



## **Pathfinder Economic Flash**

### **Budget 2013 A Step in the Right Direction: Important to Stay the Course**

It is commendable that this budget has not succumbed to the temptation of providing large-scale hand-outs that are unaffordable. The government has sought to stick to its medium-term fiscal consolidation program that reduces the budget deficit to expectable level of GDP this year and has projected to continue the trend next year.

An unsustainable fiscal deficit has been the main source of instability in the system for over 30 years. Sri Lanka has experienced repeating cycles of stop-go policies. There has not been a stable macroeconomic framework to support a higher growth trajectory over a sustained period of time. In the past, if growth accelerated for a couple of years, it inevitably led to macroeconomic instability in the form of higher inflation, unsustainable balance of payment pressure or both. The remedial measures that subsequently followed would squeeze growth out of the economy.

It is, therefore, a welcome development that the government has resisted demands that would merely serve to continue this history of weak fiscal management. If the government is able to maintain the fiscal discipline implied in this budget, a new era of sustainable budget deficits, lower inflation, lower interest rates and stable but competitive exchange rates is not beyond our reach. Such a macroeconomic framework is essential to create an environment that is conducive for accelerated growth over a sustained period of time.

It must also be recognized that the need for greater fiscal discipline is even more important now that Sri Lanka is no longer eligible for concessional assistance, as a country that has now graduated to a lower-middle-income country status. A failure to understand the implications of this would lead to a major financial crisis.

One may conclude that the overall macroeconomic impact of this Budget marks a good beginning. The challenge is to maintain fiscal discipline in the face of populist pressures that may well arise. This needs to be supported by prudent monetary policies and a realistic/competitive exchange rate.

The Pathfinder Foundation would like to reiterate that macroeconomic adjustment must also be supported by structural reforms. It will not be possible to achieve the government's growth target of 7.3% without this. Reform of SOE's, particularly the elimination of the losses of CPC, CEB and Sri Lankan Airlines should be at the top of the list. In this respect the following quote from the 18<sup>th</sup> National Congress of the Communist Party of the Peoples Republic of China has particular resonance:

*“The underlying issue we face in economic structural reform is how to strike a balance between the role of the government and that of the market, and we should follow more closely the rules of the market and better play the role of the government.”*

***This is the Nineteenth Economic Flash published by the Pathfinder Foundation. Readers' comments are welcome at [www.pathfinderfoundation.org](http://www.pathfinderfoundation.org)***

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