

"A TURNAROUND IN THE WAR-TORN ECONOMY AND ESTABLISHMENT OF DEMOCRACY REMAIN OUR MAJOR CHALLENGES"

— Minister Bandula Gunawardana

Exclusive Interview

Minister of Rural Economy and Deputy Minister of Finance Hon. Bandula Gunawardana despite his busy schedule which include the unenviable task of mapping out strategies to kick-start our economy from its present downturn and initiating various programmes to resuscitate the rural economy in order to realize its enormous potential under the purview of his newly carved out Ministry of Rural Economy, took time-off to talk to *Economic Review* a publication which has always been very close to his heart. In an exclusive interview given to Dr S.L. Tilakasing, Deputy Chief Editor, *Economic Review* and Deputy Director Research, People's Bank while taking stock of the economic scenario on the eve of the budget he talked about the hard options available for us at this crucial juncture. Excerpts:

Economic Review:

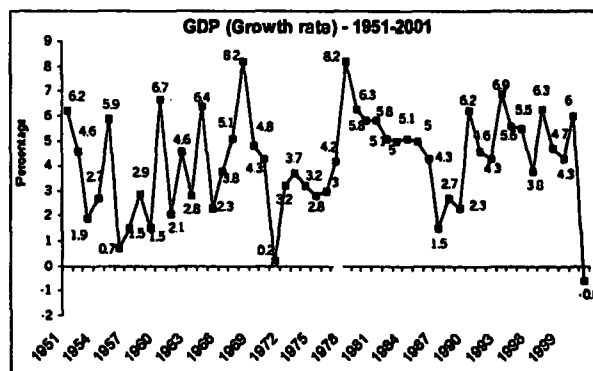
Various views and opinions have been expressed on the performance and constraints of the Sri Lankan economy during the previous decade. As a Minister holding important portfolios (Rural Economy and Deputy Finance Minister) in the UNF Cabinet and as a keen student of the Sri Lankan economy, how would you assess this situation?

Hon. Deputy Minister of Finance:

The economic growth rate cannot be considered an universally applicable tool of measurement of the growth of the economy. However, many economists recognise the economic growth rate as the common indicator of the overall economic performance of a country. It indicates the percentage point at which the Gross Domestic Product has grown in relation to the previous year. Fundamentally, it generally reflects the overall performance of agricultural, manufacturing and services sectors.

According to data given below only during two occasions the growth rates of our economy has fallen below 2%. In 2001 for the first time in the post-

independence history, Sri Lankan economy has experienced a negative growth. It has been reported that this decline could be around -0.6% or more. During the entire post 1977 period the only other period the economic growth suffered a severe setback i.e. below 2% was 1987. In all other years, growth has been at a higher rate.



Source: Central Bank of Sri Lanka

Several factors have contributed for this unprecedented downturn. One of them is the global economic recession and the rapid increase in oil prices. Besides, internal factors such as attack on Katunayake airport, the debacle arising from the Elephant Pass attack, bad weather conditions and the poor management of the economy.

In this context, the budget which is the main tool of directing the state fiscal policy could not be contained within its estimates for 2001 and distortion occurred. For example estimated income declined by Rs 30,458 million (this resulted from the reduction of envisaged income from few sources such as the GST by Rs 9,198

million, excise duties Rs 3,404 million National Defence Levy Rs. 4004 million and export duties Rs 8,418 million). Further, massive outlays had to be allocated to meet the increased salary bill of about 850,000 state employees, 300,000 pensioners. Besides, massive expenditures incurred on increased subsidy payments

to Samurdhi recipients and fertilizer subsidy of Rs 9,837 mn. Notwithstanding the social benefits of such expenditures, the resultant budget deficit rose to 10.5% from the estimated 8.5%.

This situation was further aggravated as a result of non-realisation of income from the privatization of institutions such as the Sri Lanka Telecom. Inflation went up further as a result of

domestic borrowings to bridge the budget deficit. Causing a further burden on the budget the debts of some public institutions recorded sharp increases. (Ceylon Petroleum Corporation Rs. 21,500 mn. Ceylon Electricity Board Rs. 15,600 mn., Co-operative Wholesale Establishment Rs. 8,320 mn, Department of Railway Rs. 2,300 mn. and Sri Lanka Transport Board Rs. 2,100 mn) In this context public debt which stood at Rs. 550.1 bn. in 1994 rose to Rs. 1,430 bn in 2001. Accordingly, during the corresponding period the GNP – debt ratio increased from 95.7% to 101.5%.

In this background, another serious development unprecedented in the history of Sri Lanka has arisen. The debt instalments and interest payments that should be paid by us ex-



ceeded the overall income of the Government. Although the total income of the Government is Rs 235 bn. Rs. 295 bn. has to be paid as debt instalments alone.

The scrutiny of information available at the Department of Public Debt reveals the alarming proportions of this situation. In addition to the debt obligations, several other obligations also remain to be fulfilled by us.

- (a) Rs. 14 bn. has to be paid in 2002 for arms bought on credit,
- (b) Another Rs 13 bn. on Letter of Credit payments to local banks,
- (c) Rs 35 bn. obtained for governments recurrent payments from local Banks as Bank overdrafts.

For this, an interest of Rs 6.5 bn. has to be paid.

This is the real picture of the Sri Lankan economy as of now that goes hand in hand with the minus economic growth rate.

Doesn't the balance sheet of domestic State Banks represent the same picture? Aren't they also related to the overall performance of the economy? In comparison with other countries of the world, do you observe any distinct characteristics in our economic scenario?

Yes, you have raised a good point. Some immature politicians argue that the proceeds of the non-performing debts of state banks could be utilised to finance the payment of our debt instalments. This is a baseless argument. Even if all the non-performing loans of the state banks, instalments and interest

and loans of which instalments are due for more than 3 months are taken together the final figure is Rs 45 bn (this includes Rs 22 bn. due to People's Bank and Rs 23 bn due to Bank of Ceylon). In any bank in the World such non-performing loans exist. But the question is the amount of non-

performing debt in relation to total debts. This is 7% in developed countries while in developing countries it is about 12%. However, the ratio prevailing in our state banks 15.22% cannot be considered a healthy trend. In private banks of Sri Lanka, this is about 9%

Even if these total loans of Rs 45 bn is recovered by magic (no one can do this miracle instantly) how do we pay back Rs 300 bn. the huge debt in our national economy? The simple logic of saying that the total recovery of our bad loans would solve our economic crisis remains far from reality.

It is often stated that the weaknesses in the management of the economy have resulted in this situation. Do you agree with this view?

An analysis of statistics reveals that the buildup for the debacle of 2001 was created sometime back. There is evidence from various sectors to show that the weaknesses of economic management contributed greatly to this situation.

- (a) There are serious weaknesses in the agreements and implementation of the privatisation programmes.
- (b) Certain transactions related to the war have resulted in adverse consequences. Queries relating to transparency in tender procedures have surfaced. At the same time resulting deficits have threatened the existence of enterprises
- (c) Politically motivated expenditure and wastage remains another matter of concern. Although Cabinet portfolios were reduced numerically, expenditure has not reduced in reality.
- (d) Ministry of Finance and its management was complicated. There was no finance Minister responsible to the Parliament. Often as a practice, few public servants made all decisions in consultations with the Minister of Finance.

This messy situation resulted in an economic crisis, which in turn created a political crisis. As the culmination of these developments, the then government collapsed and the present government assumed power.

As the Minister of Rural Economic Affairs and Deputy Minister of Finance, you have shouldered a very challenging responsibility. The massive task of kick starting the economy, which has been inactive to a certain extent. Can you elaborate the short term and long term strategies you propose to adopt to overcome this situation?

We have declared that the country is faced with three major challenges. Firstly, the implementing macro economic policies in the context of a war situation remain our number one challenge. The huge burden of the war on our economy is in the tune of Rs

80 bn. on the annual government budget.

Secondly, we face the challenge of economic downturn *i.e.* bring about a turnaround from - 0.6% and taking to the economy to a plus growth rate. Achieving at least a 4.5% growth rate in 2002 and take the economy to a 7-10% growth scenario during the next five years.

Third challenge we are faced is the establishment of democracy so that to create a new political culture in the country.

Rate of investment remains around 3.5%. It is important to promote private sector (domestic and foreign) to raise investment. I believe that we should declare a three year investment promotion drive. During this 3 year (2002-2005) investment promotion period, it is necessary to provide incentives and inducements to private entrepreneurs in unprecedented levels in the history of Sri Lanka. A scheme should be devised to provide non-traditional incentives to all categories of investors and investments so as to promote investments infra structure development and fixed capital formation. It has been estimated that around Rs 600 bn. of undeclared money exists in Sri Lanka. All this should attract into the process of investment. Instruments such as certificates of deposits and treasury bills are outdated devices. In my personal view, in case monies are invested in vital sectors such as capital goods, industry, cultivation of land, re-cultivation or in land development machinery and transport equipment opportunities should be afforded to the people with undeclared monies, without any queries, to make investments. Likewise, there is a large quantity of money retained by our citizens domiciled in foreign countries. We must get this monies remitted to Sri Lanka.

Other incentives too should be provided to them. It is necessary to gradually reduce the 35% tax rate year by year and systematically. Equally, it is also necessary to create an investment

friendly socio-economic environment. I believe that by the next budget a package of incentives should be given to the investors in agricultural, industrial and services sectors, having considered the requirements of each sector.

As far as the agriculture sector is concerned an innovative thinking and new approach is called for. It is required to follow a pricing policy, which will give a reasonable price to the farmer while keeping the prices within the consumers' reach. There are several issues peculiar to the agricultural sector. The major issue among them as I see is the productivity of the land. Approximately 40% of our labour force concentrated in the agricultural sector. However, the contribution of the agricultural sector to the GNP still remains around 18%. Since an adequate level of production commensurate to the units of labour is not realised a problem of productivity exists in this sector. Therefore in order to raise productivity and at the same time to solve the problems of marketing in the agricultural sector, it is necessary to introduce a new programme that will direct traditional agriculture to one of export orientations. I believe that the present Minister of Agriculture (Hon. S B Dissanayake) possess the capacity to carry out necessary changes in the agricultural sector.

In the industrial sector, the export industries are faced with great challenges. In 2005, the Multi-fibre agreement will cease to operate and the quota system will be terminated. The biggest challenge in this front is as to how we are going to sustain our markets with the termination of quota system in 2005. In order to remain competitive in the market and retain buyers in our fold the issues such as modernization and continued quality improvement of the garment sector need to be addressed. Free flow of imported goods (especially from countries such as China and Russia) also pose a threat to our small and medium scale industries. In this context, they also need some protection. At the same time, a tendency of closure of industries is also prevails. This closure is caused by a number of factors - political and non-political. In order to prevent such closures we must think

In the services sector tourism has the highest potential. It is possible to earn more foreign exchange, create more employment opportunities and make a higher income, if the prevailing conditions in the industry are improved. We may be compelled to go for a Free Port concept in order to ensure a growth in the service sectors such as Banking, Insurance and other service sectors (specially Banking services, Port and air services). A new scheme is being formulated for this purpose.

The government has already launched the 100 day accelerated Programme. Do you believe that our economy will be in a suitable shape for a rapid leap at the end of this Programme? Besides, you have shouldered a new cabinet portfolio on Rural Economy at this juncture. How could you elaborate your role in this context?

I think the government's 100 Day Programme has succeeded in kindling massive expectations among the public. What is accumulated over a period of seven years cannot be cleared within mere 100 days, unless a miracle happens. No financial resources are made available for the 100 Day Programme. What was intended by the 100 Day Programme is the introduction of certain changes without any financial allocations. The period is run through by a vote on account. Budget will be presented on 22nd of March. Only after the Sinhala New Year *i.e.* after the budget that the country will have some impressive experience. Under the 100 Day Programme schemes that do not require funds and which involves low capital expenditures are being implemented. For example under the 100 Day Programme of the Ministry of Finance, auctioning of properties of debtors below Rs. 10 Million was postponed for 6 months. We have also decided to reintroduce a 40 per cent custom duty surcharge to protect small-scale industrialists and to import a very small quantity of rice (12,500 m/tons) as a remedy to the escalation of prices. The surcharge of 20% on coconut based products has been removed to prevent the rapid rise of coconut prices. The 100 Day

Programme of the Ministry of Finance is totally aimed at the preparation of a budget that would be geared towards development without heavily burdening the people.

A series of activities of the new Ministry of Rural Economic Affairs have been planned under the 100 Day Programme:

1) We conduct rural marketing outlets for the marketing of rural products with Ministry funding. One of such outlets was held at the Vihara Mahadevi Park. One each will be conducted in Kalutara and again in Colombo.

2) We have also launched a programme called "Turunu Sevana Market Promotion Drive" which will provide marketing facilities and employment opportunities to hundreds of persons who are engaged in planting of connected exotic plants and flowers. This can be called an environment - friendly self-employment programme. Facilities will be made available to the unemployed youth to sell their products such as plants and flowers at building constructed along the highways. A trade promotion center that will function round the clock also will be established.

3) An another noteworthy experiment we have ventured in this establishment of the first ever Printing Industrial Village of Sri Lanka on the surplus land available at the State Printing Corporation Complex at Panaluwa. Factories for printing and ancillary industries will be established at this site. Already applications have been received for the establishment of industries such as production of corrugated boards using waste paper and manufacture of albums, digital printing, and paints, stationary and manufacturing envelops and manufacture of file covers.

4) Action is also being contemplated on the possibility of moving away the agricultural wholesale trade

from Pettah, so as to effect a change in the monopoly enjoyed by the Pettah market. We intend to build several wholesale economic centres in the outskirts of Colombo utilizing the bare crown lands available on the lines of the one that operates at Dambulla, with the co-operation of the Private Sector. The twin objective of this exercise would be to give good returns to the rural producer and quality products to the consumer.

5) It is expected to establish an exhibition and marketing center to facilitate marketing of rural produce in the premises of the Exhibition and Convention Center located in Colombo. A large scale emporium will be established along Colombo-Katunayake highway to accommodate handicrafts and textile manufacturers, handloom industrialists, minor export producers and fancy goods manufacturers. This will be in line with the export development village programme. What is aimed at is the formation of a 100% share capital company comprising of producers and manufacturers of export crops and exportable goods. The large number of shareholders in this Company may be exotic fish culturists, mushroom cultivators, flori-culturists, comprised of those planting seedlings and lace makers. Despite the establishment of such a Company, they have no knowledge about the export trade or its potential. To make it a success we shall establish another Company. The capital of this Company will be provided by the Ministry of Rural Development (10%), Export Development Board (10%), the Company to be established (30%) and existing exporters (50%). Thus, the second Company will consist of exporters, rural producers and the government. This Company will export to the export Company of the exporters, and in the process, they will get a better price. They will also be entitled to a share of the profit. This concept slightly differs from that of export village concept. Under this new concept, two companies operate in combination. We

are discussing this matter, with the Export Development Board, which has expertise in this field.

6) We are thinking of providing equipment credit to the rural folk who do not have capital. We have farmers who depend on hired tractors, carpenters who hire lathe machines, welders who hire welding plants, fitters and gem cutters who hire machines, fishermen who hire boats. In order to alleviate this rural based poverty which arises from lack of capital Banks tend to provide cash loans. For example when a loan of Rs. 100,000 is granted to an unemployed rural youth, he utilises part of its proceeds to give his daughter in marriage, a part to repair his house. Although he is indebted to the value of Rs. 100,000 at least not even Rs. 25,000 is utilised for his venture. At the end, there is a debt burden of Rs. 100,000. An equipment loan cannot be considered a subsidy. Tractors, carpentry tools and masonry tools will be provided to the potential workers on credit. It is an interest free loan and only a service charge will be levied. They will be required to pay this loan within three year period. In case of default, the tools thus provided will be confiscated. This is an interest free hire-purchase system and once the loan is settled he will be the owner of the capital in three years time or becomes a capitalist with the ownership of his capital goods. The DFCC Bank, which earlier catered to the needs of this segment, has deviated from the path after privatization and seems to concentrate on large scale enterprises. Therefore, at present discussions are under way in order to explore the possibility of establishing an Enterprise Development Bank. The existence of Rural Development Banks does not serve this purpose since they are not oriented towards enterprise development. They remain politicised institutions. Since these Banks are based on new concepts the innovative youth power

should be utilised to enliven these organisations. The services of the talented unemployed graduates could be utilised in this project. This programme is expected to be implemented with tools obtained from a Foreign Company under a foreign aid package. A programme of distributing of these tools in the villages across the Ministry will be considered.

- 7) This will be followed by the establishment of an Enterprise Development Bank. There are certain projects that crave for funds and faced with capital problems. A need exists for a National Bank for small and medium enterprises. It is necessary to make a speedy march. It is somewhat difficult to make the inert organisations active. Thus we have been compelled to think of a new institution notwithstanding the existence of banks in the rural sector.

We have seen you as a vociferous Parliamentarian with strong views on the specific role and the key position of the state in the Sri Lankan Economy. You have also advocated the need for a strong state sector and this stance of yours remains contrast to the policy espoused by the present government. As of now, ironically you have been called upon to undertake a task of the extremely difficult job of directing the economy in line with the directions and recommendations of the institutions such as the World Bank and International Monetary Fund which were targets of your past criticism). How do you confront this situation?

At present India is implementing a programme of disinvestment. Through this programme it is envisaged to give a fillip to the private sector by reducing size of the state sector. Voluntary retirement scheme for the public sector employees also under way. Will Sri Lanka too will opt for a such scheme in the near future?

During the past, most of my analyses were based on the then available data. However, it is very obvious that there is an incompatibility between data and the reality. The question here is the

reliability of these data. According to my earlier analysis, an analysis of the public debt crisis was based on the accepted statistics of public debt. However, it becomes apparent that there is a debt that the books do not reveal. Only after coming here I came to know that there is an overdraft of Rs. 35 bn. Statistical information on unemployment represent the rate of unemployed excluding North and East (one third of the country). I cannot say to what extent some responsible institutions twist the statistical data for political objectives.

Achieving of higher growth, is no doubt, remains the basic factor that reduces unemployment, increases income and eradicates poverty. However, it is universally accepted that the mere creation of employment alone does not necessarily contribute to the reduction of poverty. A strong intervention of the government in this regard is essential. Therefore, contrary to the situation prevailing in the developed countries, in countries like ours, the government must actively intervene in order to maintain a compulsory social security net to direct the market. There are no jobs for those who seek them; meanwhile there are no skilled people for the available jobs. No qualifications for available jobs and no jobs for available qualifications. This is a structural imbalance of our education system. The country needs a massive educational reform programme to do away with this structural imbalance. The reason is that there is a wide quantitative improvement in vernacular and free education, number of students has grown to 4.0 mn, number of schools to 10,000 and number of teachers to 196,200. Despite this quantitative improvement, no qualitative improvement or structural change in education has taken place.

Under the current context, the maintenance of state institutions remains a vital issue. The major public institutions in Sri Lanka incur losses running to billions. Ceylon Electricity Board, Ceylon Petroleum Corporation, Sri Lanka Railway, Central Transport Board all these entities are maintained by the tax payers' money. All these burdens are shouldered by the public. These losses are not born either by the government or

by politicians. The whole of Sri Lankan nation is subjected to this exploitation.

It is high time that we moved away from this traditional state sector concept. Although unpalatable, the resource utilization within this sector takes place in an inefficient manner. Efficiency, productivity, cost effectiveness and competition are almost becoming the catch words of the modern world. A small country like Sri Lanka cannot stand in isolation. I do not advocate for a lumpsum open economy for Sri Lanka. Today the task that lies ahead us is to face up challenges with the objective of building up a strong economy. Modernisation is essential for a real turnaround in the economy.

It should be made efficient, productivity should be raised, opportunities to raise incomes. Traditional industries such as plantation and coconut industries are facing with a management problem. Due to this problem, coconut industry has become vulnerable today. Today some entrepreneurs have cultivated 1500 acres of coconut land under splinter irrigation system in the Mahaveli Zones. The National Exports Association provides water to 1500 Ha. of coconut plantation with the value of water required to cultivate one hectare of paddy. Economising water use they have planted coconut that yield in 2 1/2 years, by using modern technology. The present government has a policy to raise the income flow to the village.

Money incomes should go up to suit the rural economy. What it means is overcoming poverty? Source of income should be expanded. At present, there is a wide international market for organic agriculture products. There is a wide market for ayurvedic medicine and medicinal plants. At the same time, there is a challenge as the World Food Organisation states that this country will face food shortage in 2005. To face this challenge it is necessary to organise an accelerated programme of food production.

