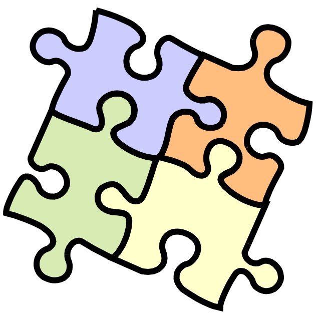
Economic Policies & Application

The SL Economic Performance after Independence

Unit- [12]

Updated for Advanced Level 2024 Exams



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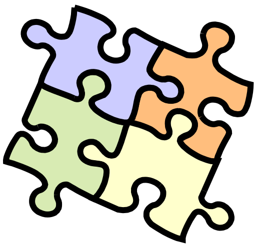


'Completing the Macroeconomic Puzzle'

Policy Essentials | SL Context

[1] MACROECONOMIC MANGEMENT PROCESS

Macroeconomic management refers to the process of directing **macroeconomic variables** (macroeconomic agents, activities and variables) by influencing such variables using a collection of different **policy** measures or instruments (**macroeconomic policies**) in order to achieve specific **macroeconomic objectives.**

Macroeconomic Policies
[Policy Instruments]

→

Macroeconomic Variables
[Agents, activities, variables]

→

Macroeconomic Objectives
[Dynamic Goals]

[2] MACROECONOMIC OBJECTIVES

Macroeconomic objectives are favorable features and developments that are existent in every economy which consists of different goals and targets any society strives to achieve from an economic point of view. Such objectives can be broadly identified as given bellow.

- **Sustainable** and **inclusive** economic **Growth** and **Development**
- **Full employment** of resources
- **Price stability** (Internal stability)
- **Equality** in income distribution

Broad Focus:
Internal Balance [Internal Stability]

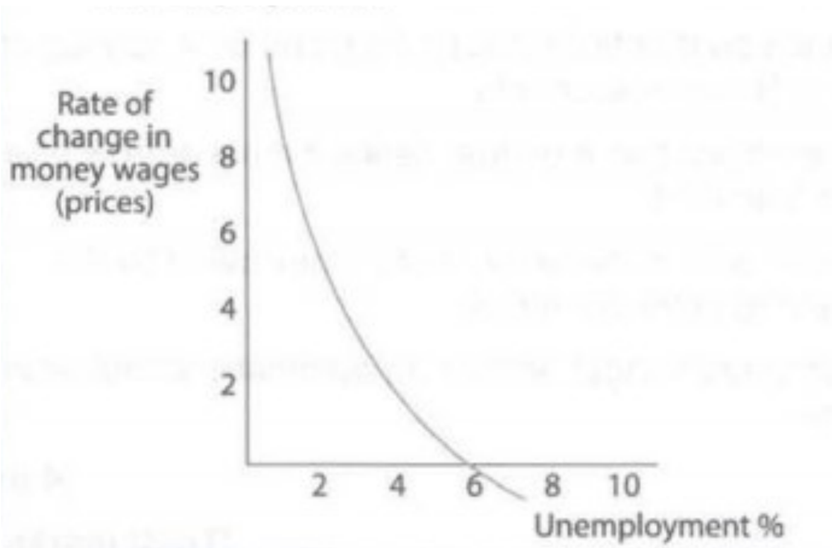
- **Strengthening** the **BOP** [BOP Stability]
- **Stability** of the **FOREX Rate**

Broad Focus:
External Balance [Internal Stability]

[3] CONFLICTS WITHIN ECONOMIC OBJECTIVES OR GOALS

All economic objectives cannot be achieved simultaneously. This is because there will be a certain conflict or contrast between different objectives. Some examples for such conflicts can be given as follows.

- To achieve price stability there can be high levels of unemployment which will result in a conflict between the economic objectives of stability and full employment. The **inverse** or **negative** relationship between price inflation levels and unemployment is effectively represented through the **Philips Curve** (in a situation where there is a certain degree of unemployment along with inflation the combination of the high unemployment rate and the inflation rate creates an index identified as the **'Index of Tragedy'**).



- Conflicts between the objective of achieving economic growth and equality in income distribution.
- The process of achieving rapid economic growth may result in compromising the economies control over the inflation rate. Such rapid economic growth requires expansionary monetary policy measures while inflation control seeks more restrictive or concretionary monetary policy measures. Therefore, an economy's effort to control inflation may decrease the rate of economic growth.
- The objective of increasing the rate of economic growth and maintaining balance of payment stability may conflict. Economic growth will increase income and consumer demand will be strengthened. This will result in an increase in the demand for imported goods that will unfavorably affect the trade balance of the BOP statement.
- There can be certain conflicts between the objectives of economic growth and sustainable development.

[4] TYPES OF ECONOMIC POLICIES

(01) DEMAND MANAGEMENT POLICIES

These policies contribute to increases and decreases in aggregate demand which are generally of two main forms

- Monetary policy
- Fiscal policy

MONETARY POLICY

Monetary policy is the process by which the Aggregate Demand of the economy is influenced by controlling the abundance of money (money supply and credit supply) and price of money (interest rate), to achieve macroeconomic objectives, specifically price stability.

Central Bank of Sri Lanka is responsible for conducting monetary policy in Sri Lanka, which mainly involves setting the policy interest rates and managing the liquidity in the economy.

FISCAL POLICY

This is a macroeconomic policy is concerned with making appropriate changes in elements (policy instruments) such as government '**expenditure, taxation** and public **debt**', in order to achieve desired macroeconomic objectives. In application, by changing the **level** and **composition** of these elements, many macroeconomic variables, dominated by **Aggregate Demand** (AD) can be influenced in a considerable manner.

(02) SUPPLY SIDE POLICES

These are polices mainly targeted at promoting and enhancing aggregate supply or national output. These policies are implemented based on two alternative views or arguments.

- One alternative view believes that most appropriate means of promoting and enhancing supply or output is to minimize the role of the government within the economy.

  This is where government intervention into market operations will be completely eliminated and markets are allowed to function independently. The main contributors to this view are two former policy makers namely Margaret Thatcher (England) and Ronal Regan (USA). They practiced extensive **privatization, deregulation** and **major tax cuts** in their respective economies based on these views of supply promotion.

- The other alternative view was that there should be a certain balanced and healthy degree of government intervention within the economy to strengthen overall supply.

  Such government interventions can be in the form of labour market reforms, education and training development, capital market reforms and development, providing incentives to businesses, micro finance facilities, infrastructure development, rural development, improving efficiency in economic processes and expanding market activities (role of markets) by promoting competition.

(03) EXCHANGE RATE POLICIES

The policy regarding the exchange rate system, exchange control and movements with regards to the foreign exchange rates.

(04) FOREIGN TRADE POLICY

This is the macroeconomic policy with regards to imports, exports, BOP transactions and international capital movements and foreign assets of the economy, which also known as the foreign policy.

(05) INCOME POLICIES

Measures through which a government attempts to control escalation in incomes (wages, salaries, and dividends, rents) to restrain escalation in prices (inflation) without increasing unemployment.

Believers in the cost push inflation theory are the greatest advocates of incomes policy, whereas believers in the demand push Inflation theory regard it as a supplement to fiscal measures. Monetarists (who believe inflation is caused by growth in money supply) consider it irrelevant in controlling inflation.

(06) DIRECT CONTROLS (PHYSICAL POLICIES)

- ✓ Licensing
- ✓ Price controls (Minimum and Maximum price)
- ✓ Minimum production laws
- ✓ Production quota systems
- ✓ Import controls
- ✓ Export controls

Special Note [1] THE EVOLUTION OF ECONOMIC POLICIES

(01) LIBERAL ECONOMIC POLICIES

This is an economic policy introduced by the renowned economist Adam Smith in 1776, which is also known as market economic policy and open economic policies.

(02) NEW ECONOMIC POLICIES OR KEYNESIAN ECONOMIC POLICIES

This is an economic policy introduced in 1936 by John Menard Keynes to rebuild the world economy in a period of global recession. This is also known as macroeconomic policies. Keynes stated that macroeconomic equilibrium is created based on aggregate demand and supply, where the government plays an important role within economic activities.

(03) NEO – LIBERAL POLICIES

These policies were introduced in 1970 mainly by two economists namely, Fredrick Von Hayek and Milton Friedman. The main features of this new liberal policy can be stated as follows.

- Market dominance or sovereignty
- Restricting and terminating government expenditure
- Privatization
- Deregulation
- Structural adjustments
- Washington consensus or agreement

POLICY (EVOLUTION) TRANSITIONS IN SRI LANKA

- 1948 – 1956: Populist economic policies with an open economy Colonial open economic policy
- 1956 – 1965: Populist economic policies with economic control
- 1965 – 1970: Limited liberal economic policies
- 1970 – 1977: Import substitution industrialization policies, with a closed (inward oriented) economy
- 1977 – 1988: Economic liberalization within an open economy
- 1988 – 2005: The second wave or phase of liberalization
- 2005 – 2015: Nationalist economic policies with protectionism, and post war infrastructure development drive.
- 2015 Onwards: Knowledge based social market economy
- 2019 Onwards: Vistas of Prosperity and Splendor

Special Note [1]

MACROECONOMIC STABILITY & INSTABILITY

Economic stability refers to a situation the major macroeconomic variables function with minimum or free of adverse or unfavorable trends and rapid fluctuations. A given economy is said to achieve macroeconomic stability when some of the following conditions are fulfilled.

- Price stability
- Reducing unemployment
- High levels of economic growth
- Reducing BOP imbalances

A situation of macroeconomic instability refers to certain unfavorable developments or trends represented with regards to certain major macroeconomic variables causing adverse effects on economic stability and growth.

A situation of macroeconomic instability is represented through some of the following indicators.

- Declining economic growth rate
- Increasing unemployment rate
- Increasing rates of inflation or deflation
- Unfavorable BOP developments
- Depreciating foreign exchange rates
- Increasing budget deficit

(05) PRO-POOR GROWTH

This refers to an economic growth process that is **favorable towards reduction of poverty** and which **efficiently** contributes to the **increase in income** of the **poor population**. In simple terms this is a growth process that creates a favorable change in **relative income distribution to the poor population.**

Pro poor growth can be measured using two different definitions, namely a relative or **comparative definition** and **absolute definition**. Comparative definition refers to a situation of growth which contributes to the increase in average income of the poor population at a higher rate than the increase in average income of the non – poor population (population above the poverty line). Absolute definition is a process of economic growth which contributes to an increase in the absolute average income of the poor population.

Basic Strategies & Policies

1. Macroeconomic Policies.
Selecting macroeconomic policies that can be used to greatly influence the poor, such as inflation (price) control policies, permitting free trade in selected sectors etc.

2. Sectoral policies
Agricultural reforms, developing human capital through extensive industrial policy studies, expanding health facilities, empowering woman etc.

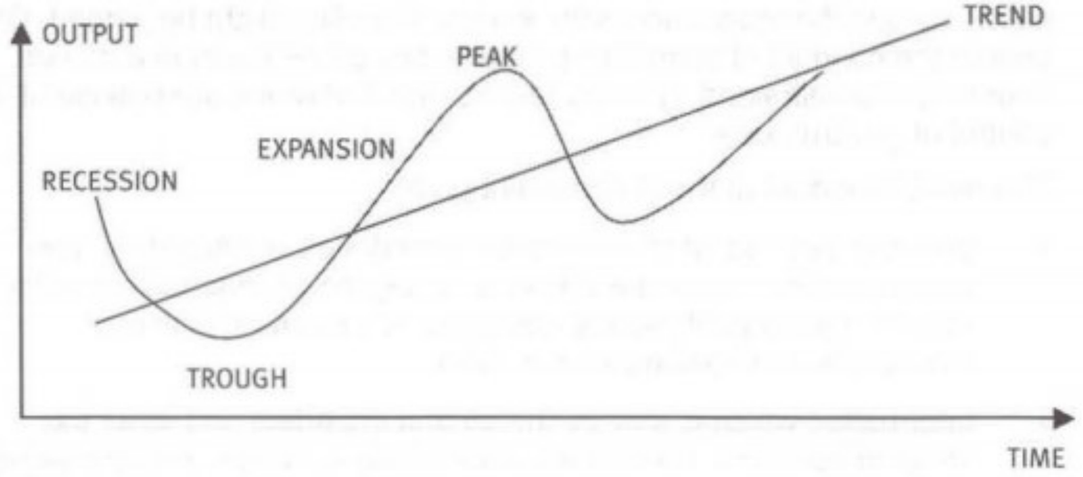
3. Regional development policies
Focusing the economic growth processes in regions where a majority of the poor population tends to be making a livelihood.

4. Redistribution policies
Formulating policies to increase the opportunities for the poor population to generate income and receive employment, such as providing the ownership of land to farmers, ensuring the legal ownership of farmland there by increasing access to the credit market and also providing effective social protection or safety nets (Aswasuma Benefits Scheme, Samurdhi Program etc).

5. Creating a favorable overall social and political environment conductive in the process of achieving sustainable elimination of poverty and development.

Special Note [2]: Trade (Business) Cycle Model

Many economies exhibit fluctuations in economic activity over time with an underlying trend of output growth.



Some economists argue that one role of governments is to smooth out this pattern to avoid 'boom and bust' years.

Analysis:

Essential Knowledge

Stage of trade cycle	Features	Causes	Policy response
Recession	• falling output/income, • high and rising unemployment, • reduced inflationary pressure, • improving trade balance as imports fall • public finance will be adversely affected due to reduced tax income and increased benefits payments	• falling domestic AD from lower levels of: consumer spending, investment, exports, government expenditure • world recession	• raise AD by reducing taxation, raising public expenditure, lowering interest rates • Note: this will further increase the need for government borrowing
Stagflation: special type of recession	• falling output, income and employment • rising inflationary pressure	• supply-side shocks reducing aggregate supply • could have a recession due to low AD combined with imported cost-push inflation	• supply-side policy to raise aggregate supply

Essential Knowledge

Stage of trade cycle	Features	Causes	Policy response
Recovery	• output and income begin to rise • unemployment begins to fall • only moderate inflationary pressure • improving public finances	• returning confidence in business and consumer sectors • effect of government expansionary policy undertaken in recession	• reduction in expansionary policy to prevent too strong a boom
Boom	• high output and employment • rising inflationary pressure • deteriorating trade balance as imports rise • Higher net income for government allows repayment of debt	• high and rising AD from higher levels of: consumer spending, investment, exports, government expenditure	• reduce AD by raising taxation, reducing public expenditure, higher interest rates

Further Analysis:

The main implications of 'boom and bust' are:

	Boom	Bust
Individuals and households	On the whole a boom time will be good for households: • low unemployment • rising house prices • high levels of confidence • increasing consumer spending. But: • People may be tempted to over-stretch borrowings. • Possible inflation, the main problem with 'boom and bust'.	The main problem with 'boom and bust' is the 'bust': • job losses • people losing their homes when unable to pay mortgages • fall in labour mobility due to negative equity • bankruptcy • low confidence.
Firms	• growth in profitability • extra competition as new firms are established. • May be tempted to over-stretch themselves through growing too quickly (which can give cash flow problems) and/or excessive borrowing.	• corporate failures • fall in profits • excess capacity.

Most people and firms would prefer steady growth without the high risks associated with the extremes of 'boom and bust'.

[Source: CIMA official study text/2019 - 2022**]**

Special Note [3]

FLOW VS. **STOCKS CONCEPTS**

- **FLOWS** (During a period of time/ per time period)
  - Creation, transformation, exchange, transfer, extinction of economic value due to
    - transactions
    - other events

- **STOCKS** (At a point in time)
  - Positions in, or holdings of assets and liabilities
  - Are recorded on the balance sheets

NATIONAL INCOME, WEALTH & **CAPITAL STOCK**

✓ **National income** is the flow of new wealth, resulting from the productive use of the nation's capital stock, measured **per time period** (generally within a year or yearly), i.e. income is a **flow concept.**

✓ **National wealth**, is the aggregate of physical assets or things that have value, owned by the nation's residents, **at a given point of time** (as at the end of the year), i.e. a **stock concept**. National wealth consists of consumer goods, in addition to the capital stock.

✓ **National capital stock** is the part of national wealth capable of producing more wealth, owned by the nation's residents, **at a given point of time**, i.e. also a **stock concept.** It includes all capital goods and raw materials, as well as social overheads such as schools and hospitals, but it excludes consumer goods. While all capital is wealth, but the reverse is untrue.

Source: ***Powell, R. (1997), A-Level Economics***

Special Note [4]

The Concept of Financial Inclusion

Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost in a fair and transparent manner by mainstream Institutional players.

[OECD: Organization for Economic Corporation and Development]

Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way.

Access to a transaction account is a first step toward broader financial inclusion since it allows people to store money and send and receive payments. A transaction account can also serve as a gateway to other financial services, which is why ensuring that people worldwide can have access to a transaction account is the focus of the World Bank Group's Universal Financial Access 2020 initiative.

Financial access facilitates day-to-day living and helps families and businesses plan for everything from long-term goals to unexpected emergencies. As accountholders, people are more likely to use other financial services, such as credit and insurance, to start and expand businesses, invest in education or health, manage risk, and weather financial shocks, which can improve the overall quality of their lives.

[World Bank Group]

Special Note [5]

[A] State the importance of Foreign Direct Investments (FDI) to Sri Lanka

- In order to improve the rate of economic growth and finance the BOP deficit on a long-term, sustainable basis
- Improving the quality of Sri Lanka's Manufactured Goods exports, through new production technologies and processes
- As an essential element of skills development and adopting new management methods
- In the process connecting Sri Lankan products with the global production networks

[A] What are the main challenges in the process of implementing GOSL's Fiscal Policy?

- The inflexibility of government expenditure [especially within the short-run due to commitments such as interest payments, salaries and wages, transfer payments (pension payments)]
- Especially the expenditure on human capital development, public goods and services is inadequate (inadequate fund allocations on education and healthcare sectors)
- High degree of inefficiency within the public sector, while having a large public sector work force
- Reducing levels of government revenue [dependence on indirect tax sources as main form of government income, makes it difficult to expand the tax base]

Special Note [6]

Essential Knowledge

[A] 'It is said that Sri Lanka has to transform from its present Inward Oriented Growth Strategy to an Outward Oriented; Trade-based Growth Strategy'. Outline the salient elements of such a strategy

- Measures to ensure the principal sources of economic growth over the medium and long term, becomes outward (export) oriented tradable economic activities [at present sources of growth is dominated by domestic non-tradable (inward oriented) activities such as home trade, communication, government services, banking services]
- Export diversification; to transition from the traditional exports such as tea and apparels , where SL is less internationally competitive, towards 'High Tech Products' by implementing aggressive and immediate measures to establish a strong Technological Base in SL, to facilitate the production and export of such products.
- Providing aggressive infrastructure and institutional support to promote sectors such as Tourism, which is another sector in which SL holds a competitive advantage.
- Measures to improving the overall productivity of the economy, with specific emphasis on the export sector

[B] Further Discussion:

Essential Knowledge

The inward oriented strategy followed over the last decade has been the root cause of the present foreign exchange crisis and debt problem faced by Sri Lanka.

It is evident based on empirical data that there is a positive correlation between rapid economic growth [effect] and growth in the outward oriented (export) activities [cause].

An Inward oriented growth strategy (focusing on domestic economy) may derive economic growth, but such growth will be inadequate and unsustainable in the long run

In the context of Sri Lanka reaching 40 years since becoming an open economy by 2017, some of the flowing stages in Sri Lanka's policy (growth strategy) transition tend to be important knowledge.

- 1977 onwards, export oriented economic policy
- 2005 onwards, heavy focus on inward oriented economic activities (strategy) and moving from an Import Substitution Strategy to Import Replacement Strategy.

- A community (or region) focused on import replacement would seek to locally produce goods and services that are currently imported in order to keep money circulating within the country.
- By developing local production, it would increase its capacity to meet the economic, social, and cultural needs of the people of the region from within the region, not in a spirit of isolationism but in a spirit of self-determination.

- Import replacement is not a substitution for exports, but a way of decreasing a region or community's vulnerability to external pressures.

Special Note [7]:

[A] Productivity & Productivity Gaps

Productivity is a measure which represents the efficiency of production resources or factors such as land, labour or capital. Productivity measured in real terms by estimating the average output or product which can be generated from one unit of inputs.

If the output which can be produced with a given unit of inputs increases, such a situation is known as an increase in productivity. When productivity improves the unit cost of production tends to decrease.

This is a concept which is highly useful in the process of explaining the disparities in living standards among individuals, economic disparities between countries and international specialization in terms of external trade.

[B] ECONOMICS BENEFITS OF IMPROVED PRODUCTIVITY

- ✓ Ability to receive a high level of output or product
- ✓ Reductions in cost of production
- ✓ Improved profitability
- ✓ Improvement in competitiveness
- ✓ Functions as a major source of economic growth

[C] MEATURES TO IMPROVE PRODUCTIVITY

Essential Knowledge

- ✓ Increase in investment on education and training activities
- ✓ Improving infrastructure facilities
- ✓ Encouraging and facilitating foreign direct investments (FDI)
- ✓ Providing incentives to increase investments on research and development activities
- ✓ Measures to improve management and entrepreneurial skills
- ✓ Increasing capital investments
- ✓ Practicing government deregulations and market driven reforms
- ✓ Increasing incentives towards SME sector
- ✓ Improving competitiveness in markets (Market perfectness)

The core forces of productivity improvement: Innovations, Entrepreneurship, Investment, Competiveness, Skills, Ethics and Attitudes.

[D] PRODUCTIVITY GAP (LAG)

- ✓ Productivity gap refers to the difference or disparity between the quantity of potential output and the quantity of output which is actually produced by a given individual.
- ✓ If the level of motivation of a given individual diminishes, there is a tendency for the actual output to decrease to a level below the potential output.
- ✓ The main factors affecting or reasons for the creation of a productivity gap can be identified as follows:
    - Inadequacies in skill levels
    - High level of rigidness and red-tapes within government involvement in business activities
    - Inadequacies fund allocation towards research and development activities
    - Limited levels of investment on new machinery and equipment
    - Market imperfectness or limitedness in competitiveness
    - Inefficiencies of the government sector
- ✓ *It is identified that productivity can be improved by influencing certain fundamental forces or elements such as, innovations, ethics and values, entrepreneurship, investment, competition, skills and competencies.*

Special Note [8]:

Essential Knowledge

[A] INFRASTRUCTURE

- Infrastructure can be considered as the stock of capital which facilitates and provide convenience to overall economic and social activities of a country.
- Such infrastructure facilities can be mainly classified as Economic and Social infrastructure.
- Social and economic infrastructure is further classified in to soft and hard infrastructure facilities, which can be further illustrated as followed.

Economic Infrastructure	***Social Infrastructure***
Hard ▪ *Highways/Expressways* ▪ *Airports and Ports* ▪ *Railway Networks/tracks*	***Hard*** ▪ *Hospitals* ▪ *Schools* ▪ *Housing* ▪ *Sanitation Facilities*
Soft ▪ *Financial Institutional Services* ▪ *Professional Services* ▪ *Technological exchanges*	***Soft*** ▪ *Social Safety/Security Nets* ▪ *Environment Protection Agencies* ▪ *Social Services*

[B] ECONOMIC INFRASTRUCTURE

Economic infrastructure refers to different capital goods or facilities (quasi-public goods) needed in order to carry out a given countries economic activities both efficiently and conveniently. Economic infrastructure facilities are treated as the fundamentals for the effective performance of an economy.

Examples

- Energy (Electricity and petroleum-based fuels)
- Telecommunication
- Road and railway systems
- Ports and airports
- Irrigational facilities etc.

Infrastructure facilities cannot be treated as pure public goods, even though some of these facilities or services can be consumed collectively and there is a certain degree of non-excludability (roadway systems, irrigation facilities etc), accordingly infrastructure facilities tend to be classified as **semipublic goods.** The **governments** in many developed and developing nations continue to provide such **infrastructure facilities** based on some of the following **reasons.**

- Requires a large-scale investment
- Creates positive externalities
- Can be supplied at concessionary rates
- The private sector may have limited expertise and interest in providing such facilities and are generally discouraged by the long-time lag in generating returns.

[C] THE IMPORTANCE OF INFRASTRUCTURE

- Infrastructure facilities increase the productivity of production factors.
- Reduces the cost of producing goods and services.
- Providing effective infrastructure facilities is an important component in the process of achieving economic growth.
- Efficient infrastructure facilities are an important precondition in order to attract foreign direct investments.

[D] PRIVATE SECTOR & INFRASTRUCTURE

The private sector of an economy will be motivated and encouraged to be a part of the process of creating and providing infrastructure facilities, only if they are able to gain a high level of Return on Investments (ROI) or profits.

It is sometimes difficult to attract the private sector since infrastructure projects require large capital investments and ROI tends to be very long term (Average two to five years). Today many governments have adopted a strategy of private public sector partnership in the process of infrastructure development to increase private sector participation.

Such private public partnership agreements and general infrastructure development projects tend to incorporate some of the following infrastructure development modules.

- Build Operate and Own (BOO)
- Build Operate and Transfer (BOT)
- Build, Own, Operate and Transfer (BOOT)
- Joint – ventures

[E] PUBLIC – PRIVATE PARTNERSHIPS (PPP) FOR INFRASTRUCTURE DEVELOPMENT

Public private partnership the private sector investors, foreign or domestic, join hands with the government through a 'partnership' arrangement to undertake development projects (social and economic infrastructure). The government could contribute to the arrangement by investing in land and providing licenses, safeguards and sovereign guarantees, facilitating the fund-raising processes and creating an enabling environment.

The private sector (domestic or foreign) could undertake part of financing and implementation and operation of the project. The expertise of the private sector will be mainly used in managing commercial risk involved with infrastructure projects, while the government will bare risks in the form of political, environmental, regulatory and non-commercial. Such PPP programs can be implemented under four main schemes (methods),

- Build, Operate and Transfer (BOT)
- Build, Own and Operate (BOO)
- Build, Own, Operate and Transfer (BOOT)
- Joint – ventures

Many developing and emerging market economies such as India, Pakistan, Indonesia and Malaysia have effectively used PPP as a method of financing infrastructure projects.

The following can be identified as the main **prerequisites (pre-conditions)** in order to attract the **private sector** (domestic and foreign) for such **social and economic infrastructure** development projects, under the PPP scheme.

- Implementing suitable and sustainable policies (consistent economic policies)
- Establishing good governance and transparency (specially within the public sector)
- Improving institutional framework and skills
- Productive regulation and efficient financial markets

Essential Knowledge

[F] BENEFITS OF PUBLIC PRIVATE PARTNERSHIP

- Reduces the budget deficit
- Government borrowings and public debt tends to decrease and the ability to reduce the pressure on inflation
- These projects in the long run or future dividends and capital profits which will help finance government income
- The private sector is more efficient in managing such projects than the government
- Inflow of foreign investments into the country
- Helps in the process of productivity and quality
- The ability to generate foreign funds through successful projects
- Competition improves
- The ability to share and better manage risk through this partnership between the public and private sector.
- Expansion in the development and use of technology

Special Note [9]

INDUSTRIAL DEVELOPMENT – ISSUES (BARRIERS) & POLICIES

- Constraints with regards infrastructure facilities
  (Limited power generating capacity, unreliable electricity supply and high cost of energy, inadequate roadway systems etc.)
- Imbalances and inflexibility
  (Rigidness) within the labour market (rigid labour laws, lack of skilled labour and adverse trade union interventions etc)
- The existence of inelastic market situations
- Limitations in initiating new industries
  (Limited availability of investment capital, inefficient planning process and difficulties in securing financing facilities etc)
- Constraints in terms of sourcing raw materials
- The lack of a long term and national industrial policy of the governments
- The lack of effective communication and coordination between the private and public sector.
- Inefficient management methods and practices within the industrial sector leading towards loss of industrial peace
- Political instability
- Reduction in demand for export due the practice of exporting inferior quality goods.
- High cost of overall industrial production
- The impractical locating or positioning of factories and industrial zones

Special Note [10]

[A] THE PROBLEM OF CAPITAL SHORTAGE

Steps to **overcome** the problem of capital shortage in developing countries

- Maintaining macroeconomic stability in terms of price levels, employment, interest rates and foreign accounts
- Achieving government (public) savings through effective fiscal policy management, which will help reduce the overall budget deficits. Resulting in low levels of public borrowings from expansionary sources (limits inflation) and increases the availability of funds for private sector borrowing and investment activities (reducing crowding out effects).
- Implementing measures to improve the productivity of capital resources such as using improved technology, technical knowledge and better management practices.
- Encouraging domestic private saving, using attractive interest rates, flexible savings options or schemes and inflation (consumption cost) controls.
- Strategies to promote foreign direct investments such as free trade zones, industrial areas, tax holidays and concessions, infrastructure facilities and creating an overall investor friendly environment (political and economic stability, specially resolving the ethnic conflict).

[B] OBSTACLES FOR INVESTORS

The main obstacles or reasons for the limitedness of investments in Sri Lanka

- Macroeconomic and political instability & inadequate infrastructure facilities
- High cost (interest rates) and the difficulties (procedures) in obtaining loans and funds required for investment activities.
- Lack trained and skilled employees and the inflexible nature of the labour market (skilled labour resources) and limited market opportunities (small market size)
- The high cost that needs to incurred in order to carry out investment agreements and undue (unlawful) political influences, corruption, bureaucracy and strict regulatory barriers on investment activities.

[C] THE UNDERUTILIZATION OF FOREIGN AID

Factors responsible for the underutilization of foreign aids of Sri Lanka

- Unnecessary and unethical political influences in the process of allocating and devising strategies or projects, with regards to foreign aids.
- Lack of transparency in terms of tender procedure and limited or no accountability of certain foreign aids, in allocation process.
- Ethnic conflict or civil war situation creating a high level of insecurity in many parts of the country, limiting accessibility or spread of development projects to these areas and effective monitoring of projects become difficult and unsafe.
- Inefficient management of major development projects, mainly due to the lack of a proper monitoring system (a government agency with clear authority and responsibility) and able, qualified and experienced human capital resources or project personal.
- Inefficient tender procedures and the government failing to release pre agreed counterpart funds.

Notes

Notes

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