Pathfinder View Point – 2

Defensive and corrective approaches towards destruction……?

No steps forward many steps backwards

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When we look at the developments in the economic policy arena after the Presidential elections, we hardly see any way forward for Sri Lanka. Apart for revisiting governance issues, what we find is policy actions that were "defensive" and "corrective" in form but is "destructive" in substance.

When I bring this to the notice of others what I hear is that "The government is now focused on the 100-day programme; and therefore, we are to wait and see how things change after that". Surprisingly, no one seems to understand that what the government does from day one will impact the country, beyond the 100 days. After 100 days it may be too late to correct the negative repercussions of our policy blunders as they may be irreversible at least in the short-run.

Defensive strategies

Defensive strategies are those which you implement in order to safeguard your position. In the first place, we should know that these strategies are subjective, because they are based on perceptions rather than facts; it is you who think that they would defend you. As a result you may go forward by thinking that what you offer may be the best way to defend your position and to avoid challenges.

For instance, look at the amended budget 2015, which replaced the budget presented in November 2014. Being a pre-election budget, the initial budget prepared under the previous regime had overwhelming promises to give away much more. But it did not answer the question how the resources are generated to provide increased recurrent expenses. The danger was that the promised increase in recurrent expenses is irreversible.

		LKR billion		% of GDP
	Initial	Revised	Initial	Revised
REVENUE				
Tax revenue	1416	1337	12.5	11.8
Total revenue & grants	1689	1622	14.9	14.3
EXPENDITURE				
Recurrent expenditure	1525	1612	13.5	14.2
Public investment	696	520	6.2	4.6
Total	2210	2121	19.5	18.7

The amended budget prepared under the new regime got locked up in the trap fabricated in the previous budget. Assuming that the political challenge could be avoided and that the popular validity of the previous budget could be nullified in the same way, the same promises were inflated many times over in the revised Budget. Estimated recurrent expenses increased even more against a declining government revenue. This decline seems to be more than what was estimated in the revised Budget.

For a moment, let us be sympathetic about the prominent expenditure proposals in the revised budget that came in between two elections. However, it is surprising that, firstly there is nothing about how to generate additional revenues even in the short-run for increased giveaways. Secondly, there is nothing about the policy directions of the country. Finally and more importantly, the budget sent negative signals damaging long-term investor prospects of the country. In fact, the budget confused and frightened investors who were anticipating business-friendly policy directions from the new government.

Corrective strategies

As the new government started digging into wastage and corruption associated with large-scale investment projects among other things, initiated during the previous regime. The motive is to re-establish good governance, and perhaps to charge the accused. In effect, a series of infrastructure projects have come to a confusing state of progress; some of these projects include Matara - Hambantota Expressway Expansion, Port City Project, Lotus Tower project, Colombo - Kandy - Northern Highway project, and some FDI-projects.

There is no question of investigating into wastage and corruptions within the premises of law and order of the country or re-negotiating terms and conditions of the projects under concern. Yet bringing the ongoing projects to a state of standstill will have far-reaching negative consequences on investor confidence and economic growth prospects. The Sri Lankan economy may not be able to recover from this downfall even after the 100 – day program plus the parliamentary elections. The direct economic cost of abandoning infrastructure projects include: public or private investment foregone, possibility of claiming compensation by investors and other funders, and their direct economic benefit to the economy that is foregone.

The long-term potential cost is more important than the immediate costs of the policy actions. It damages the credibility of the political leadership and the regime resulting in the loss of investor confidence. In a business-friendly policy and political regime, potential investors expect contractual obligations to be honored. Protecting investment and enforcing contracts are essential ingredients of the Ease of Doing Business as measured by the respective indices.

It is difficult to forget that, in spite of being one of the few countries in the Asian region to adopt market-oriented policy reforms, Sri Lanka has struggled for more than three decades to raise its FDI inflow to at least US$ 1 billion a year. Of course, Sri Lanka can easily overcome low levels of domestic savings if it creates a conducive environment for attracting a fraction of the FDI that flows into the Asian region. As the size of FDI inflow does not depend on the size of the country or the population, Singapore can attract over US$ 60 billion, while India attracts about US$ 28 billion. Malaysia and Thailand raise over US$ 12 billion and Vietnam about US$ 10 billion.

Although the problem of the lack of FDI inflow was attributed to the country's 30 year conflict, it did not turn around even after the dawn of peace. This shows that Sri Lanka has a structural issue that needs to be corrected with respect to the establishment of a business-friendly policy and political environment. Yet the measures taken and signals transmitted during the 100-day period seem more damaging than restoring the country's investment climate.

Conclusion

The major issue of the policy regime is the "mixing-up" of multiple objectives. Apparently, a government unlike any other organization has multiple objectives to achieve. It is not wise and statesmen like to use economic and fiscal policies to achieve narrow political or personal objectives. The objective of sustained growth and prosperity needs to be achieved through the adoption of prudent economic policies. A mature people-oriented leadership has to make decisions to serve a larger interest of the people without considering the petty interests of a select group.

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