Economic Policy Statement

CHANDRIKA BANDARANAIKE KUMARATUNGA

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Prime Minister of Sri Lanka

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The Speech made by
Hon. Chandrika Bandaranaike Kumaratunga
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Sri Lanka
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B.M.I.C.H.

Economic Policy Statement

The Government stands committed to building a strong national economy within a market framework. The principal engine of growth is expected to be the private or, both domestic and foreign. The role of the State is to provide an institutional framework that is wholly supportive of rapid private sector development. In order to do this effectively, the Government will pursue "market-friendly" policies which support rather than supplant markets. Accordingly, government intervention will be limited to areas where markets fail to function effectively and therefore need to be strengthened or supplemented, so that they serve the welfare of the people.

A necessary condition for the success of these policies is the maintenance of a stable macro-economic and financial framework which is conducive to the reduction of inflation, the pursuit of rapid economic growth, the creation of productive employment opportunities, and the equitable distribution of the fruits of development.

These policies will be pursued in a variety of mutually reinforcing ways. First, nothing will be done to weaken market signals. There are no plans for the nationalisation or expropriation of private property, whether domestic or foreign. All bilateral investment protection agreements and relevant international conventions will be honoured. No restrictions will be placed on the repatriation of dividends and capital. The foreign exchange liberalisation measures, already implemented, will continue, and will be improved upon. Private foreign investment, both direct and portfolio, will be strongly encouraged through the provision of appropriate incentives because domestic savings are inadequate to generate the investment needed for rapid development. The Board of Investment (BOI) will be restructured from an organisation granting *ad hoc* privileges to one genuinely promoting foreign investment in a transparent manner.

Second, there will be no adverse change in labour policy relating to foreign investment. This is crucial to the Government's strategy for eliminating the large backlog of unemployment. Consultative mechanisms will be established at the work place, under the aegis of the Board of Investment (BOI), whose objective will be to promote harmonious relationships between management and labour.

Third, the scope of the private sector will be expanded by encouraging and providing it with the required facilities to enter into new areas of production in agriculture, industry, infrastructural development and in the services sector, with helpful and appropriate credit and fiscal policies. These facilities will be available to all – on a level playing field – which will make it unnecessary for the private sector to canvass for contracts and concessions. This will imply the strictest adherence to the Government's financial and other procurement procedures, which will be fair to all. Complete transparency of the process will be ensured with a view to eliminating corruption and cronyism. We are compelled to review certain questionable and fraudulent transactions of the previous regime with a view to preventing similar abuses in the future. In this process, every endeavour will be made to honour our international obligations.

Fourth, the proposed National Development Council will be constituted with state, private sector and labour representatives, and professionals. It will evolve proposals for economic development and establish national priorities. It will facilitate a productive dialogue between the private sector and the Government aimed at strengthening the market mechanism in the national interest, as in East Asia, so that private sector opinions will be fully taken into account in the formulation of Government policy. The interaction between representatives of labour and the private sector, alongside those of the Government, in the Council, will promote mutual cooperation for enhancing productivity growth and economic efficiency.

Fifth, public intervention will be limited to the areas where markets fail to function effectively. These lie principally in the general area of human development expenditures. For instance, in education, there is the need to improve the quality of education and technological skills, in order to re-orient our youth to the needs of a modern economy, which would be firmly situated on the foundations of the Sri Lankan identity, built out of it's social and cultural heritage. Similarly, there is a need for intervention in health, in protecting the environment, and in creating a viable social safety net to protect the poor, by means such as the Prosperity (Samurdhi) Movement for the eradication of poverty, as pledged in our Manifesto. The pursuit of sustainable human development, to which we are committed, will not become possible, without adequate public intervention and investment in these areas. The creation of employment opportunities should be accompanied by measures to improve the quality of life.

Sixth, public investment would be needed to build the infrastructure that is required as a necessary complement to rapid private sector growth. However, as the resource requirements for the provision of adequate infrastructure are so overwhelmingly large, a significant portion of the infrastructure investment effort will have to be undertaken by the private sector. This would be expected to complement public sector infrastructure expenditure in areas such as roads and highways, power, telecommunications, and ports. Private sector infrastructure investment would occur under arrangements such as BOT (Build, Operate and Transfer) and BOO (Build, Operate and Own), which would be implemented within an evaluation and regulatory framework that would guarantee transparency and accountability. The present Secretariat for Infrastructure Development and Investment (SIDI) will be strengthened and will work in close cooperation with the Board of Investment (BOI).

The implementation of this strategy has both short-term and long-term dimensions. There is an immediate short-term need to address the claims of poverty alleviation by measures designed to reduce the cost of living. The commitments undertaken in our Manifesto, such as the reduction of the price of bread, will be implemented in a manner wholly consistent with the dictates of fiscal prudence so as to contain inflation. This has become a difficult task in view of the fiscal profligacy inherited from the previous Government. However, every effort will be made to contain the fiscal deficit at a tolerable level without resorting to inflationary borrowing from the Central Bank. Printing money will under no circumstances be countenanced, as it will both rapidly deplete our reserves and lead to high inflation, which will more than wipe out the cost of living benefits of particular price reductions; indeed, safeguards will be introduced to insulate the Central Bank against any pressures to provide inflationary finance.

Given this constraint, the Government is faced with two options in the short term – namely, raising additional revenue, reducing expenditure and targeting welfare measures to those who are most disadvantaged.

As regards the first option, fiscal revenue would be augmented by eliminating the practice of granting arbitrary import duty waivers and by refraining from granting over-generous next tax exemptions in the future. Also, the tax system would be reformed to improve compliance and efficiency. This would mean a progressive reduction in the levels of direct taxation on both corporate and personal income, as in East Asia, which would lead to an expanded tax base and greater tax compliance. It would also mean a rationalisation of indirect taxation by placing greater reliance on a Value Added Tax (VAT). There is no intention to introduce taxes that would be inimical to private sector expansion.

With regard to the second option, there are limits to reducing expenditure in the short run in view of commitments on wages, debt repayments and defence etc.. However, some savings can be made by eliminating waste and corruption, restoring financial discipline, and reducing personnel at the highest levels of government. Further savings could be generated in the near term by ending the Northern conflict. Additional foreign resources could be expected in recognition of sound economic policies, good governance and restoration of peace.

All these measures will help raise the required budgetary resources for implementing the new poverty alleviation programmes, in a non-inflationary manner.

The longer term dimensions of policy will be based upon a ten-year perspective, encompassing the period 1995 to 2005, which would be implemented through a succession of three-year policy framework cycles. The ten-year perspective takes as it's premise the vigorous development of national production in all sectors. The resolution of the Northern conflict will result in the channelling of the savings (the peace dividend) along with matching foreign aid contributions into rehabilitation of damaged areas and retraining for demobilisation. There will be a further channelling into productive investment in the private sector of the new capital inflows which will be generated by increased international confidence in Sri Lanka. This would accelerate economic growth to reach an annual rate of 8 percent well before the year 2000, so that unemployment is virtually eliminated in 5 years from now, and per capita income doubles in ten years.

The eventual goal of policy would be to continue to reduce the overall fiscal deficit from a level of 8 percent of GDP in 1993 to a level of 3 to 4 percent of GDP well before the year 2000, which would both be consistent with a significant reduction in inflation, and be sufficient to absorb a reasonable amount of concessional aid. In order to accomplish this goal, budgetary revenue will, as mentioned, be buoyed up by rapid economic growth and tax reform. A substantial current account surplus will be generated both by the significant reduction of military expenditure and by curtailing unnecessary and wasteful current expenditure, both through the improved targeting of welfare programmes and reducing the role of the public sector in the economy. The long run objective would be to run an overall surplus in the Budget so as to enable the retirement of the high stock of public debt outstanding.

The medium term goal of 8 percent GDP growth annually would require a continuing emphasis on export led growth, with encouragement being given to the private sector to diversify into areas of higher value added production and exports. Any such transition would require maintenance of Sri Lanka's competitiveness in international markets. This would mean flexible, and market-oriented, exchange and interest rate policies. Sri Lanka will also undertake not to impose restrictions on trade and payments transactions.

An important new pole of growth in the economy would be the development of an export-oriented services sector by exploiting the unique geographical opportunity conferred on Sri Lanka by its location at the hub of a potentially dynamic South Asian region. The vision that is compelling is for Sri Lanka to become the principal regional financial services and trans-shipment centre, with preferential access to the regional market being obtained either through an acceleration of the SAARC process of regional cooperation, or by suitable bilateral preferential arrangements, as for example with India.

The overall development strategy we are committed to means the pursuit of sustainable human development. While promoting rapid economic growth and employment, it also distributes its benefits equitably. It ensures that rapid development, far from destroying the environment, protects and indeed regenerates it. In investing in people, and developing their skills and aptitudes, it enhances their capability to pursue fruitful lives. It necessarily gives special protection to the poor, who will be mobilised to evolve viable livelihoods through the Prosperity (Samurdhi) Movement for eradicating poverty. In sum, it is a strategy which harnesses the market to social purpose.

Politically, this means a commitment to good governance. It not only involves political pluralism but, the maintenance of democratic institutions, and the preservation of human rights. It also makes of politics the discharge of a public trust, where decision-making is transparent and free of corruption, and where everyone in public life is accountable for their actions. This is a beautiful but difficult dream, which we shali strive to realise.

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