

## **Growth Strategy Faces Many Challenges**

With the elections over the attention of the government has turned to the economy. There was much talk from high officials during the month of making Sri Lanka an economic powerhouse in Asia and doubling its per capita income in five years. Simple arithmetic suggests that the annual GDP growth rate must reach nearly 14.9% to double the per capita income in five years assuming that the population remains unchanged. If the population in Sri Lanka grows, as it does by about 1.0%, the GDP growth rate must even be higher. In theory this is possible. But just now Sri Lanka is struggling to maintain an annual growth rate of 6% to 7%.

Inflation remained steady during the month. The annual rate of inflation was a modest 5.3% down from 6.9% in February.

The Central Bank noted that with moderate inflation, policy interest rates of the Central Bank also have been lowered to encourage commercial banks to cut lending rates to the private sector. The Bank expressed its dissatisfaction at the reluctance of private commercial banks to lower their lending rates. While it is true that bench mark rates on Treasury Bills have come down in the past few months the fact is the government has an almost insatiable demand for additional borrowed funds. Commercial banks are happy to lend to the government that is virtually risk free rather than lend to private business at high risk and higher administrative cost. In other words crowding out is at work.

The All Share Price Index fluctuated around 4,100 to 4,200 during the month with no discernible trend. This suggests a wait-and-see cautious outlook on the part of investors and the absence of significant inflow or outflow of foreign funds. Those engaged in the tourist sector appeared to be the most optimistic in the private sector. The tourist industry got a boost when the government cut import tariffs on motor vehicles by about 50%. However, the business sector wants to see a simplified and lower overall tax structure to encourage investment.

The Government sent a high powered official delegation to Brussels to persuade the EU to continue GSP+ tariff concession to Sri Lanka. All the indications so far are that the EU will discontinue the concession in August of this year unless the Sri Lanka government complies with EU's demand on human rights concerns.

The new Minister of Power and Energy who is a professionally qualified electrical engineer in a wide ranging interview given to the media identified major problems confronting Sri Lanka's power sector. They include lack of planning, ad hoc decision making in the past, politicization of the CEB, violation of basic technical specifications such as extending power supply lines beyond 1.8.k.m. without the support of a transformer, and the CEB incurring an annual loss of Rs 3 to 4 billion on street lighting. The projected total income of the CEB for 2010 is Rs 128b and expenditure Rs 160b incurring a loss of Rs 32b. CEB also has an outstanding debt of Rs 161b. The minister stated that he will revise tariffs, reduce or cut subsidies and streamline the management to reduce the loss.

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