SESSION 1: WINNING ECONOMY

In the aftermath of the 2008 financial meltdown, which is somewhat comparable to the great depression in 1932, economies are still struggling to make a recovery. Sri Lanka and other developing countries being no exception to these circumstances are faced with many economic issues such as unstable depreciation of local currencies, drying up of foreign direct investments, high rates of inflation, trade account mismatches, balance of payments issues, high interest rates etc. to name a few, leading to a highly volatile and turbulent economic environment, where economic uncertainty has been the only certainty. This session will focus on identifying the means of becoming a Winning Economy that could withstand the pressures created by uncertainty and turbulence, on its path to achieving its goals of stability, growth, efficiency and equity.

Presented by:

Premachandra Athukorala is a Professor of Economics at the Australian National University, Fellow of the Academy of the Social Sciences in Australia, and Honorary Professorial Research Fellow at the University of Manchester, UK. His major areas of research interest are international capital mobility and financial crises, structural adjustment and stabilisation reforms, multinational enterprises and international production, patterns and determinants of trade flows, and international labour migration, in which he has published several books and made numerous contributions to scholarly journals and multi-author volumes.

At various times, he has served as a consultant to the World Bank, Asian Development Bank, International Labour Organisation (ILO), United Nations Industrial Organisation (UNIDO), United Nations Commission on Tariff and Trade (UNCTAD), Economic and Social Commission for Asia and the Pacific (ESCAP) and the Australian Agency for International Development. These assignments have resulted in work on India, Indonesia, Pakistan, Bangladesh, Nepal, Sri Lanka, Malaysia, Thailand, Vietnam, Laos, Cambodia, Ethiopia, Jordan and Georgia.

Prof. Premachandra Athukorala
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Winning Economy

Dr. Premachandra Athukorala’s Presentation – Professor of Economics at Australian National University

As an introduction to topic Dr. Premachandra presented a quotation from John Keynes, which expressed that while Sri Lanka is facing a global economic crisis there is a huge debate ongoing regarding the appropriate development strategy for a post-conflict Sri Lanka: Should we go back to the failed import protectionist strategy or open economic policy regime or a mix of both.

In order to expand on this topic the structure of the speech followed the pattern of:

1. Historical Context
2. Recent Policy Shifts
3. Economic Performance
4. Concluding Remarks

1) Historical Context:

Expanded upon by outlining a quote from Alexander the Great which stated “Past is the prelude to the future.” When looking at Sri Lanka’s economy since independence, Sri Lanka was known as “The best bet in Asia”, from examining the earliest date on record (1950) it was evident that Sri Lanka was well ahead of many nations in Asia (based on PPP GNP relative to the USA). In addition to this strong growth position there were many other advantages present in Sri Lanka, however, in the late 1950s Sri Lanka embarked on an import led protectionist strategy which impacted that strong growth position negatively, which eventually led to the World Bank classifying Sri Lanka as a low income country in the early 1970s. Through trade liberalization, initially in 1977 and in a second wave in the early 1990s, further contraction of the Sri Lankan economy was averted. Unfortunately due to the heightened of the Civil War in Sri Lanka during the late 1990s policies aimed at further liberalization was halted.

Then reform outcome, which was a dramatic transformation of the economy despite continuing civil war and the resultant macroeconomic instability. This reform outcome consisted of:

- Emergence of the private sector as the engine of economic growth
- Annual average growth rate of over 5%
- Increase in manufacturing share in the GDP from 10% to over 20%
- Export diversification
- Emergence of export-oriented manufacturing as the major generator of domestic employment

From the trade liberalization period the Barter Terms of Trade and Income Terms of Trade increased due to these new efforts.

2) Recent Policy Shifts:

Recent policy shifts are encouraging a backsliding of trade liberalization reforms, these policies started taking effect from about 2005 and have increased after the ending of the Civil War in 2009. When
When examining Malaysia you see there are many policies aimed at aiding the poor and needy, however, they never closed the border to foreign trade (import and export), which allowed the private sector to be the dynamo for economic growth.

When examining the Trade Protection Regime in Sri Lanka you see there was continued liberalization, however when examining the current nominal rate of protection you see that it has risen from 12.5% in November 2002 to 23.7% by January 2011. When further examining the factors that make up the Trade Protection Rate (Custom Duties and Para-tariffs) it shows that while Sri Lanka maintains one of the lowest Custom Duties in the world it has an increasing Para-tariffs. Please note that Para-tariffs only apply to imported goods and not exported goods. When examining the tariff duties and Government Revenue it has been shown that an increase in tariff duties associated with importation does not have a direct correlation with an increase in Government Revenue as high tariffs may encourage manipulation through bribery and ‘playing around’ with the tariff schedule (components tariff is significantly lower compared with total machine tariff).

When examining foreign direct investment policies there are specifically two policies, the Strategic Development Project Act of 2008 and the Underperforming Enterprises and Underutilized Assets Act of November 2011, that have damaged foreign investment confidence. These policies allowed the agency in charge of approval for FDI ample discretion in their approval process and the ability of the government to take over ventures from foreign enterprises respectively. In addition, the minimum capital requirement of USD. 500,000 for a five-year tax holiday for FDI projects may be viewed as high when compared to other regions in Asia.

The concept of Domestic Value added is not consistent with the current thinking of open door economic policy, we have to think about High-Value products not Domestic Content. As an example of this, Dr. Premachandra iterated on the IPod and Ford examples.

A major government policy during 2005 to 2012 was keeping a stable Nominal Exchange Rate, and because of this policy did not have a stable macroeconomic policy which thus allowed domestic prices to shoot up, resulting in a drop in the real exchange rate. The black market premium is widening which is the best indicator of the lack of confidence in the currency, which highlights that the current macroeconomic policy needs to be looked at.

3) Economic Performance:

The main drivers of growth are non-tradable sectors (construction, transport, utilities) in Sri Lanka. When examining the per capita income you see that this figure has doubled partially due to the domestic inflation present in Sri Lanka and the artificial exchange rate stability during 2005 to February 2012. With regards to unemployment it has been evident there is a current decline in unemployment rates, this could be attributed to the high level of public sector recruitments and a huge chunk of the potential labor force leaving Sri Lanka to work overseas.

When examining the external payments position it can be seen that it remains fragile as:
• Current Account deficit has widened due to poor export performance and faster import growth;
• Net foreign reserves are very low; and
• The share of non-concessional loans in total external debt has ballooned from 7.4% to 42.9%.

4) Concluding Remarks:

• Sri Lanka’s experience under liberalization reforms has clearly demonstrated that an outward oriented policy regime can yield a superior development outcome compared to close economy regime even under severe strain.
• Viewed against this background, recent developments in the Sri Lankan policy scene do not seem to bode well for the future of the Sri Lankan economy.
• Policies based on the past paradigm of inward oriented state centered development offer no viable long term solution to the huge challenges facing Sri Lanka in the face a global economy that is in deeper trouble than at any time since the 1930s.

Panel – Mr. Amal Sanderatne’s Presentation – CEO/Director of Frontier Research

• Just to reiterate, from 1978 onwards Sri Lanka was a massive economic success story (3rd fastest growing economy in Asia) the backsliding we see is from the period before 1978 – the open economy did work. The economy did extremely well during the war time due to the open economy.
• While looking at Malaysia and Singapore as success stories, we should also look at how these countries failed, and see how Sri Lanka can learn from those lessons. Sri Lanka should look at these countries and avoid strategies that failed in those economies, with special attention placed on the economic crash.
• When looking at Malaysia you see high volatility in the GDP growth rate with high growth in places and high declines in certain area.
• Singapore increased the CPF contribution to 50%, causing companies to feel that no upgrade improvement was needed.
• The lesson of this is that regimes can become complacent, and the danger of that is a re-examining of outdated and old policies (backsliding of reform).

Panel – Dr. Indrajit Coomaraswamy’s Presentation – Former Director Economic Affairs Commonwealth Secretariat

• What should a winning economy look like:
  • 8% sustained growth (which is the Government’s objective) over a period of time which should be inclusive and equally balanced.
• Key issues that we need to address in Sri Lanka:
• Fiscal consolidation, when you look at the main problems in the economy you need to look at the budget deficit.
• Productivity is the key determinant of global competitiveness. When you look at Sri Lanka you see two pools of low productivity in the public sector and agricultural sector.
• Looking at the post-war period, probably the most disappointing aspects is domestic investment. When looking at FDI you see that domestic investment has to come before FDI, when looking at this the Sri Lankan government needs to have reforms aimed at easing doing business
  • Supplement the stabilization methods the government has introduced with a wave of structural reforms.
• Diversify our exports and exports destinations.
  • We have zero presence in intra-firm trade (supply chain in Asia), Sri Lanka needs to examine not being a finished goods supplier and see how Sri Lanka can integrate vertically into the manufacturing sector’s supply chains and horizontally into the service sector’s supply chains.
• Maintain and grow the level of CAPEX spending, which can be strengthened through the PPP model.
• Evaluate and redevelop training and development of skills of the human capital of Sri Lanka.