‘The central confronting us is challenge fiscal management’

Good fiscal management, improvement of money supply with easier credit. specially for small and medium scale Industry, better infrastructure facilities, with no overall cuts in welfare expenditure will be the highlights of the forthcoming Budget, says Minister of Justice and Constitutional Affairs and Deputy Finance Minister Prof G L Peiris, interviewed by Lucien Rajakarunanayake, as the minister prepares the PA Government’s third budget.

Q: Having presented two budgets for the People’s Alliance Government, what is the broad vision that you would have seen at the initial stage, and

what would you seek as the vision in the up-coming budget of this government?

A: Well really, the country has gone through a difficult period, because of three factors, any one of which would have been serious, and the combination of all three is exactly what we have had to deal with. There is, first of all, the significantly escalating war expenditure. We have spent approximately Rs 49 billion on the war. Last year we brought before parliament about 57 supplementary estimates connected with defence expenditure. That creates a serious problem in containing the overall budget deficit, at a relatively low level of GDP, but even then we think we will succeed in containing the overall deficit at around 10% of GDP, which is a very considerable achievement given the circumstances.

The second factor is a natural phenomenon which coming at the time indeed has aggravated the problem appreciably, and that is the drought. In the previous year 1995, the agricultural sector did very well. This year the drought unfortunately affected us in this sector, but the redeeming feature has been that the tea and rubber prices have been good.

The third factor which is connected with the second was electricity cuts, sometimes up to eight hours, which naturally resulted in a downturn in industrial production. So these were the factors which have made the year difficult. But we are quite certain that the worst of it is over. Things have bottomed out and we are now seeing the beginnings of an improvement.

The thrust of the budget will be prudent management given these circumstances, many of which are beyond our control. Obviously, if you are fighting a war you have to spend on it. You have to equip the armed forces. It is really a question of

priorities. You have to decide what are the things that you need to concentrate on and we know for a fact that we have public opinion behind us. People want the war fought properly. So, there is really no political problem that we perceive with regard to the expenditure that is being committed to military expenditure.

But the central challenge confronting us as we prepare the budget for presentation to Parliament on November 6th is fiscal management. How do we do the best we can in these circumstances? By imposing minimum burdens on the vulnerable sections of the community, retain ing the welfare apparatus, but re-structuring it, in order to deliver the maximum benefits to the people. I think that is very important. We have not cut down on welfare expenditure at all. The total expenditure on welfare is Rs 15 billion, of which more than Rs 8 billion is being spent on the Samurdhi programme, the principal poverty alleviation programme. One and a half billion on the fertilizer subsidy; then there are the free school uniforms, the season tickets, subsidizing of uneconomical bus routes and things like that. Fifteen billion is a solid commitment to welfare and notwithstanding the strain imposed on us by war expenditure. However, there is the question of re-structuring You have to decide whether you are to continue with very large consumption subsidies which entail no benefit to the country at all, but is really an important benefit to the wheat farmers of the United States. So, within the resources that are allocated for welfare we have to re-order priorities and ensure that welfare resources are utilized to confer optimal advantages on a sustainable basis on the people for whom they are intended. So, that is how we see our task in preparing the third budget of the People’s Alliance Government.

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Q: There have been for the past several months a constant complaint by vocal sections of the private sector and the main opposition party about this government being unable to manage the economy. What is your perception of this charge?

The important thing about this charge, the striking feature of it is that there are no specifics mentioned. No attempt is made to pin this down on any particular aspect of performance. It is a vague, nebulous generalization, an attempt to create the feeling that things are not going well; and statements which are disseminated, word going from mouth to mouth that the economy is in the doldrums, nothing is happening. and so on. But look at the facts, in spite of all the problems which are certainly unprecedented. They may say what is new about the war. The war has been fought for 13 years. So, how can one blame economic difficulties on the war, which is by no means a matter of yesterday or today. Now, that is a gross distortion of the truth, because the war can always be fought at different levels of intensity, and it is a historic fact which is quite undeniable, whether one likes the government or not, that never before have resources of this magnitude been committed to the war. The whole strategy is different. We believe that if you are to sort out this problem once and for all you have to deal with the source of the problem. One has to take the war, to the North. And that has been done successfully. Of course, in any war there will be ups and downs. You can’t win every battle. But if you are dealing with the problem by means of a war that is being fought in the North, of course, there necessarily has to be a significant escalation in the level of military spending. So, that does make a significant difference.

Now, in spite of all that, we were able to maintain the foreign reserves of the country at approximately 2.5 billion US dollars. And what is more, the projected rate of growth is a little more than 4%, something like 4.1%, which given all the circumstances is not discouraging at all. There were times during the previous regime when the rate of growth was lower than that. So ours is by no means a dismal performance. Even to restrict the overall budget deficit at around ten percent is certainly a significant achievement. When we took over, the budget deficit was more than that. It was around 10.5 % when we took over in August 1994. Then in our first year we were able to bring it down to 8.3%. We were trying

to bring it down to 7.5% but we failed only because of the significant military expenditure. Let’s not forget that there were times in the eighties when the overall budget deficit went to beyond 20%.

So, one has to be scientific about all this. One has to look at facts and figures, and not talk in terms of vague generalities. When the previous government was in office how many years were there during which the rated growth of the economy in terms of GDP was less than 10 per cent, and the circumstances then were nowhere as difficult as they are now. So let’s look at the situation from the point of view of the criteria, the indices which are recognized – growth rate, inflation, overall budget deficit. Judged in terms of each of those criteria the situation was a great deal less satisfactory during much of that period than it is now, despite all the difficulties. So how can one say that things are so bad.

If things were so bad as they are made out to be, will Holderbank come here, to purchase a major stake in Puttalam Cement. Would the largest and oldest shipping company in the world, Peninsula and Orient P&O be interested in coming in a big way for the development of the Colombo Harbour and Queen Elizabeth Quay? Well, would Shell Company come in? That is certainly a vote of confidence. Not only the fact that Shell came in, but who are they. The largest players in the field in that area. Shell, Mobiloil, Total of France, they all showed interest in investing here. So what is happening is that, there is a certain perception that is being created that has no relationship to the actual facts. There is a psychological theory which says that if you repeat a thing often enough, it gains a certain measure of credibility, through sheer repetition. That is largely what is going on today.

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Q: If one would look at the broad outlook of the forthcoming budget, you have explained certain aspects of it now, what would be the outcome of the changes that you may bring about when you present the third budget of this government?

A: Well, I think the desired outcome, what we are working towards, is an increase in the money supply, more vigorous economic activity, particularly at the periphery… in the outer regions of the country. We are addressing in earnest the question of unemployment. That, we see, as one of the most serious problems. To deal with that, you have to encourage investment. I think the principal problem with regard to investment today is the lack of access of capital. The phenomenon of tax holidays is useful, but only when the profits start to come in. It doesn't help before that. But the principal problem seems to be the seed capital for investment. The main problem with regard to seed capital are clearly the rates of interest, which are about three or four times the prevailing rates in other parts of Asia. But this has a direct causal link with the military expenditure. We are mopping up all the available resources for the purpose of prosecuting the war efficiently. Then raising of money through Treasury Bills, and so on. This has a direct impact on commercial lending rates. So, I think to create economic activity which in turn will sustain larger numbers of people, you have to address the problem of making credit available at concessionary rates of interest for certain types of entrepreneurial activity, which are perceptibly identified from the point of view of import substitution and the conservation of foreign exchange, and more importantly, employment generation.

That is one of the outcomes that we are emphasizing very strongly. There will be a very sharp focus on that. That was what was made clear to the country when the President inaugurated the second stage of the Samúrdhi pro gramme recently. This is the aim of some of these schemes that we are now inaugurating under the umbrella of the Samurdhi scheme. The first phase of it which is now nearing completion emphasized the consumption component. Now we are moving into a somewhat different phase, to engender the kind of economic environment conducive to viable schemes of self-employment. The public sector which was the traditional avenue for employment is no longer able to fulfill these expectations. So, there are several specific things that we have announced.

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One is that there will be 50,000 loans that will be given of Rs 10,000 each. For this purpose we have earmarked Rs 500 million. This is basically for rural cottage industries, minor irrigation works, construction of roads etc., beneficial activities, particularly from the point of view of rural infrastructure. People will be gainfully employed. That is a very diffused programme, spread all over the country.

Then through the 40,000 Samurdhi Niyamakas appointed up to now, we hope to muster together some of the families that are beneficiaries, to whom we will make available larger sums of money. The targeted sum is Rs 50,000 for each project by these groups, and there will be 400 such projects throughout the country, where eight to ten families could come together and start viable projects with the capital provided. Rs 200 million has been set apart for that.

Apart from those two schemes, both of which are very important in terms of that particular objective, we are making available Rs 500 million for the development banks the DFCC, NDB and so on. This is credit to be farmed out to small and medium-scale industry to start projects which are important from the objectives of import substitution and employment generation. The development banks will only have the overheads to worry about, because the capital will come from the state.

As to the outcome of the Budget, we will have to put a very sharp focus on small and medium-scale industries. Export industry is important, but bulk of the employment opportunity in this country comes from import substitution. I am not playing down the importance of exports. But small and medium industry have been

having trouble, caused by the rapidly reducing tariffs, import duties and so on. That is in or der if there is a genuinely level playing field. But the fact is that there isn't. Because the local industry has to pay much more for their electricity than their competitors in other parts of Asia, they certainly have to pay much, much borrow, and correspondingly, the provision they have to make for debt servicing is much more substantial than in neighbouring countries where competitors operate. So, in those special circumstances, which in a very compelling way militate against viability of the concept of a level playing field in the pragmatic sense, the fledgling industry which sustains employment is in a difficult way, and there has to be some element of protection, for a limited period. You can't have a fifty-year-old infant. These are aspects we are conscious of and would like to develop further in the Budget.

Q: You mentioned infrastructure with regard to the rural sector, but what is the policy of the government, or what will be the thrust of the Budget, with regard to larger scale infrastructure development in this country, which has been lagging behind for a long time?

A: I think that is very important specially if one is talking of investor confidence. One way in which we can revive and resuscitate investor confidence is by making adequate provision for infrastructure development. In an increasingly competitive economic situation, where there are lots of options and alternatives for potential investors, Sri Lanka simply cannot be attractive unless the infrastructure facilities are adequate. This includes roads, airports, harbours, telecommunications, water, electricity, all of this. So, that will be one of the main planks of the government's strategy to improve the climate with regard to investor confidence. These last couple of years we have been thinking largely of BOO-BOT projects to develop the infrastructure, for the obvious reason that there is no major initial outlay on the part of the government, and the risk is that of the investor rather than that of the state.

But we see that a multi-pronged approach to this is necessary. BOO-BOT projects certainly have an important role to play, but when it comes to major things like the Colombo-Matara Highway which will open up three of the most intensely populated parts of the country, there is certainly a case for making provision directly out of government funds, and not. waiting for BOO-BOT projects. So, I think there has to be a certain juxtaposition of direct government investment with regard to infrastructure, with BOO-BOT projects. We will be doing that. Which means a more direct and central government involvement in a strategy for improving infrastructure within a reasonably brief time span.

Q: Do you think that the continuing war is a major disincentive for good foreign investment in this country?

A: I think it will be futile to deny that the prime requisite for investment is political stability. Whatever incentives we may offer by way of tax holidays, repatriation of dividends lower rates of income tax for expatriates employed by companies that invest here, various other forms of fiscal incentives for companies that bring in high technology, all that is useful, but they will not achieve the desired results, except where fly-by-night investors are concerned. If you are looking at genuine, long-term substantial investors, certainly the prime requisite they would look for is political stability. You can't really achieve political stability in a situation that is pervaded by a war that is being fought in all its ferocity in an open-ended way. Of course, the war is a part of the contemporary scene. It is a fact of life. But investors need to feel confident that there is a multi-pronged strategy which goes beyond the war, transcends it, and which embraces certain political elements as part of a solution to this conflict. There must be something to look forward to. The return of peace. Not as a vague dream in the distance, but as some concrete steps that are being taken to achieve a solution to this problem. That of course is one of our principal aims. We will be bringing the political proposals before parliament, not at some distant date, but before the end of April next year.

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Q: To come to the political proposals itself, if the political proposals are endorsed in parliament and subsequently endorsed by the people, and the structure of genuine devolution as is so often stated does take place,

what kind of impact would it have on the development process of this country?

A: Indeed, a very important impact. Because it will facilitate regional economic development on an equitable basis. It is very necessary to empower the different areas of the country in terms of decision-making authority, allocation of resources, and the identification of priorities vis-à-vis economic development. Since independence, we have had a problem of a gross inequality, a disparity with regard to the allocation of resources with the lion's share being consumed by the Western Province, Colombo and the environs. Whether you look at expenditure on health, education, roads, transport, or recreational facilities there really has been a very striking disparity. This is because of the concentration of decision-making authority at the centre. And, if you are interested in a balanced development, the fruits of development being available not only in and around the capital city but in all parts of the country, then I think the devolution of decision-making power is not only desirable, but indeed essential, indispensable. That is why I have frequently emphasized that the devolution proposals must not be seen purely and simply as a way of achieving a solution to the ethnic conflict. It has a much broader rationale. It is to do with participatory values and mechanisms. It is to do with empowerment of people at the very grassroots level. That is the significance of the proposals and their very objective.

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Q: For a large number of years a lot of the country's budget requirements were met with foreign assistance. What is your impression of the preparedness of the rest of the world, particularly the donor countries or the aid-giving consortium of countries. Do they have that same

commitment even now, or have their interest in Sri Lanka waned?

A: I think the commitment is still there. Recently, the President visited Korea. The Koreans have given about US$ 15 million, that is about Rs 900 million, part of which we will utilize for the schemes I outlined a moment ago, to provide credit at concessionary rates of interest to small and medium-scale industry. There is certainly no lack of interest or empathy. The Paris Aid Group meets on November 18th, that is soon after the vote on the Second Reading of the Budget on November 15th. I think the interest, the commitment is there, but to induce donors to give the maximum, there needs to be a coherent and a realistic strategy for restoring peace in the country. They would not expect this to happen within the next few months. But there must be a basis, a foundation for a realistic expectation. That is why the government's plans for the achievement of peace are so important, for the purpose of instilling, inculcating in the donor community the kind of confidence that will enable them to give us the maximum, at a time when we need it.

Q: To go back to what you said of the need for good fiscal management, do you think that at this stage of our post-independence budgeting, there is the need for a second look at the type of management that we have in this country, specially budgetary management and government expenditure. India, for instance, has now initiated what is known as an Expenditure Management and Reforms Commission. After the last government's privatization record, this government introduced PERC to oversee the privatization process. Do you see the need for such an organization or some such structure, to expedite the process of development and the implementation of whatever policies the government may have?

A: Well, I am not really enamoured of new systems and structures, to have more and more of these entities is not necessarily helpful. But I think the function that you referred to is certainly a vital function. We need to look at expenditure in terms of the degree of the benefit that will accrue. So, there has to be a proper evaluation and you may have to be fairly ruthless in cutting down expenditures that do not satisfy that criterion. That is the way you lop off the fat. You also need to look at very obvious problems of this sort. Although we complain of the paucity of resources, the situation with regard to the utilization of foreign aid in the past has not been satisfactory. There have been cases where in certain projects, only 12 to 13% of the money allocated has been actually spent. That position we have looked at very carefully and the performance with regard to aid utilization has improved,

quite considerably. These are complex issues.

That particular problem is exacerbated by tensions between the line ministries and provincial councils. If you get money from the World Bank or a foreign donor to be spent on primary education, that is a devolved subject under the 13th Amendment, monies cannot be directly disbursed by the line ministry. It has to be done through the provincial council. And if there are political antagonisms arising out of the fact that the People's Alliance is in control of the centre and a rival political party is in control of provincial councils, tensions of that kind sometimes slows down spending money that is placed at our disposal by a foreign donor. There have been instances of that kind. Then there are great problems faced due to lack of coordination. Some of the investment projects have been delayed, because of problems of approval by the environmental authority, release of land, valuation, provision of necessary facilities, now for all these things to be coordinated you have to streamline some of our systems.

A clear matter of significance is that if there is a bureaucracy, then there is the need for greater motivation of the public service. Public Service reform is very crucial. That's a matter that has not really been attended to for decades, because there has been no significant structural reform of the public service ever since the days of the British, and the ethos of the public service at that time is different to what is needed today. So, that is an area which we are looking at closely because the bureaucracy is the instrument through which policy has to be implemented, and if there is tardiness on the part of the public service, for a variety of reasons, then the effectiveness of budget ary policy is necessarily impaired. So, there is a whole cluster of issues that require to be looked at. I am not myself convinced that it requires the creation of a separate commission It only requires recognition of these various elements as being crucial They tend to get relegated to the background because of our preoccupation with more immediate issues. It is not that anybody denies the importance of some of these things, it is just that they do not get the attention they deserve because they get elbowed out by more mundane more immediate concerns. Just now, these other issues have to be kept very much in the forefront, and policy makers today are acutely conscious of that.

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Q: You are obviously having a hard time these days preparing for the Budget. How would you feel, if you could describe it, entering the chamber of parliament with your Budget Box in the third year of the PA government, as compared to the first year of the PA government?

A: I don’t think there is any need for pessimism or despondency of any kind. I will actually be comfortable walking into the chamber with the Budget Box because we have kept faith with our people. We have done what was expected of us. We have responded to popular aspirations. We have fought the war with a sense of purpose, dedication, according to a properly integrated strategy. That is appreciated by the people. The people also realize that some of the difficulties that they are called upon to bear are the direct result of the military expenditure, which is being undertaken for a purpose that is fully compatible with the wishes of the people. There is continuity. As I walk in with the Budget Box, I will be sustained by the conviction that there is continuity, there is progress, there is development. We could have told the people that in this difficult situation we have to take away more of the benefits that they have enjoyed. Welfare has to be cut down. But we haven’t done that. Because the total quantum of expenditure on welfare has not diminished. So, it is a combination of compassion, of concern, of solicitude for the well-being of the people with economic pragmatism. And I would describe that as a hallmark of our approach to budget making. So we know that the people will have understanding and empathy, and it is that that would give us courage to go on with our work.

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