparently became fully convinced the expansion of labour intensive manufactured commodity exports was the only means available for Korea to achieve rapid industrialization. The government launched its first five-year development plan in 1962, setting the annual target growth rate at 7.1% to be achieved during the plan period (1962–1966). By the 1970s, however, increased focus was given to the development of import substituting strategic heavy and chemical industries (HCIs), as well as maintaining the export growth of light manufactured industries and the development of new heavy goods exports.

Based on this development strategy, the government began to promote exports with all kinds of incentives. The “nation building by export” was the national slogan and efforts were made to attain the export target set for every year and also initiated close consultation with the export industries and monitored the performance of supported firms through “monthly export promotion expansion meetings,” chaired by the president. Ministers with trade related duties, high-ranking government officials, representatives from business, banking institutions, and shipping companies, and labor-union leaders participated in these

meetings to review export performance broken down according to product and destination, and to discuss international market trends and emerging problems. If export performance was weak, the president urged relevant government officials and bankers to provide enhanced support to achieve a target volume of exports as planned. Through the process of consensus building in these meetings, export promotion policies were systemized (Kim 1990).

Since export marketing has substantial fixed costs in the beginning stages, the government established the Korea Trade Promotion Corporation (KOTRA) mainly to explore foreign markets. Because of all these incentives share of export to the GDP has increased rapidly. The system of export financing played a critical role in supporting export industries until the mid-1980s when the Korean current account recorded a surplus.

Early in the 1970s, there was a rising protectionism in developed countries for labor-intensive products. This prompted the policymakers to improve the structure of export because Korea could no longer rely on labor-intensive industry for its continued high growth. Therefore, composition of the export structure changed from primary to manufacture industries. In 1961, major contributor in exports was Iron

while in 1975 Textile had become major contributor amounting of 32.6% of the total export (Siwook LEE, Korean Experience on Economic Development-PPT). Because of this change exports recorded over USD 100 million in each of the categories; woven textile fabrics, electrical machinery and appliances, miscellaneous manufactures, fish, plates and sheets of iron and steel, veneer sheets and plywood, foot wear, transport equipment, manufactures of metal and non metallic mineral products (Dal Hyun Kim-development experience of the Korea economy-2011). Therefore, it seemed that relative importance of manufacturing as a source of foreign exchange earnings has increased remarkably.

4.4.3 Heavy and Chemical Industries

The Korean government made deliberate efforts to upgrade the industrial structure by promoting the HCIs during the period of its second five year plan (1967-1971) while export promotion generally aimed at light industries, which resulted the share of HCIs in domestic production has increased remarkably. It was a remarkable start in the Korean economy but there were many crucial obstacles occurred: (1) Korea was a lacked capital economy and Korea's market was very small while the HCIs require huge capital investments.(2) Technical

skills necessary to produce HCI products efficiently were absent in Korea.

Therefore government paid fully attention to promote HCIs by raising factory sizes to international standards in order to promote their competitive edge. Since the domestic market was too small for these large factories, the government decided that the HCIs were to be promoted as strategic export industries to solve marketing problems and to practice economies of scale (Kim 1990). The HCI policy was implemented through subsidized credit and special tax policies, selective protection, entry restrictions, and direct government involvement in industrial decision making. A series of preferential financial and tax incentives were devised in order to induce investment in HCI. The government also established a special system called the National Investment Fund (NIF) in 1973 to facilitate the financing of long-term investment in plants and equipment for the HCIs.

Although the heavy and chemical industry promotion policy was very successful in terms of economic growth, it had a number of adverse side effects on the economy such as a soaring inflation, structural imbalance within the manufacturing sector, weakening industrial competitiveness and balance of payments difficulties. Therefore, the

government took steps to overcome these problems by introducing wide range of macroeconomic, trade and industrial policy reforms early in the 1980s.

4.5 Market Opening Liberalization Policy

In 1980s there was an acceptance that the Korean economy should rely more on market mechanism for resource allocation rather than government intervention and assistance (Chuk Kyo Kim, Development experience of the Korean economy-2011). In this period, Korea had a potential comparative advantage in IT and therefore it was easier to the government to open the entire market to the world to compete with the internationals. Accordingly all industries were treated equally and incentives were given mostly to R&D activities and man power development. Tax and various incentives which were given to HCI were reduced and interest rate system was reformed. The government has greatly liberalized its policy towards foreign investment since 1980 and technology licensing was fully liberalized from 1984. Also stabilization policy and floating exchange rate system were introduced in this period. It helped for foundation for the successful implementation of trade and industrial policy reform. The trade and

industrial policy reform as well as stabilization efforts have greatly contributed to regaining the competitiveness of the Korean industry.

The main thing that helps to Korea's successful industrialization and rapid growth was they adjust their economic policy according to the changes of economic environment and also they adopted those policies very strong manner. Therefore it could be easier for them to continue these policies at its end destination without failing.

CHAPTER FIVE

Analytical Review of Industrial Policy of Sri Lanka in the Context of Korean Industrial Policy

5.1 Introduction

This chapter will assess the industrial policies adopted by Sri Lanka in the past by examine the impact and relevance of implementing those policies in terms of economic, social and political context. In here, I would like to use South Korea's industrial policy as a bench mark to asses Sri Lanka's industrial policy. In this process, first it will discuss briefly the journey towards industrial development in Sri Lanka, then the contemporary industrial experience of two countries. Afterwards I will conduct an analytical review of Sri Lankan industrial policy compared with Korean industry policy. In here, a conceptual frame work will be developed to address identified issues that hindered Sri Lanka's industrial development.

5.2 Journey towards Industrial Development

Being an agricultural country and more than 70 % of her total population is living in rural areas, Sri Lanka's journey towards

industrial development was very slow during the early stages. Since the kings' era, to date, agriculture, especially farming was considered as a major livelihood of the people and has been given priority. In the early period, there was cast system in Sri Lanka and farming was considered as the highest category among them. The farming is still dominated in Sri Lankan economy because it has been inherited in people's mind and it was connected with Sri Lankan culture too. Therefore, government also has given more attention mainly for farming when formulating economic policies. In contrast, although Korea was mainly agrarian country in its initial development stage, they could have transformed in to industrial state within short period of time miraculously by proving neither country can achieve economic development by giving priority only to agriculture other than industrial sector.

By the way, there has been a structural transformation of the Sri Lankan economy over the last six decades and the sectoral contributions to total GDP have also shifted reflecting this structural change. The records show that contribution of agriculture to the GDP has decreased gradually while industrial sector becoming relatively high in the GDP. Following table shows upward trend of industry sector over agriculture over the decades.

Table 01 GDP Growth rate and Sector Composition (%)

Period	GDP Growth (%)	Share of GDP (%)		
		Agriculture	Industry	Services
1955	5.9	45.9	16.5	39.6
1965	2.3	33.6	17.4	49.0
1975	2.8	30.4	26.4	43.2
1985	5.0	27.7	26.2	46.1
1995	5.5	23.0	26.5	50.5
2005	6.2	11.8	30.2	58.0
2010	8.0	12.8	29.4	57.8

Source: Central Bank of Sri Lanka

However, a drop in share of GDP by agriculture does not mean at all that the sector plays an insignificant role in the economy or livelihood of many citizens of the country, because still it plays major role in the Sri Lankan economy.

Moreover, when we consider the export composition, we can see that contribution of agricultural exports has declined gradually while an industrial export has been increased rapidly. However it does not mean that Sri Lanka had transformed to an industrial country's status, because it is still far behind the industrialized country of Korea. Sri Lanka has to give more attention to increase its export volume, diversifying export items and adopting new methods to compete with

international markets. On the other hand Sri Lanka has never changed its manufacturing structure composition to gain rapid development by promoting manufacturing exports. Sri Lanka often thinks about light manufacturing rather than heavy manufacturing industries. This affected export volume has not seemed to be improved for a long time. In Korea targeted sectors have changed over time from 1961s to 1970s, from primary to manufacture by judging the future export potential of those industries.

In its journey, one of the reasons for lagging Sri Lanka's industrial development was, in early Sri Lanka, we had inherited industries such as pottery industry, handicraft, jewellery etc., the People generally considered these industries as the industries which are engaged with low cast people. Therefore, people were not willing to select those industries as their livelihood while smaller numbers of people were selecting them. However if these industries were improved since 1960s, and introduced to the outside market it would have contributed favourably for Sri Lanka's journey to industrial development. Unfortunately people do away from those industries and tried to engage with the jobs which considered as white collar jobs in the society. In contrast, Koreans being hard working, efficient, work oriented and with

a fleet of strong minded people needed by a country for its development and they were not reluctant to join industry sector.

Sri Lanka has initiated State led ISI strategy from late 1950s, following balance of payment difficulties with a change of political leadership. However, Sri Lanka couldn't achieve considerable industrial development by adopting Import Substitution policy. If these strategies were succeeded, balance of payment would have favoured while import is being decreased. Governments addressed the balance of payments deficits in the 1960s by imposing direct controls that restricted imports. Even though, it was unable to avoid increases in imports. It can be seen in the following table. It shows BOP was further worsened after adopting IS strategy.

Table 02 BOP - Selected Years from 1950 to 1975 Values in US\$ million

	1950	1955	1960	1965	1970	1975
Imports	246.3	310.4	421.3	403.6	391.8	767.3
Exports	296.5	397.5	377.2	400.9	338.7	563.4
Balance of Trade	50	87.1	-44.1	-2.7	-53.1	-203.9

Source: Central Bank of Sri Lanka

Now lets look what has happened after adopting outward policy as a solution for the issues country faced during that period. Sri Lankan

economy was fully opened to international market and all the trade restrictions were released while introducing open economy to the country by adopting new trade policies by the new government which came to power in 1977 hoping specially the improvement of balance of payment. However the situation was not getting better. It is reflected in following table.

Table 03 BOP - Selected years ,1977 to 2002 Values in US\$ million

	1977	1982	1987	1992	1997	2002
Imports	726.2	1994.1	2075.1	3505.4	5863.8	6105.6
Exports	767.1	1013.7	1395.7	2460.8	4639.0	4699.0
Balance of Trade	40.9	-980.4	-679.4	-1044.6	-1224.8	-1406.6

Source: Central Bank of Sri Lanka

By observing above two tables, it is clear that even though governments came in to power in time to time and has adopted both IS strategy and outward oriented strategy, they couldn't address to BOP difficulties. Sri Lanka's journey towards industrialization is still far behind from the export oriented industrialization and it has to go for a long way to succeed economic development through industrial development.

However, the current industrial policy of the government is focused on the creation of a globally competitive and knowledge based

manufacturing industry sector, with the maximization of value addition in exports (Annual report, CBSL -2013). Generally, leaders of Sri Lanka always make fabulous slogans while formulating economic policies but the problem arises when implementing them owing to many reasons such as political influence, mismanagement, financial difficulties and corruptions etc. Therefore it is very difficult to proceed as pre-planned in the policy papers. Any how it seemed, currently various programs are being practicing in the country anticipating a vast development in the industrial sector.

5.3 Contemporary Industrialization Experience of two countries

Since the British colonialism, Sri Lanka dominated in cultivation mainly in plantation sector exporting tea, rubber and coconut as these products were given more priority by the British rulers. Korea under Japanese rule too had experienced the same what Sri Lanka had experienced under British rule. Japan's main aim was to bring raw materials from Korea for the use of Japanese industries. Therefore it is clear that Sri Lanka and South Korea were suffered equally before the independence of both countries.

Sri Lanka, since its independence in 1948, has been adopted different industrial policies as same as South Korea did after its independence in 1945. In 1950s both countries were in similar position in terms of economic, political and demographic but Sri Lanka was somewhat ahead in several social development indicators. Following table indicates the economic and social status of two countries in 1950s and 1960s.

Table 04 Several indicators between 1950s and 1960s

Indicator	Sri Lanka	South Korea
GDP per capita	USD146(1962)	USD 104(1962)
Growth rate	2.7% (1954)	5.6%(1954)
Savings rate	12.5% (1965)	13.2%(1965)
Investment rate	14.6%(1960)	10%(1960)
Literacy rate	77% (1963)	78%(1959)
Life expectancy	61.4 (1962)	55(1962)
Unemployment	16.6%(1963)	7.8%(1961/65)
Birth rate(per'000)	36.6(1960)	43.95(1960)
Death rate(per'000)	8.6(1960)	14.34(1960)

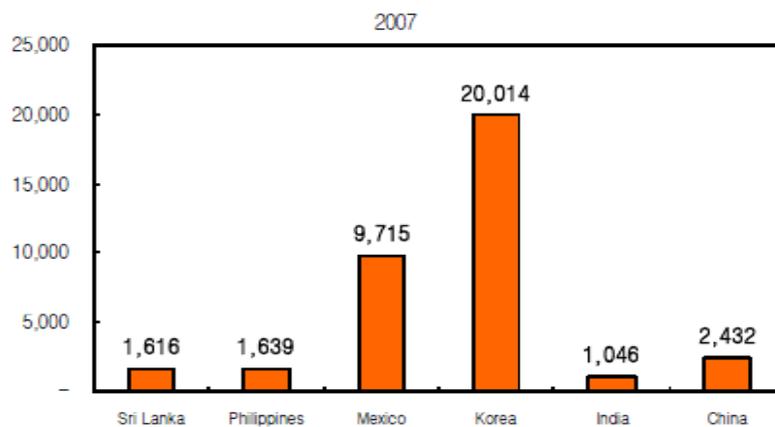
Sources: Dept. of Census and Statistics, Central Bank (Sri Lanka)

Bank of Korea, National Accounts Statistics, World Bank

Accordingly, Sri Lanka economy specially in terms of per capita income was better than that of Korea. Table shows, GDP per capita of Sri Lanka in 1962 was USD 146 while Korea it was USD 104.

However after 45 years in 2007, GDP per capita of Sri Lanka was USD 1,616 while Korea it was USD 20,014. It was a huge difference and Korea has achieved a rapid growth unbelievably through industrialization. It can be shown graphically as follows.

Graph 01 GDP Per Capita (current price USD) by country in 2007: World Bank



Source: World Bank

This huge difference gives us a hint that Sri Lanka has made mistakes in its development process. Therefore it is important to know how Korea had gained that much of development within a relatively small period of time.

In Sri Lanka, during the period of adopting IS strategy, domestic industries were improved to some extent and foreign debt was becoming favourable to country on the other hand. However, because

of the restriction of private sector activities including import restrictions and price controls were introduced in this period consequent to many bad effects on market activities, capital formation and normal life of the people. In Korea, during the period of 1953 to 1960 government policy was focused on IS on non- durable consumer goods and some key raw materials, although manufacturing sector was growing at 11% per year, the overall economic growth rate remained at about 4% per year due to sluggish growth of the primary sector, which averaged 2.5% (Chuk Kyo Kim, Korea's development policy).

However, Sri Lanka in this period, focusing more attention to the domestic market, many business activities including plantation sector were nationalized. Also, many programs were implemented especially in the agricultural sector, for achieving self-sufficiency. This strategy did not have a significant impact towards improving the economic structure where the economic performance of Sri Lanka seems to deteriorate further. It can be proven by the GDP growth rates for the period from 1950 to 1979. Accordingly, GDP growth has decreased apart from (except the period of 1960-69) 1950s, because during this period industrial sector reflected somewhat improved but again it got stagnated.

Table 05 Annual average GDP growth 1950-1999 (%)

Period	1950-59	1960-69	1970-79	1980-89	1990-99
GDP Growth	3.1	4.7	3.9	4.3	5.2

Source: N.S Cooray, macroeconomic performance of Sri Lanka since 2000(p.104)

Therefore, it is clear that IS strategy was not contributed much to the Sri Lankan economy.

The export growth was the major factor behind South Korea's rapid growth. A conscious attempt was also made to make production for exports more profitable by providing incentives. It has recorded that, export has gone up from US\$ 55 (2.4 % of the GNP) in 1962 to US\$ 14,705 (31%) in 1979 that was within 17 years (Comparative analysis of foreign aid and its role in the economic development of India in comparison with South Korea and Colombia, p176). In Sri Lanka economy after its 1977/78 reform package, exports of manufactured goods responded immediately and grew very rapidly, at around 20% annually between 1976 and 1984. However, this growth slowed drastically during the next five years, but then accelerated to an average rate of 16% between 1989 and 2000 due to the largest and fastest growing of garments (Garry Pursell and F.M.Ziaul Ahsan, Sri Lanka's Trade Policy back to Protectionism).

Also the period after 1977 highlights a completely different economic policy aiming economic growth by the increase of investments and higher employment. Import restrictions and price controls were abolished and many areas were opened for private sector. Encouragement of foreign investments by granting tax incentives and providing infrastructure was a phenomenon in this period, which several investment promotion zones were declared. The currency, which stood independently, was devalued several times as to increase the exports and to make better the weak BOP as did in Korea when its BOP was unfavourable. Because of these policy reforms Sri Lanka economy suddenly woke up. However, after some years, economy faced some difficulties in many areas.

Korea has opened its economy to the world of which after a couple of years Sri Lanka did, that was in 1980s in order to cope with the challenges such as inflation, weakening industrial competitiveness, BOP difficulties. The Korean government intervened in industrial restructuring to liquidate the firms which made excessive investment in HCI projects, because they distorted the allocation of resources. But Sri Lankan government had failed to identify the resource oriented products which reflects a higher proportion to export or GDP whereas

Korea could continuously develop their industrial sector by following well designed flexible plan adjusted to change environment by transferring economy from factor driven to investment driven and then to innovative driven gradually.

As mentioned earlier in Sri Lanka, there was a civil war lasted for 30 years between Sri Lankan government and Tamil terrorist groups in the northern and eastern parts of the country. The sabotage activities led by the terrorists have had detrimental effects on economic activities and growth. The problem of terrorism affected tourism industry, which is a major source of foreign exchange and foreign investment as well. Therefore, industrial sector investment was minimized within the country. Defense expenditure as a ratio of GDP rose from 1.3% in 1980 to 4.2% in 1998. This has constrained the economic growth rate by 2 to 3 percent a year (CBSL-1999). Sri Lankan government had to allocate huge amount of money for the civil war from its GDP and in 2001, the economy recorded a negative growth rate of 1.5 % (Annual report-CBSL) that was the first economic contraction since independence in 1948.

Korea was also suffered from Korean War started from 1950 until 1953. However, although it was not lasted for many years as Sri

Lanka's civil war, virtually all of the Korea's limited industrial bases were destroyed. The estimated physical war damage was amounting to 85% of GNP for 1953(Prof.Siwook Lee, KDI School of public policy and Mgt). Despite these bad affects, Korea could have started its development process right after the war, firstly giving priority to constructing infrastructure which was damaged during the War. Most probably Sri Lanka would have achieved a higher growth and higher living standards if there was no civil war in that time.

When considering privatization, the Sri Lankan government started Privatization with a view to reducing the financial burden of some State Owned Enterprises (SOEs).In the first wave of privatization from 1989 to 1994, 43 commercial enterprises in the industrial sector had been privatized(Malathy Knight Jhon, Distributional impact of Privatization; Sri Lankan experience,2002,p.2). At the beginning they showed an appreciable improvement, which has been attributed to management techniques and improved labor relations. However situation was not further improved as there was no proper planning and management system and also political influence for those industries. A similar situation occurred in Korea during the period of 1954-56 when Commercial Banks were privatized, when these banks failed to produce

efficient management which led to the misallocation of funds and the misdistribution of wealth and was biased lending for their subsidiaries. (Keuk Je Sung, Development experience of the Korean economy). Therefore these banks were nationalized by the Government. In Sri Lanka the privatization process has been suspended since 2006 under the “Mahinda Chinthana” policy as the government has decided to repossess some of the privatized organizations due to failure in achieving expected targets under privatization.

On the other hand Sri Lanka with the liberalization of Foreign exchange regulations, relaxation of trade and impose of payment controls as well as the adoption of a multiple exchange system were expected to revive domestic industry and increase production in domestic agriculture. The foreign investment was encouraged with a view to obtain higher technology and development of new export markets. But unfortunately, Sri Lanka has not given more attention for R&D in their development process while mostly depended on FDI. The Ceylon Institute of Scientific and Industrial Research (CISIR) was established in 1955 in order to develop Science & Technology in Sri Lanka. But this institution failed to deliver its objectives due to inadequate staff, lack of research groups and expertise in different fields and too wide area

coverage and lack of linkages with industry (Technology, Poverty and the role of new technologies in eradication of poverty: the case of Sri Lanka-2003). But in Korea, investment for science and technology was increased in its development process and new technology was one of the main factors for Korea's rapid industrial development. On the other hand, it seemed Korea was not likely to attract FDI in its early development process, but had to rely on foreign aid to get financial support mostly from the USA and also IMF, Korea might not want to collaborate its upcoming major firms to be funded with foreign investment.

One of the important things I found by studying Korea's development policy was that they continued their policy plan despite the change of government. In controversy, Sri Lanka whatever new government comes to power, it does not willing to carry out the development plans adopted by the previous government and hence, they formulate new plan while suspending the previous plan. The reason was, Sri Lanka had two major political parties and one party more likely to aware of socialist ideals and other party were capitalist identity. Therefore policies were changed subsequent to the change of the government. Because of this, no development plans could be continued until its end.

This was badly affected to the industrial as well as economic development of Sri Lanka.

Also in the industrial development process, government should act strongly when they launch their industrial policies and should adhere to rapidly globalizing world economy carefully. The most important thing is government should give fair leadership rather than advocate to cheap political gains. When looking at the past experience in Sri Lanka, it seems Sri Lanka's political parties were mostly acts only to get in to power and not with a pure interest to develop the country. Also there should be a real willingness to develop the country by making proper and effective development plans which can address ongoing issues faced by the country.

Following table indicates a summary of industrial policy comparison between the two countries;

Table 6 Comparison of industrial Policy Strategies

Durati on	Korean Industrial Strategy	Sri Lankan Industrial Strategy
Before Independence	Japanese colonial rule (1910-45), damage by the World War II (1939-45) -Land reforms - Education	British colonial rule(1815-1948), World War II - <i>Most of the lands were owned among privileged few who were partial with British admin.</i> -Education

1950-60	<p>Korean Civil war ,almost totally damaged infrastructure and depressed society</p> <ul style="list-style-type: none"> - Dependence on Foreign aids - Government ownership of some industries which were previously run by Japanese (Iron ore, Silk, plywood) - <i>Factor Driven Economy</i> - <i>Import substitution industrial policy(IS)</i> - <i>Reconstruction and factor driven economy</i> 	<p>Six year development plan(1948-53)</p> <ul style="list-style-type: none"> -Established Industrial Product Act <i>Emphasized in shift from large state-owned industry policy to large & small scale private enterprises</i> - <i>new policy to support private enterprises</i> <p>2nd development plan(1954-60)</p> <ul style="list-style-type: none"> -<i>encourage foreign companies to invest</i>(this plan couldn't implement due to govt. changed in 1956) -<i>Enactment of the State Industrial Corporations Act of 1957</i>
1961-77	<p><u>Three 5 year dev.plans from 1962 to 76)</u></p> <ul style="list-style-type: none"> -<i>Promotion of basic industries</i> -<i>Infrastructure development</i> <u><i>Outward and export-oriented policy</i></u> -<i>Labour intensive Industries</i> -<i>Tax incentives, tariff exemptions, subsidized credit facilities</i> -<i>Total tax exemption for exporters</i> -<i>Devaluation of currency</i> 	<p>Ten year plan(1959-68)</p> <ul style="list-style-type: none"> -<i>Industrialization emerged as priority</i> -<i>industries categorized in to 3 groups;</i> <i>Basic heavy, other heavy and light consumer</i> -<i>State-led industrialization</i> -<i>protectionist system</i> <i>Licensing, high tariffs, quotas, controls on luxury goods</i> <p>(this long term plan failed to achieve and translated in to three year plan targeting less capital and more labor intensive investment)</p>

	<p>-IS policy for capital goods</p> <p>-Exportation of light industries</p> <p>-Nationalization of banks</p> <p><u>From 1973 Priority was given to HCI</u></p> <p>- Upgrading Industry structure</p> <p>- Industries aimed machinery, shipbuilding, electronics Petrochemicals</p> <p>- Government intervened financial support at low rates, tax concessions, market information, fast solutions for difficulties faced by cheabols</p> <p>- Leading industrialists were especially encouraged to invest in HCI – Chaebols</p> <p>Investment driven economy</p>	<p>1965 turned in to closed economy</p> <p>-Emphasized agriculture sector than industrial development</p> <p>- Establishment of Industrial Development Board in 1966 to promote SMEs</p> <p>1972-76 development plan</p> <p>- Support export oriented industries(traditional export - suffered from instability and stagnation)</p>
After 1977	<p>Four development plans from 1977 to 97</p> <p>-More policy enhancements in promoting HCIs.</p> <p>- Chaebols in diversified industries and frontiers in the economic growth</p> <p>-Promotion of</p>	<p>Economic liberalizing from 1977</p> <p>-Open economy policy</p> <p>-Liberalized international trade policy designed to encourage export-led growth.</p> <p>-Employment creation was a central objective, both</p>

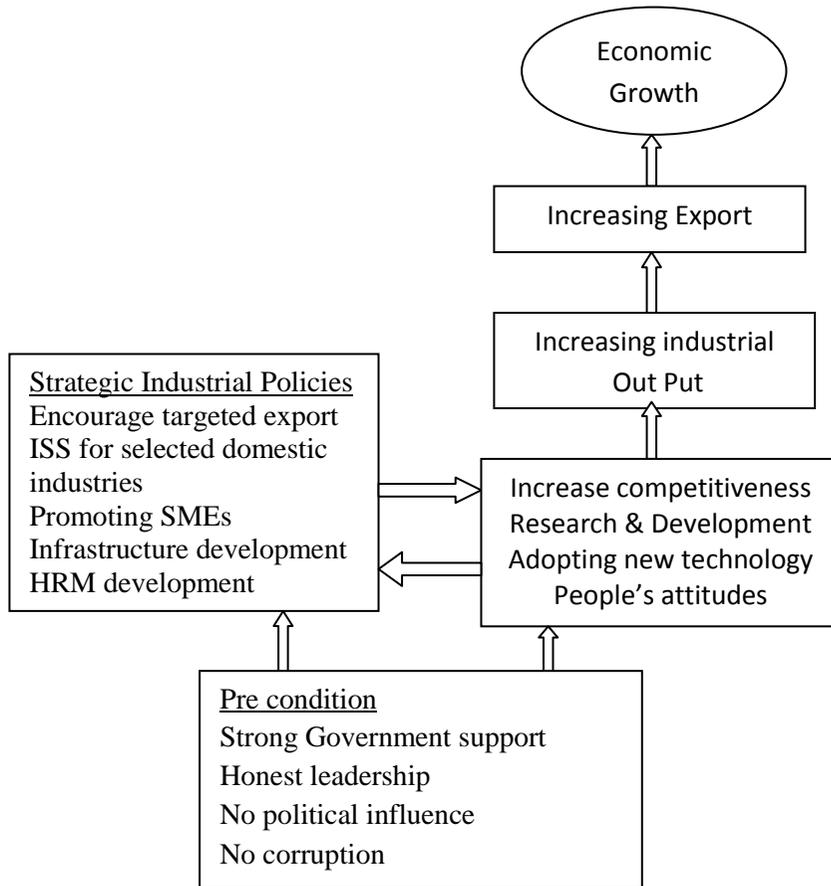
<p><i>Electronic, Semiconductor & Automobile industries with high FDI</i></p> <p><i>-Heavy investment in R&D activities in industrial sector</i></p> <p><i>-PPP in infrastructure projects</i></p> <p><i>-Started advanced country type of industrialization</i></p> <p><i>-Adjustment of industrial structure in open system</i></p> <p><i>-Strengthening business foundation by promoting SMEs</i></p> <p><i>-Globalization. Industrialization promotion of technological development</i></p> <p><i>Expansion of social overhead capital</i> <i>Innovation drive economy</i></p>	<p><i>through encouragement of domestic and foreign capital investment</i></p> <p><i>- But no special programme or initiative to local industrialists to invest in industries</i></p> <p><i>- FDI in Labor incentive industries apparels & garments, footwear etc,</i></p> <p><i>- Establish FTZ in 1979</i></p> <p><i>-Privatization of Govt. institute</i></p> <p><i>Factor Driven Economy untill 2005</i></p> <p><i>- Value addition in all manu. Indust.</i></p> <p><i>- developed infrastructure (highways, airport, harbour, expansion railway, wireless communication system)</i></p> <p><i>-Special facilities for local industrialists to diversify their industries under “Gamata Karmantha” project in 2005</i></p>
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5.4 Conceptual Framework for Development of Industrial sector in Sri Lanka

After examine previous studies and identifying some factors which were hindered industrial development in Sri Lanka, I developed following conceptual framework to address those issues.

Figure 1

Conceptual Framework – Strategic industrial policies for economic development



Now let's discuss how does these strategic industrial policy factors affect to industrial development in Sri Lanka.

- ✓ Encouraging targeted export was main industrial strategy, that the Korea was adopted when starting their industrial development. Sri

Lanka can upgrade its industrialization structure by giving more attention to the targeted industries. As mentioned earlier, Sri Lanka has some inherited industries, natural resources such as phosphate, Gem, jewelry etc. By giving priority to encourage these products can introduce to the world market. The products should be diversified and government should encourage them as Korea did in its early development period.

- ✓ Adopting IS strategy for selected domestic industries in the country is important for Sri Lanka because expenditure for raw materials amounted high proportion among all imports. In Sri Lanka, intermediary goods amounting more than 50% and investment goods amounting more than 70% to the imports. Therefore, government should restrict importation of capital goods while encourage producing them using domestic human resources and raw materials.
- ✓ SME sector is important to Sri Lanka because majority of the people are engaged with SMEs and therefore they should be encouraged by intervening to solve the issues and challenges that affect the growth of SME sector. I will discuss them later in this chapter.
- ✓ Good infrastructure makes industrial sector more expanded by easy accessing to everywhere and make it easy for competence with other

products. In Korea, reconstruction of the infrastructure which damaged by war was the main policy goal in its early development process and then expanded over the country.

- ✓ It is no doubt that human resource development is essential for industrial development. South Korea, in its development process established vocational schools and intra-firm engineering schools and other training institute to create skilful workers to recruit in to their production process. Therefore Sri Lanka needs to be giving priority for vocational trainings to create skilled workforce.
- ✓ The Government should be given priority for innovation and grasping new information and technology when they making economic policies. Steadily interact with new technology is one of an easy way to accelerate economic growth and compete with other competitive products in the world market.
- ✓ In Sri Lanka people are always try to engage in the service sector other than industrial sector. This attitude should be changed where youth should be recruited to the industrial sector by encouraging them for industrial field through awareness programs and giving them vocational training with attractive incentives etc.

✓ By introducing the above strategies, it will be easy for the industrial sector to face ongoing competition domestically as well as internationally with an increased volume of output and then such industries could be more profitable and could also become leading industries in the country which could also gradually expand in to international market as how Korea's chaebols acts in the industry field now.

To implement all the above strategies smoothly, I have identified several pre-conditions. There should be strong government support not political influence when supporting industries. Countries like Sri Lanka, political influence seem to be a big issue when implementing economic plans and other development programs. Other important issue that hamper the policy implementation is corruption. Also Political leaders should be honest on their activities and shouldn't cheat the people. Therefore, it is very important to eliminate those bad affects to adhere with the above conceptual framework.

5.5 Analytical review of Strategic Industrial Policies

As discussed in previous chapter, Korea has implemented seven five year plans continuously whereas Sri Lanka too was formulated seven development plans starting from 1948 up to now. Korea reached to their

target through industrial development while Sri Lanka couldn't make them a success because Sri Lankan development process since independence has always been an uneven one with a lot of setbacks characterized by slow adjustment to internal and external shocks, missed opportunities, policy errors etc. Korea also suffered with many difficulties in their development process but because of their dedicated encouragement and strong willingness helped them to become industrialize country status.

There is no enough evidence that Sri Lanka has cautiously promoted targeted exports during the contemporary industrialization period. In 1977, it seemed priority had given to open FTZ and because of that, it seemed textile and apparel industry had become one of targeted export industry. When looking at the composition of industrial production, it seems that textile and apparel industry has been gradually increased and it was accounted highest share among other manufactured exports. Following table shows that textile industry accounted 10% of the total value in 1977 while it was increased up to 46.6% in 2006 but almost all the other products seem decrease. Although, rubber was one of the three main export items in 1960s, it was rapidly decreased in the industrial composition from 35.2% in 1977 to 16.1% in 2006 as seen in

the following table. It means Sri Lanka couldn't maintain even the products like rubber which has capacity to produce well and have advantage in producing in the country also has good export market.

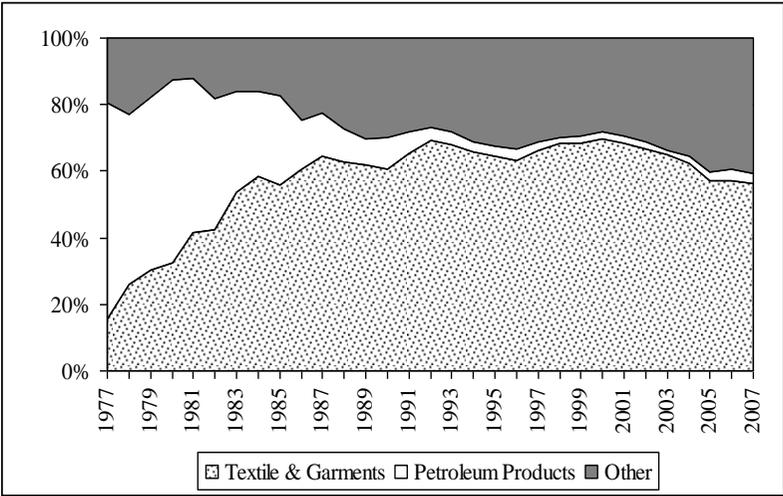
Table 7 Compositions of industrial production in selected years (as a % of total value)

Product category	1977	1982	1985	1990	1993	2000	2006
Food, beverage, tobacco	32.8	20.3	27.1	25.3	23.9	24.7	22.8
Textile & leather products	10.0	14.9	24.6	32.2	42.1	42.6	46.6
Wood products	1.8	1.4	1.8	0.8	0.7	0.8	0.7
Paper products	3.9	2.8	3.1	2.2	2.1	1.8	1.4
Chemi, petro, coal rubber	35.2	50.6	33.9	24.5	17.3	17.0	16.1
Non metallic mineral pro	5.9	5.3	4.8	8.7	7.4	6.9	6.1
Basic metal products	1.9	1.0	0.3	1.2	0.9	0.8	0.7
Fabricated metal, machinery & transport	8.1	3.5	4.1	4.8	3.6	3.2	3.4
Products not specified	0.5	0.3	0.3	0.3	0.2	2.2	2.1
Total	100	100	100	100	100	100	100

Source: Agalewatte(2004)

On the other hand, Sri Lanka's major export earnings were derived from a small number of commodities such as textile, tea, rubber, coconut etc. mainly primary commodity exports by light manufactured goods rather than heavy products. When considering the share of textile and garments in the total manufacturing exports, it has been increased from 16% in 1977 to around 50% in 2007 while exports share of petroleum products has declined and other category which mainly included with the labor-intensive products, such as leather goods, footwear, toys, plastic products, jewellery and sports goods that has been increased gradually.

Graph 2 Composition of Manufacturing Exports



Source: Central Bank Reports (various issues)

Sri Lanka is involving mainly on intermediary process; almost all the raw materials for manufacturing industries are imported and processed within the country and then export. Actually Sri Lanka had such major manufacturing industries during 1960s, However they were collapsed gradually and then closed down. Therefore, Sri Lanka compelled to depend on light manufacturing products but it is necessary to move from light manufacturing to heavy manufacturing products if Sri Lanka wants to compete with international market as did in Korea.

In a labour surplus Sri Lanka it is exists comparative advantage in labour intensive export industries. Similarly, domestic IS industries which utilize only domestic raw materials or very little imported raw materials resulting in a high domestic value added. An IS and export production are two strategies which Korea also has used in its development process (Westphal, Larry E, 1990). In early 1970s, when Korea's light industry exports began to weaken then they shifted from general export promotion and incentives to targeting of heavy and chemical industries hoping continuous economic growth by implementation IS policy focusing upon the development of HCI industries. Therefore, outward looking policies supplemented by

necessary protection to select domestic IS industries may be most appropriate strategy for Sri Lanka too.

Strengthening business foundation through promotion of SMEs is easy way to develop industrial sector in Sri Lanka. While the domestic market is the main outlet for SMEs, they make significant contribution towards exports. Although direct exports from this sector may not be largely done, they play an important role as indirect exporters which are done through sub-contractors led by large-scale exporters in Sri Lanka.

SMEs have certain common challenges such as, difficulties in access to finance and shortage of entrepreneurial skills, High competition with foreign products, Lack of facilities with limited access to modern technology and issues related to taxation etc. Therefore, Sri Lanka should concern more about the SMEs in its policy planning to address the above challenges. Korean economy in 1970s, conglomerates known as chaebols was the focal point for production, employment and export growth for the Korean economy. But, as these LEs became increasingly questioned because of serious imbalances in the economy between firm size, economic sectors and regions, government has paid attention to the development of SMEs. Although the purpose of developing SMEs in two countries is difference, it is very important to pay more attention

to encourage this sector for industrial development in Sri Lanka because it can be considered as back bone of the economy.

It is clear that infrastructure development is one of the important factor for encourage investment. The development of highways, ports, bridges, public transport, railways, telecommunications and irrigation are important for industrial as well as an economy's development. As an example, Sri Lanka has an experience of energy crisis in the mid 1990s and it affected industrial production adversely to such an extent that the country's economic growth was decreased. Korea in the initial stage of development has given priority to infrastructure development. However, Sri Lanka at present started its infrastructure development programs rapidly.

In Sri Lanka although literacy rate stands in a high position compared with the region, still cannot satisfy with its quality. The government expenditure for education has been declining over the years. It can be shown in the following table. Accordingly, the share of education expenditure in the total government budget declined from 13.84% in 2007 to 8.62% in 2012. The decrease in education expenditures as a share of total public expenditure does not appear to support the human capital development.

Table 8 Public Education Investments as a Share of Government Expenditure and GDP, 2007-2012

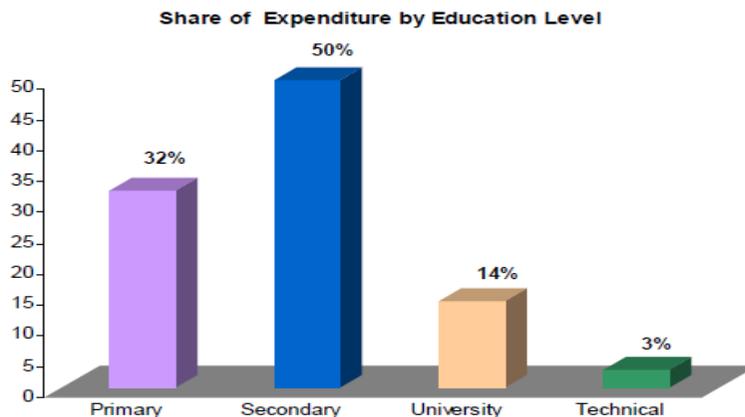
Year	Education expenditure as a % of GDP	Education expenditure as a % of govt. expenditure
2007	2.77	13.84
2008	2.27	10.27
2009	2.24	9.33
2010	2.05	9.61
2011	1.97	9.62
2012	1.72	8.62

Source: MOFP(Various years), Annual report, CBSL(Various years)

In Korea, in its planned process, by the latter part of the 1960s, was devoting more than 4% of its GDP on education (Siwook Lee, 2014). Also as I mentioned in Chapter 4, Korea has a strong bureaucratic economy and it helped in the decision making process of early development. When making economic policies, it is very important to have public officers with knowledge and experience in the subject area and this can be gained from education and developing knowledge and skills. Therefore public officers in Sri Lanka should understand the directions of development trends including the main elements of economic, social and environmental development.

Moreover, Korea has taken positive steps to increase the number of its vocational trainees considerably to meet the ongoing development needs. In the past, Sri Lanka didn't have enough vocational training institutes and training collages even the existed institutions didn't managed well. Therefore it was badly affected to increase the industrial efficiency and effectiveness. As mentioned earlier, Sri Lanka should invest more on education especially on higher and vocational trainings. Following table shows how Sri Lanka spent on vocational education in the year 2005. Accordingly, only 3% has spent for technical while the highest amount has spent on secondary education. Expenditure on technical should be increased to create more technically skilled workers.

Graph 3



Source: "Treasures of the education system" in Sri Lanka, WB 2005

However, Sri Lanka is now taken steps to establish vocational training institutions throughout the country specially aiming to improve professional skills of the youth.

Sri Lanka in its early period of industrial development didn't focus on R&D. Korea, when it began to reshape trade and industrial policy reforms in 1980s, all industries were equally treated and incentives were given mostly to R&D activities and man power development. By doing so, government's aim is to strengthen its support towards technology and man power. This kind of system was never happened in Sri Lankan economy until now. Sri Lanka was far behind in the field of technology at any specific period when compared with South Korea.

It is important to supply workforce especially for industrial sector with the market oriented skills. If young school leavers are not well-qualified enough to take up existing positions in skilled jobs in the market, it causes many problems specially build frustration among young people who are literate, educated but without a suitable job. Because of they don't possess with required skills to engage with industrial sector, they try to come to service sector expecting jobs under government sector institutions. Therefore government sector institutions of Sri Lanka are overstaffed unnecessarily. If these excessive youth are engage with

industrial sector, it would be more helpful to accelerate the economic growth. Therefore, attitudes of the youth should be changed by increased quality of technical education that attracts school leavers to skilled workforce by encouraging them to engage with country's industrial sector.

Along with the above mentioned industrial policy strategy and requirement such as R&D, technology, and people's attitudes etc lead to improve production with high quality to the domestic market as well as to the international market and also can compete with other exporting countries.

There are some other valuable things for country's industrial development that is macro economic conditions such as economic growth, savings, investment etc. Sri Lanka's economic growth rate often fluctuated over the decades and couldn't increase or even maintained at considerable level. In contrast Korea, in its industrialization process growth rate has gradually increased and able to maintained over the decades. In Sri Lanka, the annual average real growth of GDP for 60 years since independence has been only 3.2% which is by no means sufficient for a country's development.

To succeed above industrial strategies it is very important to have strong government support in implementing them. In Korea, they had a strong government support in every promotional activity. Government always stayed behind the activities specially done by large firms called chaebols by solving their problems face in the international market and other unfair macroeconomic situations. However Sri Lanka didn't have strong government support in its industrialization process. Most of the leaders didn't have pure willingness to improve Sri Lanka industry sector or carry country to international market to compete with other countries. Most of the industries are not functioning well because of influence of politicians. Therefore it is inevitable that action should be taken to create a favourable environment without political interferences specially in high performed sectors.

Other thing is corruption. Corruption has been spreading throughout the country, majority of them are politicians. The politicians always try to launch the programs only which they receive more advantageous or to gain their personal benefits. On the other hand, people do not trust politicians because of the experience gained in the past, most of the politicians after they come in to power, forget their principles, promises and targets. Political leaders should be honest on their activities.

CHAPTER SIX

Findings and Conclusion

6.1 Introduction

The study has examined why Sri Lanka still couldn't achieve industrialized status and what lessons can be learnt from Korean industrial experience to gain industrial development of Sri Lanka. When studying Sri Lanka's industrial policy in the context of Korea's industrial policy, I found many weaknesses and failures while formulating and implementing them. Therefore, I would like to summarize those findings and then to suggest what lessons Sri Lanka could get from Korean industrial experience to minimize or eliminate those weaknesses and to reach industrial development of Sri Lanka.

6.2 Major findings and lessons learned

For Economic Structural Improvement:

- In attempting to deal with numeral structural problems of Sri Lanka, different governments sought different strategies that are free enterprise approach and inward-directed. This was badly affected to continuity of industrial policy and other macroeconomic policies as

well. In Korea these things does not happen as in Sri Lanka and policies has been continuously implemented with more modernity.

- Sri Lanka didn't identify strategic industries which can produce within the country despite depending mostly on traditional exports while Korea in its initial development process had identified what they can produce and how to improve them to the international market by giving them priorities in the allocation of resources and other incentives.
- Sri Lanka's open market policies allowed import of goods without restrictions and it affected to infant industries in the country. But Korea had been protecting its domestic IS industries continuously.
- Sri Lanka needs to maintain low inflation, manageable budget deficits; maintain appropriate and stable exchange rate and interest rates so as to spur confidence among investors. South Korea has a long history of relatively consistent and stable macroeconomic policies.
- Many manufacturing firms have identified the cost of finance, high interest rate and tedious loan as sever constraint to expand or operate their current business. In Korea due to a strong government always stood behind to guide the industries.

For Institutional Improvements:

- Although Sri Lanka has formulated fabulous economic plans in time to time, at least one plan has not been successfully completed yet, after more than sixty years period of time. The main reasons are;
 - Political influence when implementing the plans.
 - It seemed most of the plans were only to get people's attention for political gains and to stay in power for a long period but not for real need of country.
 - Corruptions are generalized specially among politicians.
 - Less qualified once and relatives of the Ministers/politicians are appointed for key positions of government institutions.
- Sri Lanka's public service should be transformed into a more professional, high quality and competitive body to enable it to face the enormous economic challenges.

For Overhead Development:

- Sri Lanka during the IS phase has used technology but it was not given satisfactory initiatives in technology development in the country. Korea in its initial industrialization phase has adopted new technology and used it in all industries.

- Unsatisfactory transport infrastructure and high cost electricity has been cited as major obstacles for doing business in Sri Lanka. As a result, consequence competitiveness of local industries has deteriorated. Korea has upgraded its infrastructure parallel to suit the promoting industries.

When looking at the above facts it is clear that most of the failures Sri Lanka faced could have been overcome by adopting Korean experience. The important lesson is that the government has to take the leading role in developing and continuously revise the policies and legislation as has been done in Korea. Therefore in the conclusion, I would like to mention that if Sri Lanka really needs to achieve economic development through industrialization, one should be given keen attention to industrial strategies stated above and to do so, pre conditions which I have pointed out should be established as an initial step in the economy.

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