

FEATURES

GOVERNMENT'S INVESTMENT PRIORITIES AND EXPECTATIONS OF THE PRIVATE SECTOR

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(An address to the Ceylon Chamber of Commerce at its annual general meeting on July 27, 1984 Hon. R.J.C. de Mel, Minister of Finance and Planning)

It is indeed an opportune time for me to speak to the leaders of industry and commerce as the Government is about to launch the second phase of its development programme. As you all know, I introduced a series of far reaching reforms in 1977 which stimulated the economy by removing restrictions and providing inducements for the private sector to assume a major role in promoting economic development. As a result we doubled real economic growth in the period 1977 to 1982. We also doubled investment as a percentage of GDP. Unemployment was also halved from 26 percent of the work-force to about 13 percent of the work force during this period. Per capita incomes increased by 70 percent in dollar terms. Inflation has been reduced from 35 percent in 1980 to 18 percent in 1981 and 10 percent in 1982. The Central Bank and the Director of Census and Statistics claim that we reduced inflation to 9 percent but I prefer to take the more conservative figure of 10 percent. This is a combination of achievements in the period 1977 to 1982 of which any country could be proud of. Few countries in the world could boast of such a combination of economic achievements during this period which was marked by the worst international economic recession since 1932. There was some slippage after the ethnic disturbances and the severe drought last year. Inflation rose once more to about 20 percent and our growth rate declined to 4.9 percent. Our recovery however, has surpassed our expectations.

Paddy Farmers show the way

The paddy sector showed even more remarkable progress. From a

situation where we were importing 46 percent of our rice requirements in 1977, we have come to a position where, given reasonable weather, we are unlikely to import any rice at all. This remarkably demonstrates what is possible. If the production energies of the people are not hindered by restrictive policies, I am confident that the performance of the paddy sector can be emulated in other areas too. The productive capacity of the economy must be expanded if the country is to achieve sustained growth and development. This means that entrepreneurs must demonstrate great dynamism, business acumen and managerial capacity. They must adopt a more far sighted approach and increase the time-frame of their investment decisions. The paddy farmers of this country have certainly shown us the way, by patriotically responding to the incentives which we offer. I hope you will follow suit.

Disappointing Private Investment

Capital formation or investment is the source of sustained growth and development of an economy. The achievements of the past six years have to a significant extent, been dependent on a massive increase in public investment. Though there has been some increase in private investment, the overall performance has been rather disappointing. The tendency has been to choose easy options such as trading activities which yield quick returns with less effort and enterprise. Unless there is a significant change in attitudes on the part of the business community, we will not be able to put the economy firmly on a path of self sustained growth and development.

332-67
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The liberalised economic policies can be continued only if there is dynamism in the productive sectors of the economy. Our debt servicing has reached a point where we can no longer afford to borrow to support our balance of payments. Unless we develop the priority sectors of export and efficient import substitution, the pressure on the balance of payments will compel us to revert to controls and the stagnation inducing policies of the past. In this context the private sector has a major role to play in the development of these sectors.

In the beginning it was necessary to provide a wide range of fiscal and other incentives to reactivate a stagnant economy. The time has now come when we have to be more discriminating in the tax exemptions and other incentives that we offer. In future I propose to confine such benefits only to exports and efficient import substitution to ensure that resources will be channelled to the productive sectors of the economy.

Though Sri Lanka is a relatively poor country, we have an abundance of resources that still lies untapped. Later on in my address I will identify some of these areas. The Government for its part will try to create an environment that is conducive to increased investment in sectors that have the greatest potential for development. The private sector must support these measures by becoming more responsive to the opportunities that are made available.

It is indeed a truism that sustained development is only possible in a context of political and economic stability. Our Government is making every possible effort to ensure political stability in the future. Given the necessary goodwill on all sides, it is not impossible to achieve a lasting solution to the ethnic problem.

Ensuing Financial Stability

You are all aware that the impressive economic progress made by the country has not been

easy. We have had to face very serious problems. Our efforts to pull Sri Lanka out of the low investment/low growth/high unemployment syndrome, to which it had become accustomed for over 20 years, placed great strains on the Budget and the Balance of Payments, particularly in the context of an extremely hostile external environment. We have, however, taken a number of corrective measures to ensure domestic and external financial stability. The Government Budget this year will be deflationary. The Central Bank has tightened monetary policies to contain inflationary pressures. A better balance in the Budget will be achieved this year. The improvement in the fiscal position, combined with our monetary and exchange rate policies are expected to result in a substantial surplus in the balance of payments and a manageable rate of inflation by the end of 1984. It is also heartening that the donor community continued to demonstrate its confidence in the economic policies of the Government at the recent Aid Group Meeting in Paris by increasing its pledges by 18 percent, in real terms, over last year.

The economic fundamentals of the country are in reasonable order. I must, however, warn you that there is absolutely no room for complacency. The buoyant tea prices that we have enjoyed are undoubtedly the major explanatory factor behind the current improvement in Sri Lanka's macro-economic indicators. But many important structural problems have yet to be resolved. We have learnt some painful lessons in the past regarding the viciousness of the commodity price cycle. It is, therefore, of paramount importance that appropriate policies are adopted to use the buoyant export prices to build up our reserves in order to enable us to make the necessary structural changes in the economy in the medium term. If we fritter away this temporary advantage, we are likely to face dire consequences when the commodity boom ends. We must,

therefore, continue to maintain strict financial discipline and ensure that resource allocation is based on a clearly worked out system of priorities.

Fundamental Objectives

The Government is determined to push forward vigorously with its plans for the further improvement of the economic and social conditions of the people of this country. The fundamental objectives will be rapid economic growth employment creation, price stability and structural change necessary for further growth. Our medium term programme has been spelled out in the document "Public Investment 1984-88". It envisages investment of Rs.202 billion over the next five years. Public sector investment will account for Rs.106 billion while the Private sector is expected to invest Rs.96 billion. A growth rate of 5.6 percent is projected for this period, which I think is a sustainable growth rate for Sri Lanka. The next five - year plan of India for example projects a growth rate of 5 percent. We hope to further reduce our budget deficit in the current account and the balance of payments to make them more viable. We also hope to bring down inflation to single digit figures to make it comparable to the rates of inflation of our main trading partners. A number of decisions have also been taken to strengthen the institutional structure within which these objectives will be pursued. Efforts are being made to strengthen the whole project cycle.

The Government has recently taken a very important decision that is of crucial importance to you, in the private sector. It has been decided that no project will be undertaken by the State sector, if it can be better handled by the private sector. Public investment is to be viewed basically as a means of providing the infrastructure facilities necessary to support private entrepreneurship. Only in the case of

the plantation sector, where the large majority of the estates are vested in the State, will the Government embark on investment in directly productive activities.

Public Investment Priorities

A major objective in our medium term programme will be to increase emphasis on rehabilitation and maintenance of the country's capital assets. In the past few years most of our resources were diverted to large new projects like the Mahaweli Dams. As a result, existing assets were neglected and now require urgent attention. The Government will therefore undertake new infra-structure projects only where such projects are absolutely essential, for example, the power sector. Emphasis will be focussed more on the rehabilitation and improvement of existing capital assets such as roads, buildings, and irrigation systems. The road system in particular, will benefit from a major rehabilitation programme.

Another important feature of the development programme in the period ahead is the greatly increased investment envisaged in our plantation industries. One of the most disturbing aspects of Sri Lanka's development process has been the steady decline of our plantations. The Government proposed to take urgent action to rectify this. A detailed investment plan has been prepared for the plantation sector and substantial resources will be earmarked in our Investment Programme for the rehabilitation of the plantations and modernisation of estate factories. We also propose to draw up a similar investment programme for the Private Sector.

Investment Potential For Private Sector

I have outlined very briefly the priorities for public investment. The

private sector will be expected to taken the lead in the other sectors of the economy. There is tremendous scope for rapid expansion of both exports and efficient import substitution. It is, however, essential that areas identified for import substitution are competitive. It is often argued that we must protect our domestic industries. Sri Lanka's experience with such protection in the past has been far from happy. Consumers have been confronted with poor quality goods at exorbitant prices while a few inefficient entrepreneurs made large profits behind protectionist barriers. The effects on the consumer are much more invidious in developing countries than in developed countries, where there are well developed consumer protection institutions and stringent quality controls. Further more, protective barriers make inefficient sectors attractive and lead to a misallocation of resources. As a result, sectors which could yield real returns are squeezed for funds. This leads to a loss of efficiency in the economy which results in losses in output, incomes and employment. Hence, it is in the country's interest to ensure efficient allocation of resources by developing only those import substitution industries that are competitive. In doing so, the need may well arise to protect nascent industries which have the potential to become competitive once established. Such protection must eventually be phased out so that the discipline imposed by competition is brought into play once these industries have found their feet. Another plank of such a strategy must of course be strong action against dumping.

Great potential exists in the fields of agriculture, animal husbandry and fisheries and also in resource based industrialisation. Major initiatives have already been taken to boost sugar production in the country and thereby reduce our heavy dependence on sugar imports. We must also make a major effort in the next five years to increase

milk production in the country. The development of minor export crops is another area with considerable potential for development. My Ministry has already recommended coffee, pepper, cardamoms, cloves, cashew-nuts and tropical fruits (to be processed into fruit juices and concentrates) as crops with favourable export prospects. It is most unfortunate that fisheries development has received rather step-motherly treatment from successive Governments in the past. Less than 1 percent of the Government's total capital expenditure is allocated to fisheries. It is essential that our priorities are revised and a determined effort is made at rapid fisheries development. There is tremendous scope not only for the expansion of our deep-sea fisheries but also for the expansion of Sri Lanka's inland fisheries and, in particular, for the more systematic culturing and farming of the large extents of brackish water lagoons, estuaries and swamps for the production of prawns and lobsters for export.

In addition to agriculture and fisheries development there is also scope for the expansion of industrial processing. Greater value must be added to both our traditional and non-traditional exports. The progress made in the packaging of tea and the processing of rubber must be consolidated and built upon. Backward linkages must be developed in the garments sector by producing more inputs domestically. Other avenues for industrial processing must be pursued aggressively.

Over the past six years, we have been following pragmatic and realistic policies after several years of dogma and ideology. This is why we have taken a balanced view of the opportunities for both efficient import substitution and exports. If one takes a longer term view, it is apparent that export-led economic diversification is essential for sustained growth and development in an economy like Sri

Lanka which has a small domestic market and a relatively narrow resource endowment. Our export sector must become more dynamic. An Export Development Plan has been drawn up which seeks to double the rate of growth in the export sector. A number of lines of activity with export potential have been identified. Many incentives, both fiscal and monetary, have been provided for investment in the export sector. The Chamber of Commerce must play a leading role in the implementation of this plan.

Financial Resources and Investment

The Government also hopes to provide an environment that is conducive to the development of the priority sectors. The system is not perfect, but we are constantly seeking to improve it and we will always entertain any constructive suggestions that may come from your Chamber. One of the major constraints to new investment has been the high interest rate structure. On numerous occasions in the past, I have deplored the instability introduced into the system through the Government's fiscal operations. The Budget has been pre-empting a large share of domestic resources. Interest rates have been kept high because the National Savings Bank which has been a captive source of budgetary financing, has in effect determined the level of interest rates in the economy. As the budget deficit is brought under control, I foresee more resources being made available to the private sector at a lower cost. This presumes of course that strict financial discipline will be maintained in budgetary operations.

The level of investment in priority sectors is influenced not only by the cost of funds but also by the availability of financial resources for such investment. It is regrettable that the banking community has not been sensitive enough to the needs of a developing country like Sri Lanka. Conventional

banking practices, evolved in a totally different social and economic milieu, at a very different stage of world history, still dominate much of our thinking regarding banking. It is for this reason that I have recently introduced legislation to strengthen the hand of the monetary authorities. The new Banking Act will I hope lead to a greater flow of credit to the productive sectors of the economy. The Rural Development Banks and the efforts to set up "bare-foot" banking in Sri Lanka are all part of a sustained thrust to create a banking system that is in harmony with the development priorities of the country. I hope that in future the banking community will adopt more development oriented perspectives to ensure the success of the Government's policies.

Private Enterprise Promotion

I have also taken a number of direct steps to foster private sector development in this country. The Private Enterprise Promotion Project which is being implemented through my Ministry by Sri Lankan business leaders and officials appointed by me, is designed to accelerate the process of private sector development. I have been able to obtain assistance to the tune of US\$ 4 million from USAID for this project. One of the key elements in the implementation of this project is the establishment of the Sri Lanka Business Development Centre (SLJDC), a new organisation which is privately chartered and managed. It will work in partnership with the existing business organisations, government agencies and other institutions involved in business development activities in Sri Lanka. This institution is innovative in that it helps to mobilise resources available in both the private and public sectors to promote private sector development in Sri Lanka. I am confident that this institution will not only play a catalytic role in the development of the private sector in the country, but will also serve to break down the mutually suspicious, sometimes even antagonistic, relationship that prevails between the private and public sectors. These petty

divisions must be broken down. All of us must work together to put this country on the path of self sustained growth and development. At the same time we must not under-estimate the magnitude of the task before us. Small countries like Sri Lanka have to learn to survive in a harsh international system. There are no easy options, so we must cooperate to achieve our common objectives.

The most important objective of the Sri Lanka Business Development Centre will be to identify, motivate and support entrepreneur development throughout the island. Opportunities will be provided for entrepreneurs in small towns and in the rural areas to play a more active role in economic development. The performance of the paddy sector, in recent years, bears ample testimony to what is possible when private initiative is given the means to prosper in these areas. This programme will be supplemented by services rendered to investors regarding information on business opportunities and market conditions. This centre cannot be an effective instrument without cooperation from the Chamber. I hope everyone of you will support this innovative effort to promote private sector development in the country.

The Centre will also work in close liaison with the FIAC, GCEC and the EDB in assisting private foreign investors to collaborate with Sri Lanka partners. The Government will continue to encourage foreign investment that helps Sri Lanka fulfil its development potential through the transfer of technology and the provision of access to external markets.

The stage has now been set for the private sector to play a more dynamic role in Sri Lanka's development process. The private sector oriented policies carries with it a need for responsible action on the part of the beneficiaries. Any abuse of the system will only serve to weaken it. You must now look beyond your own immediate interests. If you are not able to adopt a more enlightened approach, then the whole private sector oriented strategy will be undermined. Given the great stake that all of you have in the success of private

sector oriented policies, I do not think that you should leave the role of policing the system entirely to the Government. We are taking steps to improve the operations of the Inland Revenue Department, Customs and other government agencies. These efforts must be supplemented by developing systems of self regulation by the private sector itself. Self-regulation of this sort is found in other countries. Your Chamber should give serious thought to this idea. Of course such self-regulation must be devoid of all petty personality conflicts and rivalries. It must be administered in the interests of the private sector and the country as a whole. Investment, production, sound business ethics and business morality is essential if the private sector is to grow and flourish. The confidence of small investors all over the country must be built up. There is money in the country. It is not forth coming due to lack of confidence in the system. This is where a proper Stock Exchange together with a Securities Council will help. But please do not put the cart before the horse. This will be a futile and worthless operation.

We must look to the future with optimism and confidence. We must eschew negative thinking of all kinds. The programme of economic and social development that I have outlined requires the concerted, collective support of all the people of Sri Lanka. No Finance Minister can or should advocate adventurism or irrational risk taking. However, it is important that the entrepreneurs of Sri Lanka must be more dynamic. Your horizons must be widened. There is need for a pioneering spirit. New ground must be broken and the frontiers must be pushed back. If I may borrow Prof. Joan Robinson's phrase "Animal Spirits" must be activated. There must be a sense of excitement about the possibilities before you. No government has provided an environment that is more conducive for the fostering of private initiative. All of you as leaders of Industry and Commerce have a special responsibility. I hope that you will make maximum use of the opportunities that are becoming available to bring about development that will benefit all the people of this country.