MOULDING A Progressive Future

Dr P B Jayasundara, Secretary to the Treasury and Chairman of the national carrier, SriLankan Airlines, speaks on the path of economic development envisioned by the Government and further comments on how the present global economic climate is having a direct effect on the day-to-day lives of Sri Lankan citizens.

By Harin Fernando

On the state of the nation's economy?

Well this is a challenging time globally, our economy which is Rs 3,500 billion (US$ 2,000 million) in size grew by 6.8% compared to a 7.7% in 2006 and 6% in 2005 in 2007 and reached US$ 1,600 per capita income level. The economy was on a three-year strong growth path which has resulted in today's noteworthy per

capita income thus bestowing middle income status. The nation has witnessed a fairly strong integration with the region – the Indo-Sri Lanka trade agreement, the Sri Lanka Pakistan Trade Agreement, SAARC, SAPTA, and SAFTA have made progress. The trade and investment relationship with European markets, the US market, and the countries in the East Asian belt and emerging China have also been deepened.
Trade has grown significantly. In 2007, exports grew by 12% in US$ terms. Total exports reached US$ 7,700 million. And imports increased to US$ 11,300 million. The country's import structure is heavily biased towards the importation of intermediate and investment goods reflecting a conducive import structure for a strong economic growth. The current account deficit at US$ 1,400 million remained below capital transactions thus generating an overall surplus slightly in excess of US $ 500 million in the balance of payments. This was in spite of the fact that the country was paying almost twice the amount of foreign exchange for the payment of import of petroleum products

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As you are aware, Sri Lanka spent US$ 900 million in 2000 for the importation of oil. This increased to US$ 1,200 million in 2005 and doubled to US$ 2,500 million in 2007. The share of oil imports increased from 12% of total imports to 22% in 2007. This trend is due to increased dependency on im-ported petroleum products for both transportation needs as well as for power generation. The strain on the overall trade and payments system is stressful if not for the fact that overseas remittances reached US$ 2,500 million.
The sharp rise in oil prices has contributed to increase cost which is still on the rise and now crossing US$ 135 / bbl mark. Adjustments towards rising oil prices is a major challenge, as such adjustments introduces extra burden to the consumers as well as to the entire production process, although it is only through such adjustments economy will become stronger by adopting alternative sources as well as alternative usage of energy. This country has gone through such painful adjustments in recent times. Although international price increase of oil prior to 2006 had been modest, the price increase in 2007 onwards has been very sharp. Within less than 6 months, oil prices have increased from about US$ 70/bbl to US$ 137/bbl. Every US$ 1 per barrel increase of oil results in Rs 1 per litre

increase in the price of diesel. So your can see that required price increase in diesel is nearly Rs 67 per litre but adjustments have been less than half. Price increases alone may not be enough to discourage consumption; we need to consider quantity reduction in consumption through other means as well.

Sri Lanka has also faced other challenges. The fight against terrorism is one on-going challenge. The effort to counter terrorism that commenced in 2006 requires increased public spending on national security. Although the level of such expenditure is around 3.5% of GDP, it remains below the average level of defence expenditure of many countries which do not have the level of security threats and risks that Sri Lanka is confronted with. The security expenditure has produced relatively encouraging returns so far. The liberation of the Eastern Province from terror created enabling environment for the restoration of civil administration across the Eastern Province, the conduct of elections to local authorities as well as to provincial council which have become very clear milestones in the road map towards peace and development in the Eastern Province. This has further consolidated the development initiatives launched under the 'Nagenahira Navodaya' in 2006 to provide much needed development in the Eastern Province. The vulnerabilities of various parts of Sri Lanka, its people, public property and strategic assets to terrorist threats also demand expenditure on public security. Liberation attempts in the Vanni districts are in progress. Therefore, whilst addressing many other development challenges, it is critical that the Government manages security as a national priority.

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One should also not forget that Sri Lanka is just passing the third year of post-tsunami rehabilitation and reconstruction phase. Although the country has been quite successful in the restoration of destroyed and damaged houses and revival of many livelihood activities as well as rebuilding of infra-structure facilities such as fishery harbours and anchorages, road network, water supply schemes, schools, hospitals, etc further work is in progress in respect of infrastructure development. It was indeed to the credit of Sri Lanka that the expenditure incurred so far under post-tsunami development work is around US$ 1.4 billion as of December 2007 out of US$ 2.6 billion commitment. The completion of several bridges and the 300 km south and eastern coastal belt tsunami affected road is

expected in 2009.
On the economic front the apparel industry, the country's lead manufactured export activity also was in a transition to post-Multi Fibre Agreement era. Although the risky two years was an intense adjustment, particularly to the competition from countries such as China and Vietnam, the industry has bounced back from a slower growth of 3-4% in 2006 to a near 8% growth in 2007.

Managing the new policy regime and the development agenda introduced by His Excellency the President is a new task. Fresh thinking and strong commitment is essential particularly in our attitudes. The government under the leadership of His Excellency the President is committed to a new development strategy – The Mahinda Chinthana, Ten Year Development Horizon towards a New Sri Lanka – based on a mandate received at the last Presidential election. The strategy which was placed before Parliament and subsequently discussed with private sector as well as with development partners at the Development forum in Galle places emphasis on the development of infrastructure consisting of power generation, new ports, airports, expressways, national highways, bridges, water supply and irrigation schemes which are reflected in the 'Randora' programme.

In the Ten Year Development Horizon, an equal emphasis has been given to rural development providing rural electricity, water supply and irrigation, rural roads, market places and other facilities with a view to empowering the rural economy. You will recall that His Excellency the President selected this central theme for his recent address at Oxford University. The emphasis on the rural economic development and 'Randora' programme reflects the government foresights.
The government has responded well in advance to the current global crisis – the insecurity arising from food and energy risks. The food production drive and improving economic life of the rural economy will be the surest way of providing food security on the one hand and poverty reduction on the other. The initiatives taken to accelerate the construction of the coal based power generation plants at Puttalam and Trincomalee and a large number of hydropower projects such as Upper Kotmale, Uma Oya and several medium size power plants to replace high cost fuel based power generation will reduce the high cost of electricity and dependency on importation of expensive oil. The generation of such new capacities will also help the country in its high growth path envisaged in the Ten Year Development Horizon.
Let me remind you, that this country uses about 600 million litres of diesel for

power generation and its import cost at today’s price is around Rs 80 billion or about US$ 750 million. So you can see the benefits to the economy if we could replace this with alternative energy. Japanese economy today is in a better position because they replaced fuel based electricity in response to the 1970 oil shock.
The rural infrastructure initiatives have already developed some 3,000 kms of rural access roads with concrete mix and have given new life to the rural economy. Rural electrification programme have enhanced the access to electricity to nearly 80% of the population. The expansion of school facilities including computer access to rural areas through ‘Nanasala’ and development of peripheral hospitals have also taken the development towards rural economy. The construction of over 15 irrigation schemes including Moragahakanda, Uma Oya, Daduru Oya, Manik Ganga, Rambukan Oya, etc and the new initiative to rehabilitate all major irrigation schemes are meant to convert many areas into commercial agriculture, increased food production and provide livelihood to people living in many lagging regions right across Sri Lanka.

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production and income of the people

The Government’s development strategy is also designed to correct many imbalances that have witnessed during the post 1977 free market economic reforms phase. As we all recognised by 2005 Sri Lanka witnessed an economy where growth has been confined to few urban townships particularly in the Western Province leaving the rest of the provinces lagging behind. This strategy also produced inequities in income distribution as well as inequities among regions thus rebalancing has became a priority. It is also in that background, that a policy shift towards recognising the domestic economy and a domestic entrepreneurship became warranted. Domestic enterprises, industries, SMEs have been recognised vigorously and encouragements have been extended to almost all activities in agriculture, livestock, fisheries, tourism, construction, trade, transport, etc and also to make them engaged in the production for import substitution on a competitive basis. The scope is wide as this country, despite having a solid agricultural base still import over US$ 500 million worth of food items.

Another rebalancing task is to use management reforms as an alternative to privatisation. Strengthening of management of state enterprises in place of privatisation have been explicitly articulated in the 2006 Budget speech. The restoration of proper synergy between public and private sector to ensure that the strategic role expected from the Government is efficiently played is another challenge. This was very much in contrast to a reform process implemented in 2002 – 2004 through which further liberalisation measures as well as downsizing public services and large privatisations were promoted. Agriculture was marginalised. Whilst such reforms may have had their own justifiable reasons, there had also been recognition that many imbalances were not sustainable in the Sri Lankan context. The Government is confronted with many constraints in correcting these imbalances particularly due to deficiencies in the required skills and appropriate delivery mechanisms. This compelled the Government to engage in the recruitment drive as well as institutional building phase which involves public expenditure.

Whilst managing these challenges, Sri Lanka's has attracted increased foreign direct investment. Till 2005, FDI has been around US$ 250 to 300 million per annum. The FDI flows have been fairly buoyant during the last two years and the country realised US$ 750 million in 2007. As Sri Lanka is also a middle income country and no longer rely on concessional funding, the country also turned to capital markets in 2007 to mobilise the required funding for development. The Government was courageous to take this challenge. It managed to enter the capital market and conclude the international bond issue of US$ 500 million which was three times over subscribed. It was also an opportunity for the country to demonstrate to market participants how the economy is managed particularly in challenging environment and with a new development strategy.

In response to your question, let me also mention that by 2007 Sri Lankan economy managed to come up with a strong progress in poverty reduction. People living below poverty head count index dropped to 15. 7% from over 22% in 2002. This was not only due to a three year economic growth in excess of 6% but also the reduction in unemployment, increase in producer prices particularly for agricultural produce, wage levels, investment in rural economy and infrastructure and the expansion in education and health facilities particularly in the rural economy. However, the poverty reduction indicators for Nuwara Eliya district did not reflect improvements requiring close attention to specific reasons affecting such poverty incidence.

The increased cost of living and inflation remain a major concern in the overall economic management. While an appreciative role has been played by the Central Bank to conduct the monetary policy in line with the announced road map and contain the liquidity growth and strengthening surveillance of the banking and financial system, the inflation and cost of living have also been affected by rising international food and fuel prices which are beyond the control of monetary policy. Whilst the Central Bank and the Government remain committed to maintain financial stability through monetary and fiscal instruments, it is equally important to concentrate on the removal of supply bottlenecks to increase production and income of the people. The Government also recognise that improvement in distribution network is equally important to bring down the cost of living and stabilise prices in the country. However, we need to appreciate that inflation cannot be managed through price controls and unsustainable subsidies on fuel consumption. So price adjustments in line with international prices are unavoidable and will have impact on cost of living in the short run but will not affect underlying inflation.

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What about the economic outlook for this year?

Well, you see last year our economy grew by 6.8% in spite of a setback in tea and paddy production, adjustments to fuel prices and high interest rates, because many sectors expanded due to export growth and domestic demand. This year, tea and paddy, the two main subsectors in agriculture are expected to perform well. Eastern Province will give new space for production particularly in agriculture, livestock and fisheries activities. Exports are fairly diversified and slowdown demand in selected countries may be set-off from others. Scope for import substitution in agriculture and energy has improved due to high global prices. Trade and tourism may have some further slowing down effects. High interest rates may also compress the domestic demand. The adjustments to oil prices may reduce consumption, most likely to use domestic substitutes. Public investment in infrastructure and the use of foreign finance is expected to further improve and the construction sector growth is likely to remain buoyant. Considering all these, together with the resistance in our economy, I project that our economic growth could be in the range of 6.5-7% in 2008 as against our earlier projection of 7-7.5%. Inflation is likely to moderate from July once food supply situation improves with the Yala harvest and response to tight monetary policy stance. However, we cannot predict oil prices at this stage.

Addressing the rising cost of living?

Most economies at present are confronted with inflationary pressures. It is a global problem. This is due to a combination of factors such as global food crisis, US financial crisis and rise in oil prices. Many countries which have maintained 2-3% average inflation have been confronted with 7-9% inflation in those countries reflecting sharp rise in cost of living. Prices of staple food such as wheat, rice have increased almost by 100% globally. Countries have also responded by trade restrictions and situations have been aggravated. Natural disasters in major food producing countries are also a matter of concern. The sub-prime mortgage crisis in the US and consequent financial disturbances have weakened the US currency and appreciation in several major currencies in the world. Rising oil prices have hit virtually the entire global economy and the energy inflation is on the rise.

Some people try to project this is only a Sri Lankan problem and a problem due to mismanagement. However, there in an increasing awareness even among the Sri Lankans today, thanks to the global news network for disseminating more comprehensive information among the masses. Food and energy security is a household topic now. Sri Lanka, in a way has been very fortunate, in that, it has been able to harvest for consecutive three good years and weather conditions have been absolutely favourable for agriculture. Reservoirs are full and hydro-electricity partly mitigates the impact of oil price on electricity cost. The adjustments in gas, electricity and fuel prices and the consequent impact on the cost of transportation have also affected the general cost of living. Credit expansion by all sectors in the economy and persistent expenditure pressure in the budget fuelled by increased payroll are also contributory factors for increased demand pressure.

Resolving these issues involve short term as well as medium term strategies. Unfortunately, in the context of Sri Lanka, the prevailing cost of living issue is largely explained by structural reasons and delayed response in fulfilling long overdue needs of the country. In this regard electricity can be cited as a solid example. Although previous governments were hard-pressed for low-cost power generation strategies, due to political difficulties, there has been no meaningful

response. As a result fuel based power became the 'buzz word' and the country witnessed some 70% of power being generated via fuel – a material that is fast becoming a very scarce commodity. The country now is paying for not initiating action to start the coal power plant in the early 80s and Upper Kotmale project in late 90s. Hence, the country is now compelled to live with high cost of electricity for a while. It is only the present government which had the courage to go ahead with the Puttalam Coal Power Project, Upper Kotmale Hydro-Power Project and several other medium size power projects. The potentials for generating hydro-electricity itself is very large. And as I mentioned earlier it not only reduces the cost of electricity but will also provide well over US$ 700 million worth of foreign exchange savings in the Balance of Payments. It can also be more environmentally friendly. The completion of Puttalam Coal Power Plant and Upper Kotmale power project within the next 18 to 24 months period will help the country to be on a low-cost energy source.
Another aspect is that, successive governments have neglected the public transport system. The subsidised fuel together with negligence of public transport eventually shifted transport from public to private a somewhat opposite direction of other countries. Everywhere in the world it is public transport that provides convenient and affordable transport. The creation of large numbers of private individual vehicle owners has also created a heavy traffic problem costing absolute inefficiency and waste of valuable resources. It is estimated that due to traffic congestions, 40% of the fuel is wasted. This is again at today's prices cost about Rs 100 billion or about US$ 900 million. Although this may be af-fordable for individuals who have high income, it is certainly not affordable to the country which may be compelled to spend at least US$ 3,500 million for the importation of fuel this year. Food prices are yet another concern. The scope for food production as I mentioned is very wide. High yielding planting material and seed, agricultural extensions, credit, post-harvest technologies have been neglected. So therefore, you will agree that the solution to inflation requires multifaceted approach.

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In fact Sri Lanka has never had 2-3% average inflation in the first place. The average inflation has always been much higher compared to other countries. The solution to this involves sectoral adjustments particularly in food and agriculture, energy, transport marketing and distribution networks. Improvement to the road network is equally vital to ensure smooth movements of goods and services across markets.

This Government has given due emphasis to food production. The incentive structure has been made very much in favour of cultivation. The Government removed the wheat flour subsidy and en-couraged consumers to shift their consumer preference towards rice. The reduction in wheat grain import by 15% in one year and virtually elimination of wheat flour imports from about US$ 40 million to US$ 2 million is a reflection that the domestic food production got an opportunity to substitute import. The cultivation of maize, big onions, fruits and vegetables have also increased due to incentives offered by the Government to replace imports. Awareness to develop dairy and livestock industry is much greater today and the fresh milk production and ancillary industries based on livestock have been expanded.

Food production itself is not sufficient. As you are aware, 40% of the food currently being produced is lost at post-harvesting stage. The access to food at affordable price particularly to low and middle income groups in urban townships is very weak due to the run down in cooperative and CWE network which worked quite efficiently, one time, in this country. This is why in the 2008 Budget, the Government accorded a comprehensive incentive package to revitalise the cooperative movement. The Government has also embarked on setting up of CWE outlets and budget shops in densely populated urban areas to make food items available at affordable prices. This transformation is not easy; it involves investments and good management. Both involve a time-consuming process. However, there are concerted efforts to increase the availability of essential food at affordable prices through government interventions in market places.

The Government also recognises that demand management is important in stabilising core inflation which is currently moving at around 8%. The Central Bank has made considerable progress in controlling the liquidity growth stemming from both private sector and government sector for their activities. The demand for credit by the private sector has been moderated from about 20-25% to about 16-18%. The government has also taken measures to reduce its borrowing limits by reducing fiscal deficits below 8% of GDP and by recompositioning its debt portfolio. The Government fiscal adjustment programme also involves effort to raise revenue. This is again different from the past governments which have relied more on expenditure compression to reduce budget deficit. Such approach in my view is counter productive as important public investment programmes as well as very vital service delivery mechanism could become victims in such process. The long-term consequences are very serious. In fact the prevailing weakness in the public services delivery particularly when it comes to extension services and operations is due to several years of regressive policies of public expenditure management.

In the meantime, due to inadequate consideration toward maintaining a sustainable revenue effort, the government revenue in response to national income had deteriorated to a very low level of about 15% by 2004. In fact, Sri Lanka had a revenue GDP ratio of 20% in the early 90s. At that time our per capita income was less than half of the present level. The provision of generous tax holidays and other concessions, lack of commitment to expand the tax base as well as enforcement of tax legislations, weakening of tax administration by not having proper recruitment and development of human and institutional resources, have contributed towards weaker revenue performance. Hence, the Government took bold steps to reverse this trend and increase revenue. Strengthening of the revenue departments, recruitment and training of staff have been completed to strengthen the tax administration. Although there was a setback in 2007 due to unavoidable provisions of exemption for essential food items and fuel, revenue effort performance during last two years have been encouraging . The revenue/GDP ratio has increased from 15% in 2005 to 16% in 2007. In the meantime, the Government's recurrent expenditure as a ratio of GDP has been reduced to around 17%.
These measures have complemented the Central Bank to engage in counterinflationary monetary policy stance. The Central Bank has been successful in bringing down the monetary growth to around 16% which is consistent with our growth projection of around 7% and the core inflation of around 8-9%. They managed its reserve money well within the targets.

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However, the headline inflation is likely to remain high as the government is also in a process of adjusting fuel prices in line with international prices. As you are aware already the electricity prices have been increased by 30% and this is basically based on a fuel price assumption of about US$ 90 per barrel. The Ceylon

Electricity Board may be able to manage this situation as they have the advantage of having 30-40% of power generation through low cost power generation electricity. However they are on the margin and need further energy conservation measures to keep the fuel consumption at a very low level.

In response to a recent partial price adjustment in respect of diesel price by Ceylon Petroleum Corporation (CPC) the transport fares have also been raised by 29% although the Ceylon Transport Board (CTB) still maintains a concessionary fare structure with government subsidies. Railway fares have also been raised by large margins. This will certainly affect headline inflation, however, hard monetary measures are in place. Within the CPC, still there is a heavy loss in their price structure. At today's price, refined imported diesel is still sold at below cost incurring about Rs 30/litre loss. The refinery can compensate only part of this loss. The government taxes on petrol by way of import duties, excise taxes which are imposed on a litre basis as against a percentage of selling price is expected to generate about Rs 9 billion but considering the subsidy to public transport and kerosene and diesel there is still a large subsidy element which is a strain on the budget management. The Government has also removed concessionary duties for vehicle imports for public servants in order to protect revenue.

The adjustment to today's new global price structure in line with high level of oil prices requires our economy to adjust through new income generation activities. Whilst monetary and financial policies should continue to remain tight, to maintain the required financial stability it is essential that the country shift to alternative energy sources as well as increased food production locally as a priority. The farmgate prices for all agricultural produce have become very favourable. Farmgate prices for paddy, tea, rubber, coconut, fruits and vegetable, dairy, fisheries all of which are smallholder activities have contributed to raise rural income. Average daily wage income has now increased to Rs 500 to 700 which has helped such wage earners to face this high prices. However, fixed income earners need help and the government intervention is unavoidable. Due to distortions in the distribution channels the supply of food and other services from rural economy to urban areas remains unsatisfactory. This is why government intervention is essential in the short run to streamline the food distribution particularly in urban centres.

Is the apparel industry in viable position in terms of GSP +?

In my view, apparel industry in Sri Lanka is one that our private sector should be very proud of. It is a US$ 3.5 billion industry out of the total export earning of US$ 7-8 billion. This industry is well organised. Five trade associations and numerous working groups involved in this industry in the past have formed a single working body referred to as Joint Apparel Association Forum (JAAF). The JAAF works very closely with the government and represents the industry interest quite well. When they meet us they speak in one voice raising relevant concerns to their livelihood. The industry is quite sensitive to worker welfare. They have scattered right across the country and have maintained decent industry ethics. The industry has promoted backward integration. Its value addition which was initially confined to local unskilled labour employment has now increased well over 40% through semi and skilled employment as well as by creating a managerial class with nearly 300,000 labour force. The processing activities within the country have expanded its local value addition. Quality assurances are very strong in the production process. The industry is also linked with the printing and package industry, marketing and branding, weaving, washing and similar ancillary activities. All these have therefore crated lucrative economic activities.

The apparel industry is also a compliance sensitive industry. Its compliance to best standards in reference to environment, labour laws, industry best practices, health, safety standards are exemplary. During all budget discussions JAAF provide valuable suggestions to us in our dialogue with them. Certainly we have not been able to accommodate all of their requests and suggestions but we have certainly established a two-way dialogue with them. In addition to their involvement with our Ministry they also work very closely with the Ministry of Investment Promotion and the BOI, Foreign Ministry and its missions abroad and trade chambers and their partners across the globe in order to register their presence and make their voice heard globally.

The local apparel industry can proudly offer Sri Lankan made quality products claiming they are free from the use of child labour. They can claim their production process involves non violation of ILO recognised labour laws and best corporate practices. They can proudly claim of their corporate social responsibilities. Their industry is exposed to their buyers who are required by law to comply with rules and regulations and product standards of those consumer countries.

This is not certainly an easy business as nations such as China, India, Vietnam, Indonesia, and Bangladesh still have the advantage of using cheap labour and providing intense competition. We no longer have such advantage. Our country no

longer can be marketed as a destination for cheap labour. In fact our industries need to project our country as a destination for skilled and educated labour.
The apparel industry has done this quite well. Many overseas buyers have made numerous tours in Sri Lankan factories located not only in Colombo area or in well established Export Processing Zones at Katunayake or Biyagama but also in distance areas such as Pallekale, Koggalla and factories located in other parts of the country and have seen how well each and every single factory is reported whilst maintaining highest global standards. This industry has demonstrated its ability to manage risks during the post Multi-Fibre Agreement phase. They successfully adjusted to competition. I must also mention that one should not underestimate the ability of the apparel industry to reach niche markets and also to diversify their products to emerging markets.
The GSP+ scheme was made available to Sri Lanka to promote trade and investment between European Union and Sri Lanka. Both European Union and Sri Lanka are committed to democracy. Sri Lanka has accepted all international conventions and even under most difficult situations the country has maintained its commitment to international best practices. Therefore, Sri Lanka should secure GSP+ when it comes to renewal in December. After all the interest of European Union is also to ensure its consumers have access to quality products produced in countries which respect democracy, environment, and international best practices. The Government has made representations to EU countries and is working together with the industry toward securing GSP+ in December 2008. I am optimistic that EU will extend GSP+ considering the longstanding bilateral relations, the progress in Sri Lanka's economic development within the democratic framework and recognising the best practices of our apparel industry.

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The framework of the current donor support structure?

When it comes to donor assistance, the present government has modelled its requirements based on the needs reflected in the Ten Year Development Horizon. As I mentioned earlier the Ten Year Development Horizon recognises local ownership and local capacity and hence it relies less on foreign advisers and expertise. All new projects and programmes that the Government has put forward for consideration of donor funding has very limited content for advisers and consultants. Second, such assistance is sought for timely delivery. In other words,

the implementation should be free from undue conditionalities and bureaucratic red tape of lending agencies. Third, such development assistance should be a sizable one to meet domestic priorities. On this basis the Government requests have been for activities which the Government finds difficult to fund from local resources in the short term. Therefore, consistent with Ten Year Development Horizon we have sought development assistance for the construction of roads, ports, electricity, irrigation, water supply, airports, etc.
These are investments to create new space for growth and development. Creating new space for development is critical since our existing infrastructure cannot accommodate the growing needs of our nation. In this background our country has now entered into a new phase of economic development after a lengthy period of inactive and passive phase.

The Government is in constant dialogue with the World Bank and the Asian Development Bank, two multilateral partners of Sri Lanka. The Government has requested a meaningful resource envelope in support of infrastructure development from these agencies. Our country assistance strategy with the World Bank which was formulated entirely on the basis of Mahinda Chinthana – 10 Year Development Horizon was approved by the World Bank committing US$ 900 million of IDA credit. Fifty percent of this will be exclusively for the development of provincial roads in the lagging regions. Prior to this, the government secured US$ 100 million from the World Bank and US$ 150 million from the ADB for the rehabilitation of national road network. The on-going road projects in many parts of the country are funded through these arrangements together with funds provided from the budget. We signed a new agreement with the World Bank for US$ 63 million to upgrade and maintain Sri Lanka's major irrigation dams and systems. The project is expected to complete within four years using local expertise.

The Government secured US$ 300 million from the Asian Development Bank to develop the Co-lombo South Port Project which is now under construction. This is one of the largest single foreign loan project under the ADB. The completion of a new breakwater facility in the Colombo South Port will facilitate the development of new terminals on a private public partnership basis. Annual resource envelope from the ADB also recognises the funding for the development of the provincial roads and water supply schemes. It is just recently that the ADB also granted a supplementary loan of US$ 90 million for the additional funding required for the

Southern Expressway which is expected to be completed in 2009.
Japan, the major bilateral partner in Sri Lanka's development, continues to provide long-term funding with an increased annual resource envelope. In the last weeks the government of Japan communicated to us of a new Yen Loan package to the value of US$ 330 million for the development of outer circular road and several other infrastructure programmes. Japan also provides funding for Southern Expressway and several other road projects. The development of Galle port is undertaken with the support of Government of Japan. With the grant aid from Japan the Manampitiya Bridge was completed last year and the construction of Manar Bridge and Anuradapura Teaching Hospital have started.
The Government of China following the request made by His Excellency the President readily agreed to fund a new port in Hambantota, a project that has been spoken about for decades. The construction work can be seen today in Hambantota on the new port development. The Chinese Government also funds a US$ 455 million Coal Power Projects in Puttalam and has committed to fund the long overdue Colombo Katunayake Expressway. It is only after many years of negotiations that the government was able to successfully conclude and facilitate the commencement of the Performing Arts Theatre in Colombo. The work has commenced already.

Whilst the Government has commenced the initial work of the Moragahakanda irrigation project from its own funding, it has received confirmation for assistance from the Kuwait Fund. Further funding has also been sought from the Government of Japan. For the development of Oluvil Port and Kalani Right Bank Water Treatment Plant, the Government has obtained assistance from DANIDA to the value of US$ 150 million and yet again work has commenced.
Iran has offered long-term financial assistance to modernise and expand the Sapugaskanda oil refinery which was established in the 60s. This investment which is in the order of US$ 1.1 billion will increase the refinery capacity of crude processing output from 50,000 to 100,000 barrels per day. The modernisation will also increase the refinery capacity from the current 55% outcome to 85%, thus helping the Sapugaskanda refinery to meet our fuel needs. This project will create a new economic space for the next 30 years. The Uma Oya multipurpose development project is also underway with the help from Iran. This was a project on the cards for a long time but could not start due to lack of funds although the economic benefits of the project is enormous. This project will take water through a 27 km tunnel to Monaragala and Hambantota districts to provide irrigated as

well as drinking water facilities in addition to setting up yet another hydro-power project with 100-120MW capacity.

The Government secured GB£75 million from UK banks for the construction of flyovers and by-passes to ease congestions particularly in Colombo. One flyover which was already commissioned at Kelaniya and 14 such flyovers are being lined up for construction in greater Colombo areas to ease traffic congestions. With India, the Government has concluded a loan agreement for railway modernisation project. The Government is in the process of finalising a major water supply scheme for Hambantota and a road connecting from Katunayake to Trincomalee via Anuradapura with the assistance from Korea which is also funding the convention centre with 1,500 seating capacity at Hambantota and Godagama hospital. The US funded Arugam bay Bridge is now about to be commissioned. Just last week, the French Government agreed to fund road projects in the Eastern Province through supplementary financial facilities.

So you will see a fairly diversified and enhanced resource envelope is now available for the Gov-ernment to proceed with its infrastructure development programme. In fact, right now several of the projects are in construction stage. Many projects are expected to be completed in 2008.

The Government maintains a good relationship with all of our development partners and continue to mobilise funds as and when required. There is also joint initiative in order to cut bureaucracy and fast-track all related activities in the implementation. The second round portfolio review with the Asian Development Bank with the participation of the Director General of Asian Development Bank will take place in mid-June in Colombo to ensure enhanced utilisation of aid. We have scheduled similar reviews with Japan and China as well as the World Bank.

As I mentioned earlier Sri Lanka being a middle income country, also needs to look for funding from capital markets. This is why the Government issued an international bond to the tune of US$ 500 million. Since the successful completion of this bond issue, many international bankers have come forward to look at various projects in Sri Lanka. Such funding arrangements have improved the liquidity needs of very large projects funded by other donors since no project is fully funded by lending agencies and the Government also needs to provide counterpart funding.

“Creating new space for development is critical since our existing infrastructure cannot accommo-date the growing needs of our nation. In this background our country has now entered into a new phase of economic development.”

The immediate future of both Mihin and SriLankan Airlines?

Mihin was started at a time when SriLankan was managed by Emirates. It was not seen positively by them unfortunately. However, the immediate benefit of setting up Mihin was that it gave us leverage. Mihin was initiated at a time when the Government was exploring for a low-cost budget airline to provide air transportation particularly for those in the lower income levels. The Government was also keen to assist SME sector that was desirous for a low-cost cargo facility to work alongside with the rapidly booming fruits and vegetable export industry. The Government also wanted to help out those travelling especially to the Middle East for employment and to India for pilgrimage. With many countries today offering a wide range of incentives for cargo handling to encourage exports, there is potential to develop a low-cost budget airline for agricultural sector development. These areas were overlooked by SriLankan when it was managed by Emirates. Even now there is strong demand to provide air facility for SriLankan to travel to Madagascar.

At the formation of Mihin there was an expectation from several government agencies which are involved in the promotion of foreign employment and export to become equity partners of the gov-ernment- owned budget airline. The Government had only very limited funds to provide equity and it honoured its commitment on the expectation that other agencies would also do so. It is in this back-ground, Mihin was started and it has gone through the first phase of operations. No industry should expect return on investment in one year. Mihin has prospects. It requires funding, it requires a focus, and it really can make a contribution to facilitate budget travellers as well as to promote cargo facilities to neighbouring markets.

At present the scenario has changed. Emirates management in SriLankan has ceased and the Government is back in the management of SriLankan. At the same time, there are now strong pros-pects for two airlines to co-exist. Several routes covered by SriLankan could be effectively covered by Mihin and SriLankan can concentrate on more lucrative destinations. Mihin could also be an excellent feeder carrier to SriLankan as a code-share partner. Managerial skills could be shared between the two which will reduce operating cost of Mihin. The hostility between Mihin and SriLankan no longer is the case. Synergises between the two in their business operation could be worked out in the best interest of both airlines. SriLankan Airline is not a budget airline hence Mihin and SriLankan can have more defined core-activities in their operations. Therefore, all what we need is to look at the two airlines more objectively and promote their commercial viability over the medium term.

Right now we are working on a turn-around plan for SriLankan which is managed by a competent group of staff and workforce. Operational aspects, cost effectiveness, procurements, recruitments and governance are being seriously looked at. All four Sri Lankan directors are involved in various areas of specialisations. A working arrangement with a modified organisational structure is in place. Staff is given specific responsibilities under the direct supervision of the CEO who is working under the Board. Already the head office at the Colombo World Trade Centre is being shifted to Katunayake not only to cut costs, but also to have management and staff under one roof. The cargo facility at the airport is also being taken over by SriLankan to promote cargo to local industry. Cost efficiency of terminal handling charges and catering is being examined. Engineering and technical capacities have been identified to promote airline maintenance activity in our country and attract other carriers to use SriLankan services. By mid-June the new turn-around plan is expected to be put into operation.

Environment is not easy. Fuel prices are on the raise. Global economy is facing many challenges. In this background more realistic working arrangements between the two airlines are being looked at and we hope both airlines will serve to promote Colombo as an aviation hub by facilitating passenger and cargo volumes to promote tourism and other business activities in the country.

Duty of all citizens to pay their taxes?

Well, the Government provides universal free education and health throughout the country including the districts affected by terrorism. No citizen is denied the access to education or health. For education and health, the national budget alone spends 5% of GDP each year. This is a large resource commitment. The Government has not compromised education and health to resource claims from other priorities. As a result we have a strong human resource base. Our industries have benefited from this. The present government is giving its focus to promote a knowledge economy. Hence expenditure on education and skills development are vital. The progress our country has achieved in basic health indicators are commendable in international standards. The country’s health system has reduced its vulnerabilities to global health risks including HIV/AIDS. One probably does not know even the hospitals located in Kilinochchi and Mullathivu districts are maintained from the funds released from the national budget. The doctors, nurses, and other staff serving in those hospitals and the medicine, food, uniforms and all other facilities are provided promptly through annual budgets. Classes are conducted on a daily basis and teaches are paid by the Government. The students sit for national examinations such as O/L and university entrance in those schools. So it is a unique system which the country should be proud of.

There is no single village in Sri Lanka without access to postal network. Water supply schemes, established all over the country has increased access to water significantly. Nearly 80% of the popu-lation have access to electricity. These are schemes funded under rural electrification programmes funded by the National Budget. Internally displaced people due to terrorist attacks are being helped and resettled by the Government with its own funding. They even participate in the electoral process. The Commissioner General of Essential Service is entrusted with the responsibility of feeding the residents of Jaffna and other places to which supply of food is often obstructed by terrorist threats.
Successive governments have raised long-term funding from both domestic and international sources for economic development. Our country has built an enormous asset base from such debt. When people speak of debt, they must also remember there is corresponding asset here in Sri Lanka. The ports, electricity, water supply schemes, railways irrigation projects, roads and bridges, schools, universities and hospitals of world- class quality have been developed through such funding. It is because of those assets we have an economy here. It is those infrastructure that generate our income which is currently growing by 6-7% – a decent growth. Our exports are growing by 12% and it is possible because we have some infrastructure at least. The Government has now increased public investments in excess of 6% of GDP and place the country on a new infrastructure building phase which we have never seen in recent times.
Our country has maintained a good track recode. It has never defaulted even a letter of credit. The Government has been responsible to manage its debt within prudential limits. The debt/GDP ratio has been brought down. In this context, the public too has a duty. They are beneficiaries of what they enjoy today. Every Sri Lankan benefits more than what they enjoyed 10 years ago from the government services. Every Sri Lankan should be proud that we have a per capita income of US$ 1,600 with a reduction in poverty to 15%. This is not enough. It must improve further.

“The Government maintains a good relationship with all of our development partners…”

Therefore, in order to make our journey more progressive people must pay tax, people must pay their share of tax. Every citizen in other countries pay much higher tax for less benefits than what our people get for much lower taxes. No road is free to drive and people have to pay toll, no hospital is free and no school is free. After all, our taxes are not too high the first Rs 300,000 earned in Sri Lanka is tax-free. Up to Rs 1 million income the average tax is around 6%. Interest income is taxed at maximum of 10% after an exemption of Rs 300,000 is granted. Income from agriculture is exempted. Foreign earnings are tax-free. Export income is liable only for 15%. Therefore, considering the benefits that the Government is offering there is a duty for everybody to comply with tax legislations.
The Government from its part has also initiated programmes to make the revenue departments more taxpayer friendly than before. So my request is that all those who can afford must pay their taxes as a national duty particularly at a time when the country has embarked on a major infrastructure development drive costing probably more than 10 times the Mahaweli investment that some people at least can remember. There is a new wave of construction of roads, irrigation schemes, water supply projects, ports, power projects, etc. In addition, the country is also confronting a threat from terrorism and those expenditures are met from these revenues.

“Mihin could also be an excellent feeder carrier to SriLankan as a code-share partner..”

This request is not only for income tax. It is also for other taxes by way of custom duties, VAT and levies. There are abuses and leakages. No one should use excuses to evade taxes or use loopholes or even engage in corrupt practices. It is their social responsibility to pay due share of taxes. It is from these taxes and other revenues that the government offer many services which no other country offers. There may be inefficiencies in our work. The correction of those inefficacies also needs system and quality improvements and responsible citizens should not wait till ideal conditions are established in the government machinery. Therefore it is my humble request to those who wish to see development in our country to ignore the negatives that may reach their ears and eyes but instead look on the broader picture of development towards a self-sufficient island. Every one who pays his/her taxes can be a proud partner of Sri Lanka's development story as a middle income country. I am quite optimistic that we will have modern infrastructure and peace soon, for us to grow rapidly.

"Every one who pays his/her taxes can be a proud partner of Sri Lanka's development story as a middle income country."