ADB Plans U$800 Million Assistance

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Can it be said that the cooperation between the Bank and Sri Lanka has been cordial and mutually beneficial to both parties resulting in the ADB setting up a resident mission in Colombo?

Sri Lanka is a founding member of the ADB which goes back to 1966. The cooperation has always been cordial be- tween Sri Lanka and the Bank and a strong

development partnership exists. The Bank's first loan to Sri Lanka was made in 1968, and since then 82 loans have been approved amounting to $1.98 billion. Under the Bank's technical assistance programme, 154 technical assistance grants amounting to over $47.8 million have also been approved. Sri Lanka receives soft funds from the ADB. At present there are 24 loans amounting to $740 million under implementation. The Bank is currently emphasising good portfolio performance as the basis for future lending

Further, policy dialogue, capacity building, regional coop- eration, good governance, sub regional cooperation, and mobilising co-financing are important non-lending activities of the Bank. It was, therefore, considered important to have a local presence in Sri Lanka to strengthen both the lending and non-lending activities of the Bank.

Can it be said that the ADB is the largest aid donor to Sri Lanka?

The ADB is one of the largest donors to Sri Lanka together with OECF (Japan) and the World Bank. The Bank's lending to Sri Lanka has been $140 million in 1995, $44 million in 1996 and $165 million in 1997. The lending level for 1998 is expected to be $185 million.

What is ADB's strategy of assistance to Sri Lanka?

The prime developmental concerns in Sri Lanka are the need to reduce unemployment and poverty, mainly by accelerating the rate of growth and job creation but also by the more effective targeting of resources to the poor. The corner- stone of the approach to poverty reduction and unemployment is the need to move the economy to a higher growth plane. This vision of faster growth, with the benefits widely distributed among the population, must be supported by two major policy thrusts: first, sound macroeconomic stabilization policies and exchange rate competitiveness; and secondly, structural reforms to dismantle protectionism, regulatory barriers and public sector privileges that curb competition and private initiative.

There are a number of serious obstacles to achieving sustained high growth rates over the medium term: notably a high current account deficit and the heavy reliance on foreign and domestic borrowing; a large savings investment gap and

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budget deficit; inefficient public sector; a labour force whose skills do not match market requirements; an infrastructure eroded by years of neglect; and growing environmental degradation.

The Bank's current operational strategy for Sri Lanka has the following thrusts: promoting sound economic policies to improve domestic resource mobilization and providing an attractive climate for domestic and foreign investment; deregulating the economy, liberalizing trade, reforming the financial sector, promoting export-oriented industries and encouraging a more productive agriculture sector; rationalizing public sector enterprises to free resources for private sector growth; upgrading the skills of the labour force and addressing the current mismatch between availability and requirements; improving physical infrastructure; and ensuring sustainable development and contributing to environmental improvement.

What would be the benefits for Sri Lanka by having an ADB Resident Office in Sri Lanka?

Having a Resident Mission would primarily improve portfolio performance. Project implementation issues which need to be acted upon could be facilitated by a local presence. The Bank could also be more responsive to the country's needs which would be reflected in the interventions planned through country programmes which are prepared on a multi-year basis. The Resident Mission would also engage in policy dialogue with the Government. Better donor coordination would also be possible.

Further, information dissemination and interface with civil society would also be enhanced by a local presence. Although, when originally established as a Regional Bank in Asia, it was felt that Manila was close enough to its clients, the Bank has now broadened its services from a mere project lending bank to a full fledged development institution offering a large range of non-lending services as well. Bringing regional best practices to our member countries is a major task of the

Bank. The Bank now has 11 Resident Missions in the Asia-Pacific Region.

There has been a misconception that the Bank is an organization representing the interests of the developed world and disbursements have been centered on promoting the developed world products, services and strategic interests.

The Bank is an international organization representing 56 member countries. Of these, 40 are regional members and 16 are non-regional members. The Bank's Board of Governors is vested with all powers of the Bank and provides general direction, while the Board of Directors takes decisions on Bank policies, loans, guarantees, investments in equity operations and technical assistance operations. The Bank insists on international competitive bidding procedures for the procurement of goods and services from member countries of the Bank. The ADB is a regional bank which has a reputation for being responsive to regional needs and specialized in bringing regional best practices to its members.

In relation to deregulating the economy, liberalizing trade and public enterprise reform, are you happy with Sri Lanka's progress?

Sri Lanka's historical experience demonstrates the importance of a market friendly environment for private activity. The Sri Lankan economy is reasonably open to the outside world. Some further reduction of tariffs (from the present 3 band to a 2 band system) could be considered. The 1998 budget has eliminated import duties in a number of sectors (agriculture, gems and jewellery, tourism, textiles). This, however, tends to create an uneven playing field, and it may be preferable to go for uniform lower tariffs and tax treatment. Replacing the distortionary sales tax and many excise duties with GST is expected to take place in April 1998.

The Public Enterprise Reform Commission was established in 1996 to advise and assist the government in public enterprise reform. Good progress has been made in 1996 and 1997. During 1996, the Commission generated $81 million largely through the sale to foreign investors of shares in Orient Lanka Ltd., and divestiture of shares of Ceylon Steel Corporation. The privatization process has gained further momentum in 1997 with the sale of 35% of Sri Lanka Telecom to Japan's Nippon Telegraph and Telephone for $225 million, and 46% stake in

the National Development Bank for $73 million. Privatization proceeds in 1997 have amounted to $393 million. About two thirds of the privatization proceeds have been used to retire public debt. Privatizations proceeds for 1998 are estimated at Rs 8

billion in the budget. While satisfactory progress in privatization has been made, it is necessary for the government to resist the temptation to retract. For example, plantations which were bought by government entities should be privatized and no further support should be extended for the public sector to engage in activities which the private sector can carry out.

What about the government's budget deficit, which as you know is the root cause of several other economic problems?

The government has continued on the path of fiscal deficit reduction. Fiscal consolidation will be essential to place the economy back on a sound footing. The budget deficit was reduced from 8.9% of GDP in 1996 to 7.6% in 1997. The Budget Speech sets a target of 6.1% for 1998 and 4% by year 2000.

Privatization proceeds were used to reduce the amount of public debt outstanding, sending a positive signal to the markets. The significant decline in interest rates observed in 1997 will in the medium term further help reduce the burden of the country's large public debt. Action on other large items of

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expenditure the public sector wage and pension bill- would be necessary to further support the process of fiscal consolidation.

As you know, infrastructure development is vital for the country's development. How does the Bank view the current levels of investments in capital development projects?

Clearly, much needs to be done in improving the country's physical infrastructure which is constraining economic development and hampering foreign capital flows. Based on the expectation that GDP growth rate will gradually rise from 6.0% in 1997 to 8.0% by 2001, the most recent Public Investment Programme (PIP) prepared by the government in 1997, identifies the total investment requirement

for the period 1997 2001 at Rs 1,659 billion. Of this amount, about Rs 531.9 billion is expected to be from budgetary resources and Rs 1127.3 billion from private investment.

Is it correct that the Bank has expressed concern about Sri Lanka's absorptive capacity due to a lack of viable projects?

It was disconcerting to note that in 1995 and 1996, the loan processing activities were below the indicative planning figures of the Bank. However, 1997 has seen a recovery and the programme for 1998 to 2001 is robust. During this period, a total of 18 projects are listed in the Bank's pipeline amounting to $880 million. It is, however, important to strengthen the pipeline. More project preparation technical assistance and more systematic selection of projects based on sectorial studies will be required. Some of the projects in the pipeline are too small and tend to be scattered. In collaboration with the government, the Bank hopes to identify larger and better focused projects in the future.

An important indication of absorptive capacity is portfolio performance. It is important to note that, as an operating principle, the Bank's lending is linked to good portfolio performance. The Bank's recent portfolio review mission has indicated several areas which need attention: (1) improvement in procurement procedures and practices, (ii) timely availability of budget resources, (iii) timely recruitment of project staff with appropriate skills, and (iv) effective delegation of authority to project implementation units. These matters have been brought to the attention of the government at the highest levels and the Bank expects significant progress in the ensuing months.

What are the underlining causes of the currency turmoil in Asia and what lessons could Sri Lanka draw from this experience?

The recent currency crisis in South East Asia which has now spread to East Asia as well, was triggered by the lifting of the US dollar-denominated peg of the Thai bhat in July 1997. The contagion effect has significantly affected the economies of Indonesia, Korea, Malaysia, Philippines and Thailand. The level of depreciation of currencies has now reached 35-40% since July. This turmoil in the currency market has affected the global equity markets and will impact on financial and real sectors of other economies within as well as outside Asia, through financial and trade linkages. The crisis is due both to internal problems, arising mainly from fundamental and regulatory weaknesses in the financial sectors, and to external

factors operating through the surge in capital flows. The internal problems reflect a combination of lack of competitive pressures, as the financial sectors were sheltered from both domestic and foreign competition. Other factors were the weak management of the liberalization process, owing to the neglect of accounting and reporting standards, lack of transparency, ineffective legal systems, and lack of attention to human resource development issues.

The laxity in managing financial flows, along with lack of appropriate provisions for loan-loss treatment of non-performing assets in the banking sectors, also contributed to the problem. These fundamental weaknesses were com- pounded by attempts in some countries to keep the exchange rates below their real effective levels. This, in combination with relatively high domestic interest rates and low inflation, encouraged imprudent large-scale dollar denominated borrowings with short maturity in offshore markets by domestic investors and banks. Poor regulatory and supervisory frameworks and inadequate human resources to implement regulations led to much of these unhedged borrowings being invested in the real estate sector, exposed to well-known boom-bust cycles. In sum, the causes of the currency crisis tend to be interrelated.

The various factors that explain vulnerability could be grouped as weak macroeconomic fundamentals, the fragility of the financial sector, improper management of the globalization- on of financial markets, and surges in short-term private hospital flows. The lesson to be learnt is that, external capital knows while critical to bolster domestic savings to fuel economic growth, must be managed prudently.

To conclude, how do you see Asia’s growth prospects in the next millennium?

I should start by referring to the ADB’s recent study on Emerging Asia – Changes and Challenges which looks at the prospects for the Region. Asia is clearly in the midst of great economic and social transformation. In virtually every dimension, life in Asia is changing at an unprecedented pace: its people have become richer, healthier, and more educated in a remarkably short period of time. The study emphasizes that Asia must learn to cope with the turbulence of globalization, continue with market reforms, anticipate and manage complex social changes, and take measures to correct its dismal environmental record. The study cautions that not all of the regional countries face an equally bright future, and achievements in economies handicapped by remoteness, difficult political legacies, or other

structural impediments are likely to be more modest and hard won.

It is expected that poverty will be eliminated in South East Asia in the next 30 years. In South Asia, for every four people that endure poverty today, there will be only one by 2025. A confluence of better policies, improved governance structures, and favorable demographic conditions will give South Asia the opportunity to close the gap in income and social achievements with prosperous East Asia and other industrialized countries. Fast growth is also expected in other low-income countries that make similar policy and institutional headway.

Political stability will be imperative and the role of government in adapting to and managing the needed changes will be critical. The governments, throughout Asia should increasingly become less concerned with the control of resources and more with a shared vision of future economic direction. Governments should provide the needed institutional architecture that will allow markets to operate in a consistent and socially cohesive way. Modernizing government in Asia will increasingly involve forging partnerships with the private sector, and limiting government action to what the private sector cannot do.

Some analysts have suggested that the on-going currency and asset market turmoil in Asia presages the end of a remark- able epoch of fast growth. This prognosis in my view is too gloomy. The strong fundamentals which propelled growth in the past remain in place. But the extent and speed of economic recovery and future growth will depend on how successfully Asia learns to cope with globalization. Recent events have exposed weaknesses in the capacity of Asian institutions to deal with monetary and financial management in the presence of open capital accounts. These weaknesses need to be rectified, to ensure that prospects for longer-term growth are not seriously hurt. We should not lose sight of the fact that well-managed emerging economies that are integrated in global markets can sustain faster growth than those constrained by their own resources.