

Politics Trump Economics in Presidential Election

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With the nation pre-occupied with a hotly contested presidential election the economy took a back seat in January. The main election issues were more political than economic. Much of the debate was on who should get credit for the defeat of the LTTE in the war that ended in May 2009. However, the two main candidates the incumbent Mahinda Rajapaksa (UPFA) and his principal challenger General Sarath Fonseka nominated by the Joint Opposition did not totally forget economics.

The very nature of election campaigns anywhere is such that it is very difficult to discuss complex economic issues with the nuance and qualification that such issues usually merit. Campaigns are more tempted to produce slogans and sound bites that less than fully attentive voters can easily understand. Sri Lanka is not only a good example of this but even worse. Politicians of all hues are prone to make totally unrealistic economic promises. In the January 2010 presidential election the two main candidates tried to outbid each other promising pay hikes for state works, more jobs, better infrastructure and so forth.

Voters who have heard similar promises that have not been kept after winning office were probably too cynical to believe them. However, the average voter cannot be expected to seriously examine these promises for what they are worth. That is the job of the media and commentators. Unfortunately in Sri Lanka that does not happen very much. Last month government spokesmen challenged the fiscal viability of the promises that the joint opposition candidate Fonseka made. However, as far as this writer is aware the opposition failed to effectively challenge the economic program of the government. For example, much of the large infrastructure projects are funded with loans from countries such as China, India and Iran. These loans have to be paid back with interest. These projects have to generate income to do so. For example, the government says that Hambantota Harbor loan annual repayment will be around \$36 million. That would require the government to generate a gross income of around \$360m with a 10% return to repay the loan over a ten year period. This will not be easy. In 2008 Galle got 60 vessels (a mere 1.3% of Colombo's 4,424) and handled 459,000 MT of cargo (as opposed 48 million MT in Colombo). These numbers suggest that Hambantota port would have an uphill task to generate revenue to make it economically viable.

One of the significant macroeconomic management successes of 2009 was the reduction of inflation from 22.6% in 2008 to 3.4% in 2009. International factors such as lower oil prices helped. However, in January consumer prices rose at an annual rate of 6.5% mainly owing to higher food prices.

The end of the war in May 2009 helped initiate the revival of the economy that contributed to the national output. For example, the economy grew by 4.2% in the third quarter to September 2009, compared to 2.1% in the second quarter.

One of the more notable post-war economic successes came in the tourist trade with tourist arrivals increasing by 2.1% to 448,000 in 2009. In January the New York Times featured Sri Lanka as one of its top tourist destinations for 2010. If political stability holds the industry's prospects for 2010 look bright.

In 2009 Sri Lanka's share prices rose by about 125%, much of the increase registered in the second half of the year after the war ended. In January the All Share Price Index gained a further 5% reflecting sustained investor confidence,

The Central Bank revised upwards, the ceilings that it has imposed on interest rates that registered finance companies could pay depositors. These ceilings are linked to one year Treasury bill rates. Such ceilings reduce competition from finance companies for funds that the Treasury wants from savers to fund the government budget deficit. In effect it is a technique to crowd out the private sector for funds and, hold Treasury bill rates down and thus make deficit financing cheaper. The upward increase in ceilings is in the context of falling rates for Treasury bills. The Central Bank also allowed finance companies to pay a premium rate of one percentage point above the ceiling for deposits made by individuals over the age of 65. It also wanted banks to pay an additional 20% on the interest that they pay on deposits that senior citizens hold. The state banks may comply with this order. It is not clear whether the private banks will follow unless competition from state banks for senior citizen deposits compels them to match rates.

The Central Bank announced in November of 2009 that it would allow Sri Lankans to take out up to \$500,000 in capital without permission from the Bank. This is a major deregulation of capital accounts transactions that have been in place for the last sixty years. In January the Bank also announced that it would allow Sri Lankans to open bank accounts abroad and invest in equity and short term debt in "overseas" companies. The Bank justified these decisions on the grounds that the country's foreign reserve position was sufficiently strong to permit more liberal transactions in the capital account. The IMF office in Colombo expressed its support for the Bank's action. This created a minor political storm during the election campaign with critics accusing the Bank of creating a loophole for individuals with black money to take out ill-gotten wealth.

The global Logistics Performance Index (LPI) compiled by the World Bank that was released in January showed that Sri Lanka ranked 137th from the top among 155 countries. LPI measures, using six key dimensions, the efficiency of export and import clearance process in the ports and other points of entry/exit in a country. The highest score that a country can score is 5.0 and the lowest 1.0. Sri Lanka's score of 2.29 placed it in the bottom 25%. Only Nepal and Afghanistan ranked below Sri Lanka among SAARC countries. This is another warning signal that Sri Lanka

needs to improve economic efficiency and infrastructure to remain competitive in the global economy.

Dr. Samarasinghe writes a monthly report on the Sri Lankan economy for the Rapid Context Assessment (RCA) of the Consortium of Humanitarian Agencies (CHA), Colombo. This is an amended version of that report. Global Vision thanks CHA for granting permission to reproduce the article