

**The impact of the cost equalization strategy  
for the development of non traditional exports  
in Sri Lanka.**



*Master of Arts (Economics) Thesis*

EM

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*A Thesis submitted to the University of Sri Jayawardenepura for the  
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**Nugegoda, Sri Lanka.**

**(March, 1999)**



## Statement of Authorship.

This thesis contains no material which has been accepted for the award of any other degree or diploma in any University or equivalent institution, and that to the best of my knowledge and belief, contains no material previously published or written by any person, except where due reference is made in the text of the thesis.

The work described in this thesis was carried out by me under the supervision of Professor S. Tilakaratna and Professor W A Jayatissa.

  
M. Palitha Ekanayake. 30/3/99

## Declaration by the supervisors

We certify that the above statement made by the candidate is true and that this thesis is suitable for submission to the University for the purpose of evaluation.

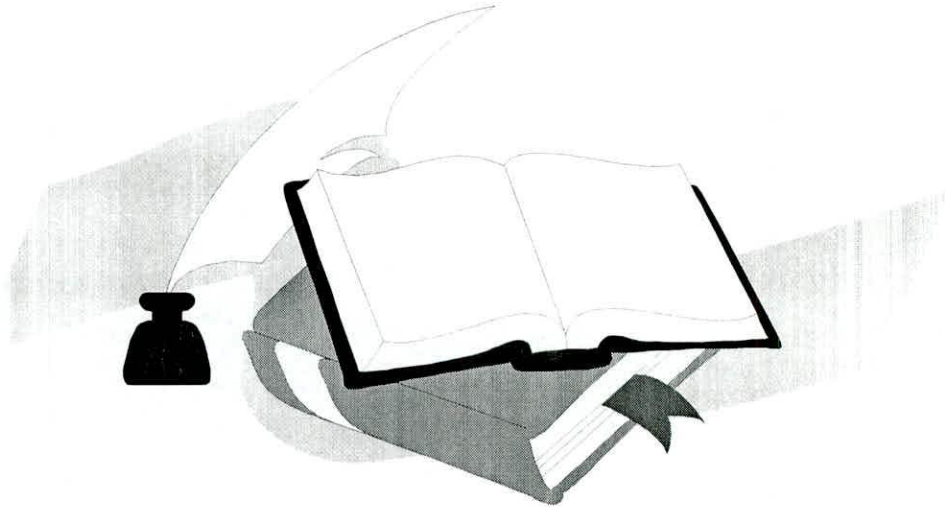


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*Master of Arts (Economics) Thesis*

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## **Abbreviations.**

- BOI Board of Investment.
- FTZ. Free Trade Zone.
- FDI. Foreign Direct Investment.
- MNC. Multi National Corporation.
- FOB. Free On Board
- VER. Voluntary Export Restraints.
- ITC. International Trade Center.
- TIEP. Temporary Import and Export Program.
- GCEC Greater Colombo Economic Commission.
- LDC. Less Developed Country.
- OLS. Ordinary Least Squares.
- NAFTA. North American Free Trade Agreement.
- EU. European Union.

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**THE IMPACT OF COST EQUALIZATION STRATEGY  
FOR THE DEVELOPMENT OF NON TRADITIONAL EXPORTS  
IN SRI LANKA.**

**By. M. Palitha Ekanayake.**

**ABSTRACT**

Sri Lanka is a small developing economy, a price taker, whose impact on both world trade and output is relatively insignificant. As tested in this study, Sri Lanka is able to export uninterruptedly with a diversified export structure provided that it maintains a freer market and friendly domestic supply condition. In this concern, the cost equalization strategy; duty drawback, bonding and duty free export processing zones have created an artificial emerging freer market and effected for a well diversified non traditional export sector. It is well demonstrated that duty free export processing strategy has its own merits allowing exporters to maintain level playing field.

This study has strongly supported duty free export processing strategy as a key strategy to maintain the diversity in the manufacturing sector, especially for an overheating economy in Sri Lanka. In support of this argument, it has found that the result of statistical evaluation procedure has well matched with empirical evidence during the trade liberalisation period. The results of this study shows that Sri Lanka has presently moved towards right direction in the process of diversification of the non traditional export sector. However, there are many hurdles to be overcome.

Having tested and explored the role of cost equalization strategy in the non traditional export sector, this study has examined the sustainability of model findings and translated them into real world predictions by forecasting the trend in diversity and its parameters. The results have been translated into trade policy strategies, coupled with some lessons to be heeded from history and relevant strategies to manage the drivers of changes in the export trade. At the door steps of the risk of deep global recession and inexorably rising unemployment, selling Sri Lankan jobs in the international markets will become a challenge.

The empirical evidence suggests that Sri Lanka is on the edge of the first stage of export processing with many more budding export products. The cost equalization strategy may help to manage the diversity as well as to step into second stage of export diversification. In this process, what matters most is a cost equalization strategy which will maintain a level playing field for export manufacturing and trade.

# Chapter. 1.

## Introduction.

### 1. Problem and its setting.

#### 1 : 1. The statement of the problem.

This research proposes to identify and evaluate the existing discrete interest on the impact of cost equalization strategy for the development of non traditional exports during the trade liberalisation regime in Sri Lanka.

#### 1 : 2. The sub problems.

- The first sub problem is to identify whether the demand for non traditional exports have an discrete impact in determining the price of non traditional exports.
- The second sub problem is to evaluate the impact of domestic supply condition in Sri Lankan small economy on expansion and diversification of the non traditional export sector.
- The third sub problem is to analyse and interpret the role of the cost equalization schemes as a separate market for export processing activities in terms of their discreteness on the non traditional export sector.

#### 1 : 3. The hypotheses.

- **The first hypothesis** that it tests that demand for export could influence the development of non traditional exports in Sri Lanka
- **The second hypothesis** that it tests the impact of the domestic supply condition of a small liberalising economy for increasing the diversity and volume of non traditional export production.
- **The third hypothesis:** that it tests is whether cost equalization schemes in Sri Lanka have an impact on increasing the diversity in the manufacturing for exports.