Of Mr. Timerman himself, it can be said that, had he not existed, the media and the left would have created him. For, when all other attacks fail, the charge of anti-Semitism is usually infallible.

Ralph deToledano

Adam Smith in Sri Lanka

Sunsets over the Indian Ocean are glorious. On the oceanfront lawn and near the pool of the Galle Face Hotel (in Colombo, Sri Lanka), a stream of tourists from Western Europe collects to enjoy the view or explore the marvelous historical treasures scattered throughout this "resplendent isle," as the name Sri Lanka means in English. However, the majority of these tourists are probably unaware that some very important changes have been taking place on this tropical island in the past few years.

By worldwide standards, Sri Lanka today ranks as a very poor country, with a per capita income below U.S. $200 a year. Since 1798, the island had been ruled by the British, until in 1948 it was granted independence. Under British rule, the island had developed a sound administrative and physical infrastructure, external financial reserves, and a high literacy rate in English. But between 1948 and the 1970s, the country slowly disintegrated economically and was only kept afloat by massive infusions of money from the international-aid-to-Sri Lanka club, to which the United States was a major contributor.

Sri Lanka's history dates back 2,500 years to its original settlement by the Sinhala people from the South Asian subcontinent. The Sinhala were followed in turn by the Tamils from South India, Arab traders, Portuguese spice merchants, Dutch traders, and lastly the British. Ceylon (as the island was named under British rule) developed as a plantation economy, exporting tea, rubber, and coconut. Its modern day political evolution developed from the westernization of its indigenous elites in the early decades of the twentieth century. Political progress was rapid. Universal suffrage was granted in 1931 and peaceful independence in 1948. Since then, however, island politics have not been so tranquil. Nationalist sentiments have dominated politics during much of the past thirty-three years. Political disputes between Sinhala and Tamil have often flared into violence, resulting in the establishment of martial law. Up-country Buddhists have continued to feud with lowland, coastal English-speaking leaders, and one prime minister has been assassinated.

On the economic front, socialism and state-control have steadily replaced private ownership and the market economy. The export-oriented plantation sector has been heavily taxed to finance free education, free medicine, free water, sanitation, subsidized food, and cheap transport. When the plantations were finally nationalized in the mid-1970s, the public sector controlled more than 90 percent of the economy. Although these policies may have increased literacy and lowered infant mortality, they were accomplished only through government pre-emption of resources and the destruction of incentives to the total detriment of economic growth. As economic stagnation set in, further government efforts to redistribute income resulted only in a redistribution of poverty. The government of socialist-leaning Mrs. Sirima Bandaranaike (1970–1977) ruled through a perpetual state of emergency, which was declared in the course of a violent youth rebellion in 1971 and remained in force until 1977. Her economic policies beset the economy with import controls, foreign exchange controls, price controls, and a plethora of state industrial and trading monopolies. She nationalized land, banks, and businesses. The results were food and other shortages, black markets, and widespread evasion of controls and taxes. Her strategy of import substitution fostered inefficient, overprotected industry. Low food prices and food rations for all, regardless of income, eroded producer incentives, even for those subsisting on their own land. A massive public sector smothered the remains of private sector initiative, and a great deal of the country's talent decided to migrate overseas. The country's external reserves were run down and massive budget deficits, financed by new money creation, brought a ruinous inflation. By 1975 economic life had virtually ground to a halt.

In past elections, communal rivalry between Sinhala and Tamil had invariably dominated all other issues. In the 1977 election, which had been postponed since 1975, economic issues were paramount. In fact, this election marked the first time in democratic Sri Lanka that any general election had not been held on schedule. Promising a new direction in economic policy, the United National Party, under the leadership of J. R. Jayewardene, swept to a landslide victory. The new government immediately set out to reverse thirty years of socialist economic policies.

The new Prime Minister and his cabinet subscribe to a philosophy of government which asserts that there can be no political freedom if the state has full control of the economy. No man is safe in his home, job, or person if a failure to support the ruling party threatens to take these rights from him. Preservation of liberty requires maintenance of a free economy.

Further, Jayewardene and his youthful followers argue that socialism and state controls have utterly failed in Sri Lanka, and were largely responsible for rising unemployment, shortages of essential goods, widespread nepotism and corruption, and an inefficient and unresponsive public sector. Sri Lanka's new president is a close friend of Singapore's dynamic Prime Minister, Lee Kuan Yew. Despite the differences between the urbanized Chinese city-state of Singapore and rural Sri Lanka, there is growing admiration in Sri Lanka for what is called the "Singapore model" of development. Singapore flourishes through competition, free trade, tax concessions, and foreign investment. Its sustained high rates of economic growth have generated sufficient revenues to pay for massive public works and a wide range of current government services. Public servants in Sri Lanka are sent to Singapore to learn about its administrative skills and techniques.

Jayewardene, as Finance Minister in the previous United National Party government of 1965–1970, introduced tax concessions for hotels to develop tourism. The success of this venture encouraged him to develop further liberal tax measures, which he was in a position to implement after his 1977 election victory.

Before 1977, economic policy in Sri Lanka had stressed import substitution—the development of indigenous industry for the local market, securely protected behind a high tariff wall. Sri Lanka's new economic policy is now predicated on the belief that a small home market defeats an import substitution strategy and that Sri Lanka has always fared best as an export-led economy. Therefore, economic growth must come from encouraging both traditional plantation exports and new manufactured goods. To this end, a spate of new economic and fiscal policies has been adopted.

New Economic Policies

The government has eliminated the old, fixed exchange rate system that overvalued the Sri Lanka rupee. Although this policy held down the costs of food imports, it discouraged exports and led to a system of price controls and rationing that created shortages, queues, and an incomprehensible maze of producer taxes and consumer subsidies to compensate for the effects of price distortions. Now the rupee is allowed to float. This new realistic exchange rate system has restored producer and export incentives, eliminating the need for price controls and rationing. The price mechanism, not the bureaucracy, now allocates goods, and corruption has been significantly reduced.

A policy of licensing imports to control the inflow of foreign goods has been replaced with a commitment to the open economy and the application of very selective tariff protection. Liberalized imports have forced inefficient, protected industries and public monopoly enterprises to compete with private enterprises. The government has closed some public firms and reduced the subsidies of others. In 1979, general subsidies to state industries were slashed by nearly 80 percent, from Rupees 1,486 million to Rupees 300 million. Public industries have been instructed by the new government to become commercially viable, which has forced them to raise prices to meet higher production costs or go out of business. The new liberal import policy increased activity in the business and manufacturing sectors so much that despite a significant reduction in the business turnover tax rate, revenues from this source nonetheless rose 62 percent in 1979—a result that would make Arthur Laffer proud.

To move quickly from an import-substitution to an export-led strategy of economic growth, the government has granted a large number of tax concessions and reductions: a true supply-side policy. In 1978, it created the Greater Colombo Economic Commission (GCEC), which exercises jurisdiction over 160 square miles of land extending north from the capital, Colombo, to the airport. Within this territory, the GCEC has established several free trade zones that offer investors a variety of incentives, with no limit on foreign equity participation. These include (a) up to ten years of full tax holiday on salaries, profits, dividends, with a potential extension of fifteen more years; (b) no income tax on the salaries of foreign personnel; (c) free remittance of dividends, no exchange controls, and tax free status for non-resident shareholder dividends; (d) free transfer of shares; (e) no import duty on raw materials, machinery, and so on.

By December 1980, the GCEC had approved 113 projects, representing investors from 21 different countries. Some 12,000 people already work in the zone and, when it is fully developed, this figure will rise to 50,000. To see the importance of these figures, total industrial employment in the entire country in 1979 stood at about 150,000. In the first two years of operation of the GCEC, total foreign investment in the free trade zone came to Rupees 3,000 million (U.S. $167 million). As a result of this economic program, industrial exports have risen substantially in 1979 and 1980.

Apart from direct tax benefits, investors are assured of freedom from "red tape," since the GCEC is legally empowered to grant exemption from a number of specific sections in Schedule B provisions—The Inland Revenue Act, The Customs Ordinance, The Exchange Control Act, The Companies Ordinance, The Merchant Shipping Act, The Finance Act, and The Air Navigation Act—to any firm and can discharge in GCEC territory the powers and functions normally assigned to a variety of ministries for sections of fifteen acts that make up Schedule C. To put this freedom from red tape in practical terms, one factory manager in the free zone told me that his plant there operates far more efficiently than his firm's other plant outside the zone. To operate the other plant, he has to run from ministry to ministry getting all the requisite permissions to do business.

In the design of its free trade zone, Sri Lanka received advice from the Shannon free trade zone in Ireland and the United Nations International Development Organization, which advises Third World countries on the establishment and operation of free zones. Sri Lanka made it a point of economic policy to offer the most attractive incentives to foreign investors that could be found anywhere in the world.

Amendments to the 1978 enabling legislation authorize the GCEC to grant free trade zone incentives and concessions to any investor who wishes to set up an export plant anywhere in the country outside the zone, if it is necessary for either technical or economic reasons. The GCEC may acquire land anywhere to establish a free zone outside of its original 160 square mile jurisdiction, subject, of course, to compensating the private owners for their land.

Phase One of the first free trade zone is fully let. To speed up development in the second phase, the GCEC has turned over to private developers the opportunity to supply housing and administrative facilities, thus reducing government expenditure and further bringing market forces to bear on the process of industrial development.

In addition to GCEC investments, a Foreign Investment Advisory Committee (FIAC) also authorizes joint ventures between foreign businessmen and local equity participants. Five-to ten-year tax holidays on profits, dividends, and non-resident management fees are granted in a variety of approved investment or business areas including hotels, urban development projects, companies that construct power and irrigation projects, pioneer industries, gem exports, and so on.

The requirement for local equity participation in investments outside GCEC jurisdiction retards new projects due to a shortage of local equity capital. Still, in 1978, the FIAC approved about Rupees 200 million in investments. In 1979, the figure rose tenfold to Rupees 2,000 million, and nearly doubled in 1980 to Rupees 3,800 million. These sums add to a total of U.S. $333 million in a few short years and 7,000 new jobs. Of course these sums are only approvals and it will take some time before the money is actually spent. Still, it represents a vote of confidence in the country's future by both foreign and local investors.

To complement the investment opportunities, Sri Lanka has established offshore banking in the form of Foreign Currency Banking Units, which offer offshore banking facilities to all non-residents and GCEC enterprises. Permissible currencies include French and Swiss francs, Japanese yen, Dutch guilders, English pounds sterling, German deutschmarks, and U.S. dollars. Profits from the operation of offshore banking are tax free. These banks are allowed to offer secret numbered accounts and severe penalties are prescribed for anyone who reveals any details about these accounts. Sri Lanka hopes to become a Switzerland in Asia.

Tax holidays to encourage investment have been accompanied by a variety of other fiscal relief measures. In 1979 these included exemption of capital gains on the first sale of a house, exemption for interest earnings up to Rupees 2,000 on deposits with the National Savings Bank (a measure to spur savings), and exemption of up to one-third of tax assessable income if such income was spent on purchase of shares in new approved businesses, a contribution to a retirement fund, the purchase or construction of a house, a donation to an approved charity, or was classified as research and development expenditure. The tax rate on resident companies was reduced from 60 to 50 percent.

In 1980, both individual and corporate tax rates were cut. The maximum tax rate of 70 percent on individuals' income was lowered to 55 percent. Corporate rates were further lowered to 40 percent, for companies with publicly quoted shares. Capital gains on publicly quoted companies are now exempt from tax. In proposing these 1980 measures, the Finance Minister stated that

"High marginal rates can exert an adverse effect on incentives to work, save and invest. They hamper growth." Moreover, he continued, "I do not expect any significant loss in revenues as a result of this measure as less evasion is likely to take place. Considering their long-term, or even, for that matter, their short-term effects, they should be self-financing by inducing increased production and exports, and less tax evasion."

Universal subsidization of all Sri Lankans in foodstuffs has been replaced with a selective subsidy in the form of "food stamps" to those with monthly incomes below Rupees 300/month (U.S. $18/month). Food prices now realistically reflect local or overseas production costs.

State industrial and trading monopolies have been gradually reduced or eliminated. In 1977, some 90 percent of the economy was controlled by the public sector; this percentage has fallen to about two-thirds and plans call for further shrinkage of the public sector throughout the decade.

The government has begun to shift public spending from consumption subsidies to investment in economic infrastructure, largely in the fields of irrigation, hydroelectric power (needed to support growing industrial demands on power), transportation, and communications. Consumption subsidies are scheduled to fall from 30 percent of the budget to 21 percent by 1984. Capital formation has correspondingly risen in the past few years.

The Results

How have these new economic and fiscal policies fared? To begin with, world aid organizations have registered a vote of confidence in Sri Lanka in the form of large sums of additional development aid. The United States, for example, gives Sri Lanka more aid per capita than any other developing country.

Economic statistics for the brief three years from 1977 to 1980 are encouraging. Unemployment has fallen from a peak level of 24 percent in 1973 to about 15 percent in 1980 and, if recent rates of economic growth can be sustained, could fall to about 7 percent by 1984. Since 1977, real rates of economic growth have more than doubled. During the regime of Mrs. Bandaranaike, economic growth averaged 3.1 percent per year, a gain of about 1.5 percent per capita. Since 1977, the economy has grown at real annual rates of 8.2, 6.2, and 5.6 percent respectively. In per capita terms, the average is close to 5 percent per year, more than threefold that in the prior regime. These higher growth rates since

1977 have been achieved despite the worst cyclone in decades, a worldwide economic slowdown, oil price hikes, and a severe drought.

Economic reforms often move in fits and starts. The United National Party government (UNP), taking office in mid-1977, inherited an economy in severe disrepair, suffering high inflation due to a 30 percent growth in the money supply in each of the two prior years fostered by the Bandaranaike government's policy of consumer subsidies. The Jayewardene government set out to fix both of these problems. First, it got the growth rate of the money supply down to 11 percent in 1978, thus slowing inflation. But it also embarked on an ambitious program of public spending on dams, power projects, housing, and other public works to make up for years of public neglect of the nation's infrastructure. Public spending outpaced the nation's internal and foreign aid resources, generating a massive budget deficit in 1980. The Central Bank was forced to buy Rupees 6,800 million of new treasury bills (virtually tripling central bank holdings of government debt in one year), and both the money supply and inflation accelerated to an annual growth rate of 30 percent. Inflation is now the country's most important economic problem. The 1981 budget forced across-the-board cuts in government spending. For the moment, government officials have learned that growth in the private economy must precede massive increases in government spending.

A second setback to economic recovery is the process of denationalization, which some feel is proceeding too slowly. Since the former government had nearly destroyed the private sector, the process of returning to a market economy is a slow, painful one. Two-thirds of the industrial and trading sectors are in public hands, but this is a major reduction from the more than 90 percent that prevailed in 1977.

Sri Lanka has far to go before it can duplicate the productivity and sustained economic growth of Singapore, Hong Kong and other Pacific Rim economies. To continue its growth-oriented economic policies, the UNP must get a vote of confidence from the electorate in 1983 lest Mrs. Bandaranaike return to power and restore her former policies of subsidies and income redistribution.

But there may be an even more important story to tell than the success of incentives and the market economy in tropical Asia. Unlike Singapore, Hong Kong, Taiwan, and Korea, Sri Lanka is a democracy with universal suffrage. Many attribute the economic successes of these Pacific Rim economies and of several Latin

American societies to the imposition of liberal economic policies by political strongmen or authoritarian governments. Such a correlation has led several commentators to wonder if liberal economic policies, which generate high growth, are compatible with western-style democracy. To the extent that Sri Lanka's reforms succeed, they demonstrate that free elections and free markets can go hand-in-hand, that a liberal economy need not be at the expense of democracy and the franchise.

Alvin T. Rabushka

Why Women Earn Less

PAUL McGOULDRICK

There is a remarkable paradox concerning women. From 1900 to today, huge numbers of women have taken jobs outside the home or the family farm. The proportion of these to all adult women has risen from less than two out of ten, to over one-half. Their formal education has risen more than men's has and legal disabilities have given way to affirmative action. Yet the average pay of women has *not* risen relative to that of men. In 1939, the average full-time female worker was making 61 percent as much as her male counterpart; by 1977 the proportion had fallen to 57 percent.[1] Why?

The conventional answer has been discrimination in the marketplace because of male aversion to working with women. And we all know about extensive government intervention to right the balance over the past twenty years, starting with the Equal Pay Act of 1963 and ending with imposition of *de facto* sex quotas by the Equal Employment Opportunities Commission. But this paper reaches a radically opposite conclusion from that on which such government intervention has been based. Not the marketplace but Big Sister in Washington is the "villain." If writers of songs and storytellers seek a mythic figure of oppression, it should not be J. P. Morgan but Franklin or Eleanor Roosevelt.

Dr. Michael Tannen and I have found that competitive markets and minimal government resulted in women's being paid the same as men, on the average and adjusted for productivity, shortly after the turn of the century. Government has subsequently created much larger disincentives for women than for men to improve their job-related skills. Government has done this by setting tax rates, benefit policies, changes in educational curricula, and regulatory laws and policies.

Measuring Discrimination

At its crudest, the assertion of marketplace discrimination against women rests on the fact that the average woman is paid much less than the average man. But economists publishing tech-

1. U.S. Department of Labor, *Employment and Earnings* (January 1979) p. 156.