

Implications of the Budget - 2009 on Infrastructural and Industrial Sectors

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The National 2009 Budget was tabled in the midst of a global financial crisis. This was characterised by the collapse of some of the world's biggest financial institutions in the United States of America (USA) followed by those in other advanced industrial nations such as the United Kingdom (UK), Germany and Japan. The impact of the crisis in due course reverberated around the world, though South Asia has yet to face the full brunt of it. Sri Lanka too is just beginning to feel the tremors of this disastrous slump in the international financial markets. Sri Lanka has a lesser degree of direct connections with the global financial institutions and the financial system. Of course, the crisis has already severely damaged the structure of industry globally, especially in the world's industrial powers. Among them are the USA and the UK, major export markets for Sri Lanka, and is likely to lead to steep decline in the purchasing power of these countries. In these circumstances, Sri Lanka too needs to brace itself for the likely hard times ahead.

The National Budget 2009, despite these crunching international trends, had a clear developmental orientation within a highly visionary framework. Two primary areas of its concern rightly were Infrastructure and Industrial Development.

Infrastructure

Infrastructure development conceptually falls under two heads - Economic and Social infrastructure. Economic infrastructural developments are of a more enduring nature and longer lasting whereas social infrastructure is subject to more changes and is more evolving. In the developed countries where economic infrastructure is already highly

advanced, changes are more frequent in social infrastructure in comparison to the former. In a developing country such as Sri Lanka, the situation is different.

A brief examination of the recent history of government expenditure on infrastructural development should give an idea of the direction of spending in this regard.

Ever since Sri Lanka gained independence from the British and until about the late 1970s (or for a period of 30 years), successive regimes did not afford sufficient attention, and more importantly, allocate resources to improve physical infrastructure. Had this been done, it would have possibly helped the economy to drive itself forward. On the contrary, economic activity was stalled by the inadequacy experienced in terms of infrastructure to meet the needs of the country. In other words, as such activity expanded, there should have been in place proper roads enabling links from the centre to the districts, communications, electricity supplies, housing and a whole lot of other facilities. But this was not to be.

Table 1
Investments in infrastructure from 1998 to 2007

Year	Economic Services		Social Services		Total	
	Rs. Bn.	% of GDP (a)	Rs. Bn.	% of GDP (a)	Rs. Bn.	% of GDP (a)
1998	44.7	4.4	15.5	1.5	60.2	5.9
1999	44.9	4.1	17.5	1.6	62.4	5.6
2000	54.7	4.4	16.5	1.3	71.1	5.7
2001	54.9	3.9	14.6	1.0	69.5	4.9
2002	51.7	3.4	15.7	1.0	67.4	4.3
2003	58.7	3.2	19.2	1.1	77.9	4.3
2004	61.3	2.9	29.0	1.4	90.3	4.3
2005	77.5	3.2	60.4(b)	2.5	137.9	5.6
2006	106.8	3.6	48.4	1.6	155.2	5.3
2007©	141.2	3.9	55.0	1.5	196.2	5.5

GDP - Gross Domestic Product.

(a) From 2003, data are based on estimates compiled by the Department of Census and Statistics

(b) Inclusive of Tsunami related capital expenditure

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Source: Ministry of Finance and Planning and Central Bank of Sri Lanka.

Table 1 shows that even during the last decade, no serious attempt was made to invest public funds towards infrastructural expansion. It also indicates that investments in social infrastructure have absorbed greater expenditure than economic infrastructure.

For a country continuously affected by the lack of good roads and quick connectivity to the metropolis from the regions, there should definitely have been a greater focus on infrastructure improvement.

It is relevant to mention that ever since 1983 when the first episode of the ethnic conflict took place, and over the subsequent years when it enlarged rapidly to assume the proportions of a war between the state and the rebels in the North and East, infrastructure development did not have the financing required for expansion and upgrading.

Before conclusion of this background

picture on infrastructure relating to the period from about 1940 to the advent of the present century, it is however relevant to highlight a major service-related transformation of the highest importance to the country. This development contrasted sharply with other infrastructural inadequacies that

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blighted the national scene during the final decades of the last millennium, and could rightly be called the Telecommunication Revolution.

The Current Status

It is a matter of satisfaction for the country that as opposed to the past, there is now a growing perception reflected through successive budgets in 2006, 2007 and 2008, of the need to invest more funds on infrastructure.

From 1998 to 2007, annual allocation on infrastructure development was over 5% of the GDP. It is debatable whether such limited investment could contribute to improving the overall situation and also help to meet the challenges posed by an expanding commercial sector in the country leave alone in improving physical connectivity from the regions to the major cities. To put it another way, could the minimal changes brought about like in respect of a single highway help in any downstream development worthy of mention. This is highly unlikely.

Ten-Year Development Framework of the Government

Before we examine the Budget 2009 and its implications on infrastructure, it is necessary to touch upon the Ten-Year Development Framework of the Government announced in 2006. This is also known as *Mahinda Chinthanaya* (MC) or the vision for a new Sri Lanka.

It centres on three main areas of particular relevance to this study:

1. Acceleration of economic growth through increased investment in infrastructure.
2. A more equitable basis of economic development by speedier regional and rural development.
3. Strengthening public sector delivery, in particular, in health and education.

Yet, another area of focus is the Government's rural development programme, known as '*Gama Nagumu*' (Village Upliftment). As this term

signifies, the plan is to transform villages and towns to be rural centres of growth through a holistic approach to development.

The Budget identifies the need to accelerate the process of development on both national and regional basis. In respect of highways, the Budget states that funds have been raised to modernise the road network in a manner that would cater to the demands of at least another twenty years. This is indeed an important statement and augers well for the future if in due course it becomes a reality.

The investment programme budgeted has afforded priority to rural and provincial roads and bridges. Equal importance has been placed on improving the Railways and Highways.

Fund Allocation for Infrastructure Improvement

On the basis of the Budget 2009, the Government has prioritised the need to improve infrastructure, which is a significant change in thinking.

As opposed to the methods adopted in the past in which a major drawback was the cost concerns in the operations of the Government which put a damper on infrastructure growth, the current Budget intends to invest in infrastructure expansion through increased state revenue. In this connection, it is noteworthy that capital expenditure has been raised to Rs 360 billion.

- a) Of this figure, nearly Rs 30 billion has been allocated to revive villages in a consolidated programme that would also improve rural roads, lead to electricity schemes, drinking water schemes and self employment projects.

A salient point in this regard is that the Government has, through borrowings, raised funds for the creation of assets. Such assets would, in course of time, not only be worth much more in terms of value than

the funds expended, but also in respect of their importance economically.

- b) A Budgetary innovation, in addition to the above that would auger well for the future, is the greater utilisation of external funds and resources for rural upliftment, for example by: (a) the supply of drinking water, (b) electricity for minor irrigation projects.

The establishment of a Presidential Task Force primarily drawn from Ministries such as Provincial and Nation Building; also the Finance Commission, is another useful development since the Commission is a composite body of relevance. Hopefully, it will concentrate on the tasks assigned to achieve the desired goals.

One of the most serious complaints made by critics of Government administration which is said to affect economic growth is the lack of co-ordination in respect of projects as well as deficiencies in monitoring them. These often defeat the very objectives of establishing such projects designed especially to improve or modernise lagging regions.

"Randora and Maga Naguma" Programmes

The Budget in referring to the above programmes mentions the mobilisation of funds from international agencies and foreign sources and will improve roads in villages.

Both the World Bank and the Asian Development Bank will play a role in supporting this particular infrastructure development endeavour. In the past too, assistance was rendered in this field by these two Institutions. In 2005 for instance, they extended their support to enable the realisation of the Road Sector Development Plan, first initiated that year. The plan has recently been subject to an improved form of implementation. A road development fund too has begun which indeed fulfils a much felt need.

The Government has also been able to utilise funds for infrastructure development through countries such as Japan and China in addition to the institutions mentioned earlier. This, we feel is a holistic approach to the upgrading of infrastructure.

Apart from the rural infrastructure program, the "Randora" also provides for implementation of projects at a national level such as (a) the development of the southern expressway, (b) Colombo-Kandy expressway, and (c) the Colombo outer circular road.

Generation of Hydro-power

The Budget of 2009 has inter-alia afforded a significant place for the generation of hydro-driven electricity. It states that around 600 small-scale hydropower projects have been identified which are capable of adding about 300 mw of power to the national grid.

Apart from the two large-scale power plants that are in the process of being built – the 150 mw Upper Kotmale hydro-power project and the 300 mw Norachalai coal-fired power plant, there are other similar projects, especially medium scale, also likely to be a reality. The key to the electricity supply meeting the growing demands, especially, of the industrial and commercial sectors at reasonable prices is dependent on the expeditious implementation of these projects.

Social Infrastructure - Education

Sri Lanka is a developing economy, constantly subject to economic pressures on the domestic front and externally. Its efforts to improve infrastructure despite these impediments is commendable.

In terms of literacy, the rate achieved by the country is as high as 92%. Similarly in respect of admission of students for primary education, admission levels to schools and in the area of gender parity Sri Lanka compares favourably with some of the more developed countries.

In respect of education, the Government, despite the obvious financial constraints, continues with its policies of re-orienting education so that it could meet the needs of an emerging economy. An indication of this is the Budgetary allocation of Rs 100 billion, a sizeable proportion of the overall capital expenditure towards education. Such expenditure aimed at improving infrastructure of schools, and also for the purpose of taking education to new heights of growth specially information technology and computer education in the rural areas. The intentions outlined in the Budget are laudable.

Hopefully as a result, the social structure of the country will be altered to satisfy the needs of an integrated and globalised community which is required in contemporary times. But it behoves on us to examine matters more closely in this connection.

Reaping the true benefits of such massive capital utilisation requires adequate planning, resourceful teaching staff on information technology to deliver programmes in order to make information technology (IT) education genuinely effective in the districts and the regions. Also relevant in this connection is to ask whether the current curriculum will help?

University education

For 2009, a Budgetary allocation exceeding a sum of Rs 21 billion has been made towards Ministry of Education. A vital factor is whether the university system within the country has addressed the required level of transformation during the last twenty years to ensure that graduates are more contemporary and attuned to the times. We however feel constrained to express the view that apart from physical expansion and improvements in respect of academic facilities on which a substantial part of the huge sum will be utilised, our priorities in this regard have not undergone the necessary level of change. This would imply that we yet do not put out the type of graduate who would fit into today's environment of an increasingly competitive and knowledge-based world.

The university system needs to be completely revamped, and the final human output should be able to enter positions largely in the business sector as a matter of course without further initial refinements or adjustments.

In these circumstances channelling the financial allocations made in the Budget of 2009 to at least begin the re-organisation of university education in the country should be the prime concern to the Government. In this regard, another fundamental input would be to create a culture of university-industry relationship, an evolving and sustained factor and not by fits and starts.

Vocational, technical and professional education

The Budget 2009 has justifiably allocated Rs 4600 million for the improvement of vocational, technical and professional education. An ongoing study of the actual needs of the nation's industry in sectors like civil engineering, building construction and others of rising significance like the food industry (which has been internationally identified as one of Sri Lanka's most promising in terms of employment and export generation) is the need of the hour.

The following are some recommendations to make Budgetary allocation worthy of the investment:

1. One of the major tasks of the Vocational Training Authority as well as the Ministry of Vocational Education should be the establishment of a regular dialogue with all relevant institutions in the private enterprise system in particular.
2. This, out of necessity, should include the network of Chambers of Commerce throughout the country which now exceeds 70.
3. Once the dialogue referred to is established, a scheme to regularly identify the needs of each such sector in respect of vocational training could be obtained. It is of course equally important to maintain records of such needs. Vocational training should be on the basis of

these needs so as to be genuinely beneficial to the country.

4. It is also useful to allocate a part of the funding towards overseas training of appropriate personnel at different levels. This would enable an understanding of how vocational training schemes operate in other countries. For example, Germany has for over a century maintained a system of dual education that combines both academic and vocational training at a secondary level. Of course the system is continuously re-adapted to meet the demands of industry of any given period.
5. The final output of such a system of education that meets the needs of Germany enables that country to satisfy the industry in terms of human resources. Germany which is the third strongest industrial power in the world has never experienced shortages of trained vocational manpower. As opposed to this, Sri Lanka has a constant problem of inadequacy of vocationally trained staff for specific industries.
6. Sri Lanka has so far has been unable to balance the demands of industry for vocationally trained with the supply and could fruitfully adapt a system similar to the dual education prevalent in Germany.

Health Sector

A sum of Rs 4,000 million has been allocated to the health sector. This allocation is to be used, primarily, to improve the staff strength of doctors, nurses and to provide better medical facilities and also towards services that are on offer free of charge.

Industrial Sector

This part will deal with the impact of the budget on industry. In this connection, it would be of relevance to examine both micro and macro factors relating to industry, and the budgetary implications on such factors.

Despite debilitating conditions, a feature of the economy in the year 2008 has been its industrial expansion.

Though not sensational, all indicators of growth reflect that the industrial sector could progress at a speedier pace provided energy inputs are more reasonably priced and ground conditions are supportive of such growth. At the outset, it is pertinent to mention that the present administration has made an endeavour to give incentives to the industrial sectors that hold promise.

Proposals for industrial development

The following are some of the important measures for the industrial sector:

(i) The threshold for Value-Added Tax (VAT) registration which was increased to Rs 650,000 per taxable period or Rs 2.5 million per annum from the current Rs 500,000 per taxable period or Rs 1.8 million per annum have obviously been designed to assist micro and small industries. This should augur well especially in respect of small-scale rural projects or individual business operations.

(ii) The reduction of the VAT rate from 15% to 12% is yet another development that should promote increased expansion in the small-scale industrial sector. It should also give much needed relief to sectors such as construction, tourism and the manufacturing segment.

(iii) VAT exemptions on locally-manufactured tea machinery and surgical gauze are useful in expanding small-scale industry and will also be a boost to rural and district-based industries. In respect of the manufacture of surgical gauze, a fiscal incentive of this nature was a necessity to revive an industry that had fallen on bad times due particularly to the rise in the cost of manufacture.

(iv) The exemption from VAT of the construction work of both "Gama Naguma" and "Maga Naguma" and community irrigation projects which involve individual inputs will also stand to gain from the exemptions. Such work earlier was subject to VAT and the exemptions are also supportive of the Government's policies aimed at uplifting rural areas.

Specific sectoral incentives

Special commodity levy on milk and sugar: The Budget proposals have rightly recognised the need to improve the milk industry which continues to languish due to the lack of a concerted drive to expand production of fresh milk. The budget notes that only 25% of the liquid milk is purchased locally. The Government on the other hand believes that the country should be totally self-reliant in respect of liquid milk.

It is with that intention that a special commodity levy was introduced on imported milk powder from Rs 5 to Rs 15 per kg so as to encourage dairy farmers. It is also intended to set aside a part of this levy to be used in importing cows and promoting breeding centres.

Whilst the budgetary incentives are timely, it is our view that in the long term, there needs to be a more comprehensive and wide ranging programme to improve and expand milk production.

In this regard an examination of the fresh milk industry in which India brought about a revolution is worthwhile. The "White Revolution" which enabled India to achieve self sufficiency in milk way back in the 1980s was the result of a well-conceived co-operative system of milk production introduced country-wide in which millions of farms were involved. This model of milk production called "Amul" was based on a co-operative ownership of all aspects of the industry including production and distribution by primary producers. It is owned by 13 million farmers who, in addition to production of fresh milk to meet the demands of the entire nation, have also diversified the product base that includes butter, yoghurt, curd, etc.

The budget with the intention of encouraging the local sugar industry which now is in doldrums has imposed a special commodity levy on imported sugar from the existing Rs 14 to Rs 16 per kg. The objective is to encourage sugarcane cultivation for sugar manufacture.

However, the manufacture of sugar entails large-scale investment that also needs land and other ground facilities together with a regular supply of labour. Thus, whilst the increased commodity levy may be helpful to the existing manufacturers, to boost production of this essential product would require greater assistance.

Cess on leather products: The Government has also afforded rightful recognition to the leather goods manufacturing sector. This is yet another move in the right direction since the potential of the leather industry of Sri Lanka has been accepted internationally. For example, the European Union is supportive of Sri Lanka to expand the market for leather products.

The introduction of a cess of Rs 200 per kg on all leather imports should encourage the leather products manufacture and enable it to gain a better foothold in the domestic market.

Cess on vegetables and fruits: The increase in cess on the importation of fruits and vegetables should also be a source of encouragement to the fruit and vegetable growing segment largely comprising of small holdings in the rural areas. This is of course subject to such growers being made aware of the measures taken in the Budget 2009 to increase the cess, so that they will re-double their efforts so as to meet any rise in demand locally.

From the point of view of local market, fruit and vegetable imports cater to only a limited high end of the market. The imposition of an increased cess will inevitably drive prices upward, encouraging the purchase of locally-grown of these two items.

Cess on other products:

- a) A 5% cess on Polythene and Plastics.
- b) Cess on imported Ayurvedic medicine.
- c) Cess on imported ready-made garments.
- d) 50% increase of cess on fridges, fans and microwaves.
- e) 50% cess on biscuit and sweets manufacture.

- f) Cess on Rubber Latex imports (Rs 25 per kg and Rs 4 per kg.
- g) Cess on imported maize.

Whilst these impositions or increase of cess could be taken advantage of especially as a means of product expansion, an awareness of the benefits accruing to the respective product or interests too is an important measure if they are to gain the desired effect.

To illustrate this point further, in industrial products such as refrigerators and fans, the cess on personal imports could be considered highly useful in expanding their local market base, thereby adding to the production capacity and expanding employment opportunities.

We feel constrained to state that the Nation Building Tax (NBT) of 1% at this critical time when the economy is being confronted with difficult conditions is unfortunate. This would also take the gloss away from a budget that seems to offer genuine hope to the industrial sector.

The NBT will apply to:

- a) Importers
- b) Manufacturers
- c) Providers of Services

We agree that a NBT for a nation ravaged by a 25-year war, may enable these sectors to make a contribution towards the major task of re-building the infrastructure, but we need to consider the current situation. Sri Lanka has already felt the effects of worldwide recession and the manufacturing and service sectors in particular will, in the course of 2009, be hard pressed to perform adequately to keep themselves afloat. In the face of such pressure, the imposition of a further tax is liable to affect these sectors further.

A Knowledge Economy

Of greater macro significance and vision is the philosophy of the Government as outlined in the Budget relating to the plans to create a knowledge economy.

It is pertinent to observe in this connection that Sri Lanka needs, not

only to realise, but also appreciate the potential the country has as an international hub for services.

The budget affords tax concessions to professionals like lawyers, accountants, engineers and doctors who render services to the international community which would lead to inflow of valuable foreign exchange earnings. This is a highly laudable initiative since the global demand for professional services is rapidly increasing. If the current trends are an indication, we should, like many Asian nations, take advantage of these trends.

It is relevant to cite the great advances made by countries such as India and Singapore in this regard. India has today emerged as a key outsourcing hub for IT where it capitalises on the resources of its professionals in Information Technology. Singapore, on the other hand, is a centre of medical treatment that has a world-wide demand. It is the professionals in these countries that drive their services in the areas mentioned. We could fruitfully emulate these two countries.

Hopefully, we will also popularise this scheme to afford tax concessions to professionals who are able to earn foreign exchange through the outsourcing of their services.

Conclusion

We wish to conclude this particular study of the impact on the Budget 2009 by reiterating that though specific allocations made in respect of improving infrastructure – both physical and social - and the thinking behind allocations are praiseworthy, it is the follow-up action and the practical aspects which will ensure meaningful results. The tax exemptions for local productions and the imposition of cess/special commodity levy on some imported products will incentivise local production of those items. However, the imposition of the Nation Building Tax of 1% at this critical time when the economy is being confronted with difficult conditions is unfortunate. This would also take the gloss away from a budget that seems to offer genuine hope to the industrial sector.