

# ENTERING A VIRTUOUS CYCLE



The Sri Lankan economy is at a crossroad where traversing in the right direction will enable economic growth that will be in line with President Gotabaya Rajapaksa's vision for the country, 'Saubagyaye Dekma'. Ajith Nivard Cabraal, State Minister of Money and Capital Markets and State Enterprise Reforms is

responsible for ensuring the stability of the currency as well as enabling a vibrant capital market, while also enhancing the performance of State Enterprises. As the Governor of the Central Bank of Sri Lanka during the period of 2006-2014, he proved that the impossible was possible, where he maintained the stability of the Sri Lankan rupee. In a similar manner, the State Minister has taken on the challenge to steer Sri Lanka in the right direction so that we emerge from the vicious cycle of economic stagnation to a virtuous cycle of economic growth.

By Udeshi Amarasinghe. Assisted by Swetha Ratnajothi Photography Menaka Aravind.

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**What is your view on the current status of the Sri Lankan economy?**

We are facing some challenging times, which are not peculiar for Sri Lanka only. At the same time, we are also at an important crossroad at which we can now

decide how we are going to travel in the future without being inhibited by our earlier baggage. Sometimes a crisis is helpful because it gives us the opportunity to look at the entire scenario, afresh. This crisis has done that not only for the world but for Sri Lanka as well. I see a new chapter unfolding in the Sri Lankan economy and I believe that it would be a good opportunity for us to move into a growth trajectory on a much more sustainable basis.

**‘Saubagyaye Dekma’ is the President’s vision for the country. Can you describe the manner in which the economy is moving in that direction?**

The economy is designed to be “people centric”. This is not simply a tagline. People centric means that we are conscious as to how economic activity affects each and every person in this country. That is why we are much more sensitive to the people’s needs and aspirations. The idea is to grow the economy, and make it people centric so that each person gets their fair share. We know that we need to make the cake bigger, if larger pieces are to be cut to include everyone. We cannot simply cut an increased number of smaller pieces out of a small cake just because we have to.

In that sense, the thrust would be to have some big projects where we would have future development assured. At the same time, we also need some small projects that are bringing benefits to people at the grassroots level. At the mid level we must see that businesses as well as the small and medium sector is flourishing. That is why you would see some projects, such as water projects that are designed to cut across the entire country. At the same time there will be projects such as building the village tank or the village anicut, which are helpful for the villagers.

It is a two-way process and I believe that the success would be if we ensure that our plans are implemented fast, so that people can see results.

**Sri Lanka is moving towards import substitution especially due to the current situation. What is the importance of taking this approach?**

The focus on import substitution arose mainly as a result of the COVID-19 pandemic, and we started thinking about it in earnest. I believe that is one of the better things that happened with the COVID-19 pandemic. It also told us that there were certain items in the economy that could be done by ourselves, which we had previously not attempted to do. The conversion of some of those imports

into local activities will provide at least two results. One, is to conserve the foreign exchange, and two, is that we will be putting the money that would have gone out of the country, into the hands of our farmers, entrepreneurs and small and medium scale industries. In that way, there will be a discernable shift in our economy where we are taking certain aspects of the work that could be done in Sri Lanka into consideration and making that a National policy.

Going forward, we would perhaps see restructuring of our industries where some industries that we thought we could not carry out in Sri Lanka will locally, be done, even to the extent of having automobile manufacturing in Sri Lanka. We will also aim to become self sufficient in milk in the future, and we might have a large part of our sugar requirement produced locally. We will have some of the vegetables and fruits that we used to import from other countries being grown here. These are all laudable outcomes that have taken shape during the last one year.

### **The capital market comes under your purview. What are the current trends?**

The capital market had a lot of potential. For five years, it was dormant. We found that the turnovers on average were about 900 million rupees only. The indices had come down and stayed at those low levels for a long period of time. The market capitalization in dollar terms had fallen quite significantly from about 25 billion dollars to around 12 billion dollars. That means, it was only about half of what it was. Even after five years of reasonably steady profits of companies, that value was not being reflected in the indices of the Colombo Stock Exchange (CSE).

The CSE was in a backward stage when I took over as the State Minister. At this moment I have only given expression to the current situation. I do not believe we have still reached our potential. We are still at a much lower level than our true potential. I believe there is great scope for the market to grow and for new companies to list, and for new activities to take place in the stock exchange. The stock exchange is a place for people to seek capital and not only for trading. I have exciting initiatives in mind for the stock exchange, and, so far we are only at the early stages of that new developments. I also do not want to see the CSE growing too fast. I want to see a steady growth. Those who take positions in the CSE now will be quite well rewarded as time goes on because the growth would

really reflect the situation in our country, and in a way, how our economy is moving.

**The Government is giving all the support to the capital market, but there are less than 300 companies listed on the CSE. Companies are reluctant to come into the market. How do we give them the confidence?**

The conditions must be conducive for companies to list. People are not only interested in what they read in the promotional materials. They want to see the ground conditions. Is there new capital to be formed in our stock exchange? That is what we have been talking about to the CSE and the Securities and Exchange Commission (SEC). I had meetings with both and I was keen to impress upon them that they must make the stock exchange more receptive; that is, for the companies who want to be listed as well as to the investors who are coming in. Those two need to go hand in hand.

The target they are setting for themselves, and which I also endorse, is that the CSE should have at least 500 companies listed by 2025. I was a member of the SEC way back in 1992 when I was the President of the Institute of Chartered Accountants. At that time there were only about 250 companies. More than 25 years later when I am appointed the State Minister for Capital Markets, the number of companies in the stock market is still about the same. Therefore, we have not gone very far. Now, we need to break free from that.

All over the world, if a company needs to attract outside capital they have to be transparent. If you do not want capital from outside, then you can do what you like. No one is going to say anything. But if you are going to invite people from outside buy your shares, then you need to change your methodology of doing business and your corporate governance structure in order to be open with them. After all, you are working with other people's money. In that sense, you need to be accountable and you need to be transparent. That is what a stock exchange provides. It provides an investor with the assurance that the companies that are listed will carry out their activities in a proper and transparent manner. Once that is understood, whoever comes into the stock exchange to list their shares, come with that knowledge. At the same time, if you are on your own and doing business there would be a certain limitation on the amount of money that you have. But when you are listed on the stock exchange, there is no such limitation. You convince others that you will look after their money and ensure the growth in

profits, then people will invest. Some companies today are worth more than 200-300 billion rupees. Some companies are worth more than 100 million dollars. Why? Because there are many people who believe that they are operating their businesses in such a way that the investor's money is not being frittered away.

In any country, you get large-scale corporates that are not listed. We see that in Sri Lanka too. We need to attract at least several such corporates, but I will admit that will occur only if there is true business confidence. The listing entities must be confident that they can come and do their operations and benefit, and they will have access to capital. That is the assurance we have to give. We have to provide a level playing field.

When anyone comes and tells me that the market has gone up or down, I do not get excited because that is the way markets behave. If you go to the Dambulla vegetable market you may pick up a kilo of tomatoes for 60 rupees on one occasion and 600 rupees on another. That does not mean there is something wrong with the Dambulla market. It is just that the demand and supply of that particular product at the particular time, is different. It is a similar scenario with shares as well. During the COVID-19 pandemic, many companies had their share prices going down. However, the share prices of the health sector and IT companies increased. That is the difference. The conditions of the world, in the country, and the general upbeat or low beat mood of the people, has an effect on the market. We have to understand that. We must not jump to the conclusion that when the market fluctuates in an upward or downward direction, that someone is manipulating. You need to have more people investing in the stock market. I was happy to see over 60,000 people trading in the stock market since of late, because that means it is very difficult for one or two people to corner the market. That is what you call a near-perfect market. Nothing is perfect, but to make it near-perfect, you must have more players. One or two people cannot corner or manipulate or do something that will change the way the market moves.

People must also be careful. There is an old Latin maxim that states "Caveat Emptor", 'let the buyer beware'. When you are buying shares, the same way that you are buying a property or anything else, you must be cautious, because you are parting with your money. At the same time, remember that different people have varying appetites for the same product. You may see something in one way and another person may see it in another way. That is why at a particular price you are selling and someone else is buying. Why should they do that otherwise? The

purpose of the market is to provide you with the space to come in and trade without hindrance. The price is your call, whether you sell or buy, and the quantity that you buy or sell is also your call. That understanding must be there.

Around the world, you have some massive markets. Some markets would trade in a day, ten times that of what we trade in a year! That's the way those markets work. Many of those markets work online today. That means they will have trigger points for buying or selling. They will factor buy or sell early. Some of those markets work in nano-seconds. That is the environment that we are moving towards. Hopefully, we will understand that and we will have a greater understanding of the needs of the markets. I know that the SEC is bringing in a new law, and the CSE is improving on their procedures and practices. I am confident that as time goes on we will have a market which will be a lot more robust than what we have today.

**As a developing economy, our regulations are getting tighter day by day. Shouldn't there be more flexibility?**

You have to strike a balance. Today, we have to adhere to some international norms, many of which have been put in place after 9/11 especially in relation to money laundering and terrorism financing. This has led to many stringent regulations being put in place across the world. Earlier, if you transferred money there were very few questions asked. During the period of World War II, some countries were built on the money of the Nazis who went and deposited their money in these countries. The Nazis built up the entire capital base of those nations. But, no questions were asked though people at that time knew what those monies were. More advanced countries that are vigorously practicing these norms today had money coming from mafias, as well as from activities that were completely illegal, such as ransoms, prostitution, illicit liquor and so on. But today, we have different laws.

Many countries also used the resources of other countries with impurity in order to develop their own countries. Colonization was legal at that time, or at least it appeared to be. Do you realize that in Sri Lanka only one percent of the population had electricity in 1948? But the country that was ruling our country, had a much greater percentage of people with electricity. Although we sometimes do not recognize or reflect on these matters, that was the state that we were in at that time. In the last 73 years, since Independence, we increased electricity usage

and electricity availability to almost 100 percent. In 1948, there was only one university but today there are 15 state universities built with Sri Lankan funds. Our Colonial masters had enough universities in their country and they used to boast about it. But we had only one at that time. That is why we have to appreciate that in the last 73 years, when we have been independent an extraordinary amount of development work has taken place. In 1960s the tallest building in Sri Lanka, the Ceylinco Tower had only 13 floors. People used to call the rooftop restaurant “Akasa Kade” (sky shop) and go there and have a great time. But today, we have many high-rise buildings. Today, we have nearly 10,000 schools in the country. We have had great leaders, top businessmen, super entrepreneurs, talented entertainers, highly knowledgeable professors, outstanding doctors, legal luminaries, and other outstanding persons, many of whom have blossomed during the last 73 years. We are quick to criticize all Governments after Independence, but we have to concede that they have all done a tremendous amount of work as far as the Sri Lankan people are concerned. That recognition is not enough, and we have to appreciate that once in a way.



All over the world, there is a new regime that we practice today where we want to



ensure that money is not derived from any illegal activities. That has put more pressure in the way that countries do business, and in the way capital is raised. Countries that did not practice any of those things, went up to per capita incomes of USD 30,000-40,000 before these laws, and only after that did they want to practice these new norms. But the countries that had not progressed up to that point, have to now go through that difficult period with all those restrictions.

### **With the foreign exchange fluctuations, what would your views be on the stability of the rupee?**

I remember you have done interviews with me way back in 2014 as well. The question that was, asked from me at that time was why was the rupee so stable? Some of the economic pundits at that time, (who started to manage the economy after 2014) said we should allow the rupee to freely float. They criticized me bitterly saying I was keeping a stable rupee for too long. Well, the rupee did float thereafter, and it went to a level where we could not even catch it! From a rupee that was 131 to the dollar, it went up to 185, and that is the story.

Our debt and interest rates went out of control, when the rupee went out of control. That has been what we inherited when we came back to Government in 2020. The rupee was unrecognizable from where it was when I left at that time. With the current context of our country, if you do not have the dollar at around 170 rupees, we are bleeding unnecessarily. But, we cannot change it overnight. We will need to steer the rupee back to health. That is what we are doing. But it is not to be done into the wave of a magic wand. It is a process that we need to put in place and diligently follow with discipline and careful nurturing. We would need to make decisions which are tough and at the same time long-term oriented in order to nurse it back to health. You have already seen it happening. For one year, we have had a stable exchange rate even in the midst of COVID-19. People did not expect that to happen. I know there were many people who were speculating as whether the rupee will end up at 250 by the end of 2020. Those were the numbers bandied about by the Opposition who actually caused the debacle. I can assure you, had they been in office, then the rupee would have been at that rate, or even higher. That is why they are in such a quandary as how the rupee has been managed. But I want to assure you that we will manage it, and we will make sure that there is stability in the entire economy, the rupee and interest rates so that there is a stable platform on which people can do their business. That is our goal, and so far, we are on track.



As I said earlier, when I was the Governor of the Central Bank, the criticism was that the rupee was stable and in an appreciating trend at around 130 rupees per dollar. Had we continued on that basis, my own view at that time that I had expressed at several fora was that the rupee would have appreciated even above that to around 120.

Unfortunately, today, our debt servicing, our growth, and many other factors have been affected by the significantly depreciated currency. But that had been what financial institutions such as the IMF had recommended because they preach that mantra to all developing countries. Sadly, they have recommendations which ultimately work for the detriment of some of the countries. Show me one country that has done well by adhering to those policies. Every country that progressed did not depreciate their currency but focused on improving their productivity.

Nevertheless, all multilateral institutions pressurize developing countries to do just that depreciate, depreciate and depreciate. Fortunately, during the period of 2006-2014, we did not take that advice. We went with the IMF during the global crisis, and got a facility, but we implemented our own home-grown policies. We were strong enough to do that. We survived and were able to grow as well. But if you go in the opposite direction, you are in trouble.

**Many of the rating agencies have downgraded the country. What are your thoughts on that?**

Many of these ratings are based on their perceptions, while they are also driven by the vagaries of the market. Unfortunately, the rating agencies have not looked at what Sri Lanka is going to do. They have taken a backward and linear view, instead of a forward looking view. They also pretend that they don't know that the depreciation of the currency in the five years 2015 to 2019 added 1.8 trillion rupees to our debt without any corresponding asset. I have mentioned this on several occasions as well. 1.8 trillion rupees is the cost of around 12 Hambantota ports! After we came back to office, we have taken the right steps to put our economy back on track.

We now have about 14 billion dollars that we have borrowed from the International Sovereign Bond markets, which are debts that we have to repay. We will repay those debts, whatever the rating agencies and some analysts may say. Sri Lanka has never defaulted and we have made a commitment that we will not default in the future as well.

In the Post-Pandemic period, we are one of the few countries that went to the extent of even imposing a ceiling on imports in order to conserve the foreign currency so that we could pay the debt. Not many other countries have done that, because they would have not wanted to disturb their way of life. But, we, as a responsible nation, ensured that we meet our debt payments. I believe many of the rating agencies did not take that into consideration as well. They saw it negatively I am sometimes skeptical about their methods and objectivity, because the day after we finished the war in May 2009, they downgraded us! But we proved them wrong repeatedly. We proved them wrong in 2009, and we will prove them wrong in 2021 as well.

**What is the status with attracting investment to the country?**

The investments Sri Lanka had been able to attract in the past five years of Yahapalanaya have been dismal. It was not at where our true potential should be. We have to now get our act together and ensure that more investment comes into the country. The last few months have been reasonably satisfying with a couple of big investments materializing. Particularly the new rubber tire factory coming up in Hambantota, and the large scale mixed development project at the entrance to the Port City, which is another 425 million dollar project, are good starts. However, we require more investments. We have a long way to go. We have built a new Hambantota industrial zone, and a pharmaceutical zone. We are looking at new investments in the form of the Ports City development. Those will need to be nurtured and new laws will have to be framed and assurances given to the investors. We have to ensure that the BOI is made more receptive to fast track operations than what it is today. We have to focus on providing a efficient and effective mechanism for investors, where they do not have to face unnecessary difficulties, by running from pillar to post.

We have to make sure that our local investors are supported as well. People generally talk only about the foreign investors, but a large bulk of the country's investments come from the local investors. Unfortunately, local investors have had to go through tremendous hardships at the hands of many Government departments, local authorities, and so on. Those also need to also be streamlined.

Our ease of doing business indicators have to be improved. Our taxation has been revised to a certain level by making sure that no investor has to pay excessive taxes than what they usually to pay in any other country. That is a good start, but still not enough. Making sure that our tax policies are consistent, making sure that those who are local investors are also supported, making sure that foreign investors are carefully nurtured, and making sure that continuous infrastructure development is a reality, result in attracting investment. I believe about three to five percent of GDP is the level at which our foreign investment should be. That is not an unachievable number. But it is achievable only if we have the right conditions in place. That is the challenge that we will have to work on it.

**There is a perception that it is difficult to invest in Sri Lanka not only for foreign investors but also for Sri Lankan investors. How do we change that image?**

The image change you are talking about will not come from advertisements that say we are an easy country to invest in. People who come to the country to do business experience the conditions, first hand. That is the best advertisement. We must ensure that investors who come, say that they had an easy passage to make their investment. There was large-scale investor who came in 2013-2014, and at every conference we went to thereafter he would say that he had a fantastic experience in Sri Lanka. He would explain how he came to Sri Lanka and the manner in which his issues were solved in two to three weeks, how his investment was processed and how he was able to start work. For me, that is much greater publicity than anything else.

Ruchir Sharma of Morgan Stanley Investment Management, in his book "Breakout Nations" in 2012 listed Sri Lanka as one of the "break-out" countries. That type of comment is better and bigger and more valuable than a full page advertisement in the Washington Post or New York Times. It is important to know the comments or responses of an investor who has had the Sri Lankan experience. That is what we need to improve. Building our image as a country based on what we do to quickly, help people to get about their business. That is a challenge that I too have been entrusted with, and I am taking a lot of steps to deliver. Let us see how it goes because we are keen to come on top as an investment friendly and supportive destination.

### **State Enterprises also come under your purview. What is the status of these Enterprises?**

State Enterprises are today carrying out some of the most important functions in our country. Naturally there is a necessity for them to be efficient and receptive to the needs of the people as well as of the society and the country. As the State Minister for State Enterprise Reforms, I am conscious of the fact that we need to make certain improvements and we are working on those. At the same time, the institutions themselves are sometimes not the decision making authority, which is one of the problems we are facing as decisions are made elsewhere. If you take the Petroleum Corporation, the price at which they sell petroleum is not a decision by the board of directors. So naturally, their hands are tied, although we may judge them by their reported performance. It is the same with Ceylon Electricity Board. That is why a certain level of autonomy to the management is necessary, which of course needs to be coupled with some norms or overall parameters in which they should work. If there are any decisions that we are

asking them to take which is outside their scope, which cause losses, we should not hold the management responsible. Accountability is something that we will have to establish carefully.

Let's see how best we can work it out, but I believe there is tremendous potential in state institutions. Some of them are working very well, and we have seen them discharging their duties diligently even during the COVID-19 pandemic, and even during the war. We have to be conscious of that too, and focus on moving forward with their support and commitment.

**At that time as the Governor of the Central Bank you urged for consolidation in the financial sector. What are your thoughts on the performance of the banks in Sri Lanka?**

We should have stronger banks that can carry our country's economy because the banking sector is the vehicle in which the economy is moving. Unless the banking sector is strong, resilient and big enough to carry the weight, the country's journey is not going to be comfortable. We must always look at the fundamentals. If we want to have a comfortable journey, we must have a comfortable "vehicle". We need to have strong institutions, and for that, consolidation is a must. I am also very particular about stability. I want people to feel stable in the banking environment. If that does not work well, it can have some serious adverse results. Therefore, if we want to avoid that, we have to strengthen the financial/banking sector.

**Do you think Sri Lanka will be able to come out of this cycle, where economy grows within a conducive environment and thereafter it doesn't and we have to start again from the beginning?**

This is a very important question. If I go back in time to 2006 when I became the Governor of the Central Bank, Sri Lanka was trapped in a vicious cycle. There were high interest rates, depreciating currency, low investment, high inflation, and low growth leading to economic instability. It was a cycle which fed itself. However, over a period of time, we were gradually able to break-free from that cycle and convert that into what is known as a virtuous cycle. The virtuous cycle was where investments increased, jobs were created, growth increased, currency became stable, and low interest rates prevailed. Each one of those factors led to further growth. That was the new cycle we were able to transform into. But, once

again in the last five years, we had gone back to the vicious cycle. We seem to be switching from cycle to cycle. The important thing to remember about those cycles is that once you get into a cycle it is easier to keep going in that cycle whether it is vicious or virtuous. That is why we must now somehow break free and get back into a virtuous cycle.

We have done a few things that are right, but investments are yet not at the level we would like it to be. It is a slow process but we have yet been able to maintain reasonably low interest rates as well as stable currency to some extent. That shows we are moving in the right direction. Given another six months or so, I believe with the new measures we are putting in place to increase the foreign exchange inflows through non-debt means, we will be able to once again enter into a more virtuous cycle. Once we get in there, we need to preserve it, and thereafter maintain that cycle.



**Sri Lanka has been a developing country from the time we can remember. How are we going to break through that to become a developed country?**

If you look at the nine years 2006 to 2014 we moved from an economy that was only 24 billion dollars, to an economy of a 79 billion dollars. That was a vast increase of about 55 billion dollars in just nine years. That was an extraordinary leap and was the best growth momentum that Sri Lanka ever experienced. That also meant we were breaking free and moving in that direction. Unfortunately, in the next five years our economy was quite stagnant. It merely grew from 79 billion dollars to 82 billion dollars, that is only 3 billion dollars. Earlier we were growing at about six to seven billion dollars per year, and for the next five years we grew only by a total of three billion dollars. My regret is that we lost those five years. Had the momentum of 2006 to 2014 not been disturbed from the beginning



of 2015, Sri Lanka would have been a 150 billion dollar economy, instead of being only a 82 billion dollar economy. The trends were visible to make it a 150 billion dollar economy, and that is the sad part of the story.

We have to now get back into that fast track growth period, although it has been disturbed by the COVID-19 pandemic. Last year was a difficult year and we did not grow, but I am confident with the policies we are putting in place, and the overall stable condition we are trying to generate, we would see a reasonably high growth this year. If we can maintain that momentum in the next five to six years, we may again experience the growth mode again. If we go on that path for about ten years, we can look forward to Sri Lanka being poised for something better, than just being a developing country.

**You are a Chartered Accountant and you were the Governor of the Central Bank for nine years. You are one of the very few people who has come from the private sector and been successful in the public sector and is a politician today. What is your advice to future aspirants?**

My success has been based on hard work. I have never taken short cuts; I work on the fundamentals and from the basics. If I am doing something, I will study that subject very carefully and absorb what is necessary. Even when I was in College I never used to memorize equations but took the pains to understand the fundamentals very clearly so that I could derive the equations from the fundamentals. That was my secret. Once you get the fundamentals right, you get a deep understanding of the subject and then any challenge is easy to tackle. You must also have tenacity; you cannot get discouraged too early or easily. Sometimes when you do certain things the results might not be there immediately. That is natural. You must not shirk or waver from your goal. If you work diligently, you will find that sometimes although there are delays you will come to that point you were aiming for.

In my career, I have achieved what I have planned. Only very few outcomes may have been unplanned. I plan diligently and I work towards my goals, and once you do that you find that life is an arrival at different locations.

**Outlook for the country?**

We are in the midst of a challenge that is global as well as local. But we have the necessary ingredients in place to overcome the challenge. I am confident that we

can emerge from this situation. The vision which has been articulated in President Gotabaya Rajapaksa's manifesto is clear, which sets out where we want to go. I want to assure the people that in this journey, we will be successful.