

## TOWARDS A THEORY OF EXCHANGE CONTROL IN RELATION TO SRI LANKA'S CONTEXT

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Exchange Control is not only an allocative mechanism of foreign exchange mainly directed towards eliminating the *ex-ante* deficit in the balance of payments but also an instrument of development planning. This administrative weapon is now identified as a lasting feature in the government armoury of many countries. However, there is no theory of exchange control as such in the economic literature. The vacuum in economic theory in the context of developing countries is well noted in the sphere of exchange control and exchange rate policies.

The purpose of this study is mainly two-fold. First, it will define exchange control and examine its characteristics against the perspective of a theory of exchange control. Secondly, the evolution of Sri Lanka's exchange control policy will be examined in greater detail to see how it could be fitted into a rational framework of exchange control.

A basic conclusion of this study is that exchange control creates distortions in production and consumption on the one hand and in exchange and money markets, on the other. As in many other countries, Exchange Control in Sri Lanka is an *ad hoc* and bureaucratic mechanism not suited to any programme of planning and development. Rationality of exchange control as a second best measure is examined to derive conclusions.