

Government Aggressively Pursues Economic Growth

By Stanley W R de A Samarasinghe

The Central Bank in its annual report for 2009 issued in early April announced that the GDP grew by 3.5% last year. Given the global economic turmoil, this is an acceptable rate. However, if such an anemic rate continues for a few more years the economy will be in serious trouble. The government is aggressively pursuing a strategy to accelerate growth and create more well paying jobs.

In economic governance the most notable event of the month was the appointment of the cabinet of ministers. The number of ministries created and allocation of tasks and institutions to those ministries are essentially political. Therefore some compromises are impossible to avoid. Unfortunately, as usual, this time also political expediency has largely trumped rational and good economic governance considerations.

The opposition UNP has demanded that the chairmanships of the two parliamentary watchdog committees, Committee on Public Enterprises (COPE) and Public Accounts Committee (PAC) must remain with the opposition and no ministers or cabinet ministers must be appointed as members if they are to be effective. The government has decided to turn down the request of the opposition.

First, the pluses from April economic news that stands in the government's favour. Inflation continues to be under control, at least for now. Year-on-year Inflation in March 2010 was 6.3% and in April 5.8%. The Central Bank left its reverse repurchase rate unchanged at 9.75% for the second successive month. The Treasury bill rates showed a small decline during the month.

The Colombo All Share Price Index (ASPI) was generally flat in March. At the beginning of April the Index stood at 3,725. After the election assured a politically very stable government the share market took off. On April 20th it went over the 4,000 mark and by early May it had topped 4,200, a remarkable rise of over 12%. Bullishness in some sectors, most notably hotels, tourism and rubber played a significant role in this increase.

Foreign reserves stood around \$6.0b which is a comfortable amount relative to the country's import requirements. However, the IMF is waiting to see the next budget before it decides on the release on the next two tranches of its \$2.6b standby loan. This is critical not because the amount that the IMF would give is substantial but because the decision would be a signal to the international financial markets and foreign investors about IMF's assessment of Sri Lanka's economic prospects. A decision adverse to the

country would jeopardize Sri Lanka's sovereign credit rating with further adverse consequences to follow.

Tourist arrivals for the first quarter of 2010 were around 160,500, an increase of 50% over the same quarter in 2009. The government is making a big effort to boost the industry. International publicity is also becoming more favorable with several prestigious publications in the industry naming the country a top tourist destination for the coming season.

The government is aggressively moving on the economic front. For example, there is a big push to revive the north-east economy. During the month the Board of Investment (BOI) Sri Lanka opened an office in Jaffna. The ADB announced a \$150m loan for infrastructure development projects in the north and east. The Jaffna International Trade Fair held in the last week of April attracted over 200 companies including some foreign companies. The Central Bank announced that commercial banks in the north and east would lend Rs 56m this year and Rs 75m next. The Colombo Stock Exchange opened a branch in Jaffna last month. Some Jaffna-based companies are expected to seek listing on CSE.

While much of what is going on in the economic front in the north and east should be helpful to the people of the area to rebuild their lives, the government also should be more sensitive to the immediate priorities of the community. For example, this month the people in Jaffna indicated their concern that the government was more keen about building tourist hotels than improving the region's hospitals that were adversely affected by the war.

Elsewhere the government also announced quite rightly to move more of state offices from Colombo city to the adjacent administrative capital of Sri Jayewardenepura to free up valuable land for commercial development.

As a part of the government's urban renewal programme the campaign to remove pavement hawkers gathered momentum this month with the demolition of unauthorized structures that hawkers have erected to ply their trade in Pettah area of the Colombo city. If successful the programme may be extended to other areas as well. It is interesting to note that the UDA that is now under the Defense Ministry has the formal authority to launch such a campaign and the police can easily be mobilized for the task through the same ministry. In the past all such campaigns have failed because of political support that hawkers have mobilized to protect their interests. It remains to be seen if this time the outcome would be different. Tidy streets and open pedestrian walks are good to have. However, there are other social consequences of such actions that cannot be ignored.

The major economic challenge the government is facing is in fiscal management. It is under pressure from the IMF to increase taxes and cut spending to reduce the fiscal deficit under terms of the 2009 IMF standby loan of \$2.6b. However, domestic political realities pressure the government to move in the opposite direction. The governing UPFA made extravagant promises to the electorate to win votes but delivering on them would be very costly. For example, the state employees are given the proposed pay hike and state pensioners are given the pension hike that was also promised the government will need minimum additional Rs 50b over and above the Rs 271b that it spent on salaries and pensions in 2009. It also wants to invest in ambitious infrastructure development projects. But increases in taxes to finance such spending too are politically unpopular. The only viable solution is to restructure the economy so that waste is minimized and available resources are made to yield maximum output.

An issue that the government is finding hard to resolve is the reform of state-owned loss making commercial and service enterprises. For example, the Ceylon Petroleum Corporation lost Rs 12.3b last year and the Ceylon Electricity Board Rs 7.4b. Both are over-staffed and poorly managed. Prices of the products that they sell are fixed partly to meet political requirements. The state postal services lost Rs 2.4 billion in 2009. While the Post Office may have a strong social benefit component, it is also over-staffed, badly managed and totally fails to modernize its operations to meet the 21st century needs of the country.

Now that the war has ended fiscal spending will have to be reformed to meet the needs of a peace economy. For example, after the war commenced in the early 1980s social spending was scaled back in relative terms in the budget to fund the military. For example, in 1982, the last year before the ethnic war started, 3.2% of the government budget was spent on health. In 2008, the last full year of the war, it was only 0.7%. Healthcare needs are expected to rise sharply in the coming decade or two as the country's population ages and chronic diseases such as cardiovascular diseases, and diabetes become more prevalent.

ADB and Japan will provide a loan of \$52m for a "Fiscal Management Efficiency Project" to streamline fiscal management and overhaul the tax system. Such a programme will help improve fiscal management. But buying computers for the Treasury and using new software to generate budget numbers alone will not solve the several fiscal problems that the government is facing. The quality of public services provided too needs upgrading. The obstacles that stand in the way are not limited to financial constraints alone. One example from the health sector related to a development that occurred in April illustrates the point.

A higher level of training for Para-medical professionals including nurses and laboratory staff is essential to upgrade Sri Lanka's healthcare. This issue came up yet again this month. Nurses threatened to go on strike if their four-year degree nursing programme started recently is scaled back. The awkwardly named Joint Council of Professions Supplementary to Medicine appealed to the president to extend their current two year diplomas course to three years. The main opposition to these progressive steps comes from the main trade union of doctors and some sections of the medical schools, both faculty and students. The ostensible reason given for the opposition is lack of facilities for training. The real reason appears to be the fear of the doctors that nurses and other para-medics too would be allowed to use a stethoscope, thereby diminishing the "status" of medical doctors.