

VISION FOR A BRIGHTER FUTURE IN SRI LANKA: ROAD TO REALIZE 'MAHINDA CHINTANA VISION'

Introduction

The main focus of the Presidential Election Manifesto 2010 – Mahinda Chintana: Vision for the Future – is on achieving medium-term economic prosperity in Sri Lanka. The end of the armed conflict has now opened up the opportunity to bring about economic benefits of the open economy at full potential. These internal factors along with the contemporary global economic recovery have brought about a rare opportunity for Sri Lanka to achieve its long-awaited economic prosperity at a rapid pace. However, it is now the policy reform process chosen by the government, which has the ability to make this growth spurt 'faster or slower' and 'sustainable or short-lived'.

This policy brief, with an assessment of the key policy elements outlined in the Manifesto, provide guidelines to policy formulation and reforms in achieving economic prosperity. It should be stressed that 'good economics' lead to 'good politics' only in the long-run, and not in the short-run. And 'bad economics' lead to 'good politics' in the short-run, but not in the long-run. The sooner the better, as the politically warranted reform process, at the time of high political popularity, is likely to get diluted as time passes.

The Manifesto sets the target of doubling the country's per capita income exceeding USD 4000 by 2015. This requires an increase in the country's investment ratio to around 40 percent of GDP from its current level of 25 percent, while sustaining the rate of real GDP growth in the range of 8-10 percent per annum. A genuine increase in per capita income uplifts the average living standards of people, while positioning the country's economic strength and progress among other high-performing economies.

Per Capita Income in Selected Asian Countries (USD)

	1960	1980	2005
India	68	207	720
Pakistan	76	259	690
Thailand	95	716	2750
Sri Lanka	152	255	1160
South Korea	152	1528	15830
Malaysia	280	1715	4960
Singapore	428	4592	27490

Source: World Bank, *World Development Reports*

SRI LANKA, CONTINUED TO 'MISS THE BUS'

Sri Lanka's development history is a tale of missed opportunities. Its per capita income in 1960 was as same as that of South Korea. During the first 20 year period (1960-1980), Sri Lanka's per capita income not even doubled, but that of South Korea increased more than 10 times. During the next 25 years (1980-2005), Sri Lanka's per capita income increased nearly 4 times, but that of South Korea again by more than 10 times. During the past few decades, while many countries in Asia grew by surpassing Sri Lanka, the neighboring countries in South Asia which were far behind Sri Lanka also came closer.

The Two Pillars of Prosperity

As outlined in the Manifesto, the medium-term economic prosperity of Sri Lanka is expected to achieve on the basis of two pillars. The first is the transformation of Sri Lanka into a 'dynamic global hub'. The second is the creation of 'local entrepreneurship, which can conquer the world'. In both cases, the Manifesto implicitly acknowledges that Sri Lanka should strengthen its openness to the world economy to achieve economic prosperity. Apparently, there cannot be a global hub without connecting to the world economy and, there cannot be an entrepreneurship development without catering to the world market.

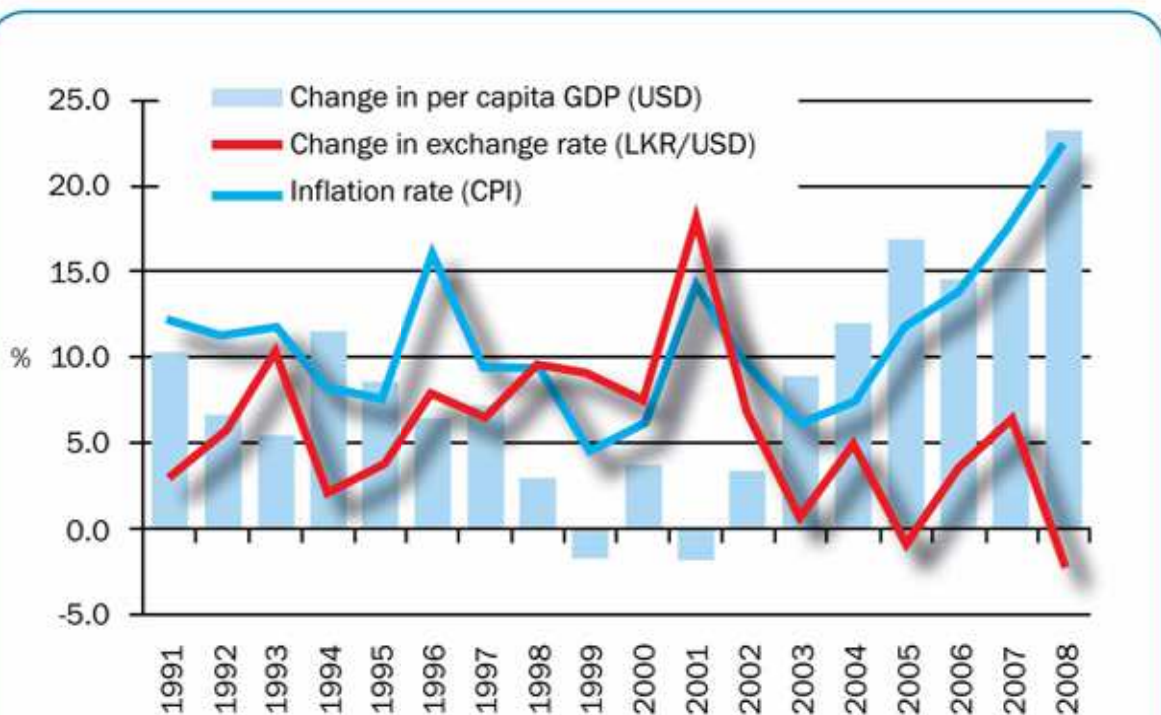
Sri Lanka as a Dynamic Global Hub

Sri Lanka is expected to take a 'massive leap forward' by transforming into a 'dynamic global hub' in terms of naval, aviation, commerce, energy and knowledge. This is an important concept that has yet to be translated into an action plan. The key to achieve a global hub status is the greater connectivity and global competitiveness in all these areas and, in all supportive economic sectors. The connectivity and competitiveness in turn require greater 'economic openness' through market-oriented policy reforms and reforms in all supportive areas such as the macroeconomic fundamentals, public sector, regulatory mechanisms and, law and order.

Entrepreneurs Conquering the World

The local entrepreneurs will rise to be globally competitive so that they will expand the local economy by catering to the international market. It is, however, incorrectly assumed that local entrepreneurs as such would emerge from 'government assistance' and not from 'policy environment'. Furthermore, development of the local entrepreneurship is a 'long-term' process, in which it cannot deliver the 'medium-term' economic prosperity. The local entrepreneur class is also too small to make a significant contribution to the anticipated massive investment drive. Even though the development strategy seems to favour local investment against foreign investment, a massive leap forward of the economy inevitably requires foreign investment to fill the wide savings gap.

Change in per Capita Income 1991-2009



INFLATION CAN ALSO INFLATE PER CAPITA INCOME

Per capita GDP in terms of USD can be inflated by a lower denominator - exchange rate (LKR/USD). Exchange rate responds to domestic inflation. During 2000-2003 average rate of inflation was 9 percent and, the exchange rate (LKR/USD) depreciated over 8 percent. During 2004-2008 when the average rate of inflation hit 15 percent, exchange rate depreciated by 2.4 percent only. The numerical rise in per capita GDP does not, therefore, reflect an increase in average purchasing power of people.

Role of the Government: Picking Winners

The form of development strategy portrayed in the Manifesto is one of 'selective intervention for export promotion' based on local entrepreneurship development. It is worthwhile noting that an approach of getting the 'government intervention right' instead of 'market fundamentals right' tends (a) to disregard the country's dynamic comparative advantage, (b) to shift the burden to tax payers for little national gain and, (c) to create scope for tainted relationships between the government and the industry. The resulting misallocation of resources will pave the way for the expansion of the selected winners, of which many would not sustain without continuous government support as in the case of even East and Southeast Asian countries.

Foreign Direct Investment: Inflows and Stocks 2008

	Inflow (USD billion)	Stock (USD billion)
East Asia	187.0	1363.1
China	108.3	378.1
Hong Kong	63.0	835.8
Southeast Asia	60.0	663.0
Malaysia	8.0	73.3
Singapore	22.7	326.1
Vietnam	8.1	48.3
South Asia	50.7	186.1
India	41.6	123.3
Pakistan	5.4	31.1
Sri Lanka	0.8	4.3

Source: UNCTAD (2009): World Investment Report 2009

SRI LANKA: NOT AN ATTRACTIVE INVESTMENT CENTRE

Sri Lanka has so far not been an attractive investment centre for foreign investment. The total foreign capital stock accumulated over the past 30 years amounts to USD 4.3 billion only. Even a country like Vietnam which initiated market-oriented policy reforms much later than Sri Lanka receives over USD 8 billion in a one year.

Road to Achieve Mahinda Chintana Economic Vision

The achievement of medium-term economic prosperity as outlined in the Manifesto requires strengthened global connectivity and competitiveness with greater openness, simple and clear procedures and, sound macroeconomic fundamentals. Moreover, reforms are a continuous process beginning with a bold step forward.

Development strategy

Entrepreneurship development is primarily a natural process in the policy regime itself with correct incentives so that it is necessary to let investment and entrepreneurship emerge from policy environment, not from government.

- i. The policy environment should not be discriminatory among production sectors, because they tend to discourage potential expansionary sectors, potential investments and potential entrepreneurship development. This also applies to foreign investment, which seeks good economic fundamentals and regulatory mechanisms more than special incentives.
- ii. Agriculture sector should be competitive to stand against competitive imports and to cater to the international markets ensuring rising income in the sector. The structural weaknesses in the sector such as land-holding system, land-utilization pattern, and the issues of property rights need to be resolved, at least gradually.
- iii. Since the domestic market is too small to take the economy too far, the prime focus of the development strategy should be on international market in general and, export promotion in particular. This is consistent with the action plan for creating a global hub in Sri Lanka.
- iv. The main focus of the government should be on reducing the cost of production in the economy and, improving competition and competitiveness. The problems in these areas usually emerge through government intervention, regulatory mechanisms, infrastructure bottlenecks, market rigidities as well as lack of human resources.
- v. The government can also expand the potential for private investment and public-private partnerships in public investment projects such as highways, railways, ports and airports, power generation and other. This will expedite investment promotion and reduce the burden on the government budget.

Regulatory framework

The regulatory framework and the bureaucratic system of a country is a key determinant of the cost of business, investment promotion and, entrepreneurship development. Apparently, a fast growth of the economy creates increasing demand for simple and clear regulations and, for efficient public service.

- i. Regulatory mechanisms and bureaucratic procedures need to be simplified and rationalized in order to reduce the opportunity costs and transaction costs of doing business. The reforms in these areas will improve the international competitiveness of the Sri Lankan economy, which would lead to a realization of the concept of a global hub in naval, aviation, commerce, energy and knowledge.



- ii. Public enterprises require greater autonomy to operate on the basis of economic and management principles because the issue in question is not ownership, but management. The government institutions dealing with public administration should also have a greater autonomy and an incentive structure to operate on demand-driven basis.
- iii. Rule of law is the key to manage a free market economy, as its enforcement prevents someone's action affecting economic freedom of another and of the entire society. The weaknesses in the enforcement of the rule of law has so far paved the way for deep-rooted economic chaos and sources of corruption, which become more and more difficult to be corrected.

Macroeconomic order

The commodity prices, interest rates and exchange rates should be stable and flexible. It should be emphasized that stability and flexibility are contradictory features, if the government or the Central Bank is intervening in the respective markets. And the macroeconomic order should also have its long-term sustainability and predictability, which enhance the investor confidence.

- i. The budgetary position needs to be improved on both revenue and expenditure sides aiming at a manageable budget deficit. On the revenue side, indirect tax system has to be simplified avoiding complex procedures of numerous taxes. Tax base needs to be widened by incorporating all income-earners and wealth-owners.
- ii. On the expenditure side, wasteful and unproductive expenditure patterns should be reviewed to improve the cost-effectiveness, transparency and accountability of the government expenditure. The re-structuring of public enterprises and other public institutions with greater management autonomy will also improve the fiscal position of the government.
- iii. The government's fiscal discipline assists the monetary authorities to maintain monetary discipline as well. With this the average interest rates should be lower and stable and, should respond to market forces rather than to the interventionist measures.
- iv. The exchange rate should also be stable, but flexible as it should also respond to the market forces rather than to unnecessary manipulations. This requires increasing foreign exchange inflows based more on export expansion than on private remittance (in the current account) and on foreign investment than on foreign borrowing (in the financial account).

Usually, it is difficult to understand what is to be done. An easy way out is to make use of international statistical reports such as Doing Business Report, Global Competitiveness Report, Economic Freedom Report, World Investment Report and, Corruption Perception Report. These reports expose the position of a country in the relevant area to the rest of the world. In all these reports Sri Lanka appears as a 'lower-ranked country' so that the policy makers can follow the steps to reach level of top-ranked countries.

Ease of Doing Business: Ranking Index

	Rank of Sri Lanka	Rank of Singapore
Starting business	29	10
Dealing with permits	161	2
Employing workers	110	1
Registering property	141	16
Getting credit	68	5
Protecting investors	70	2
Paying taxes	164	5
Trading across borders	66	1
Enforcing contracts	135	14
Closing business	43	2
Overall rank	102	1

Source: World Bank, Doing Business Report 2009

HOW EASY IT IS TO DO BUSINESS IN SRI LANKA?

Out of 181 countries in the world, 101 countries offer better investment climate to do business than Sri Lanka. Singapore is ranked as the best country in the world to do business, while the other countries in the top 10 include New Zealand, USA, Hong Kong, Denmark, UK, Ireland, Canada, Australia and Norway. In the Asian region Japan, Thailand, Malaysia, Korea, Maldives, Pakistan, China and Vietnam are well above Sri Lanka.



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This Policy Brief by Prof. Sirimal Abeyratne is based on his analytical paper titled “Vision for a Brighter Future in Sri Lanka: An Approach to Realize Mahinda Chintana” presented at a public seminar (Sanvada) organized by the Pathfinder Foundation. This analytical paper can be downloaded from www.sanvada.org

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