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Economic reforms difficult to implement - IPS

by Lalin Fernandopulle

Sri Lanka's fiscal constraints, the demographics of a contracting labour force and skill deficiencies suggest that a rise in infrastructure investment will spur growth only temporarily, Executive Director, IPS, Dr. Saman Kelegama told the launch of the IPS 'State of the Economy Report 2015' at the IPS auditorium last week.

He said sustaining higher growth in the long run must come via a competitive export sector through improvements in productivity, notably innovation and investments in human capital. Overhauling Sri Lanka's tax system, tackling loss making State-owned-enterprises (SOEs), improving labour market efficiency, filling skill gaps in the workforce, improving agricultural productivity, a better safety net for the poor and the vulnerable are among a raft of reforms that need attention, Dr. Kelegama said.

Such reforms are politically difficult to deliver through the legislative phase and are often even more difficult to implement. Reforms generate distributional impact that creates 'losers' and 'winners', entailing short-term adjustment costs and the potential for long-term benefits.

Thus, while reforms need to be ambitious in scope, it is typically the case that ambition may have to be tempered by political and economic realities. An agenda for reforms must begin by strengthening interactions between institutions, policy processes, and policy outcomes.

The environment in which many of these transitions take place is strongly influenced by broader factors such as the quality of institutions and governance in a country. The Sri Lanka: State of the Economy 2015 report addresses these through an overarching theme of 'Economic Reforms in Sri Lanka: Political Economy and Institutional Challenges'. The report examines in detail the many interrelated reforms that touch on important economic policy areas - trade and investment, labour market, foreign employment, education, health, social protection, agriculture and the environment.

The report argues for coherence and prioritization in the design of reforms on several fronts, so that they add up to a plausible overall economic strategy that will help Sri Lanka to achieve sustained high growth in the long run.

It takes a look at the many promising development achievements, opportunities and challenges ahead for the country. The report argues that rising socio-economic prosperity in Sri Lanka, if fostered skillfully and inclusively with progressive reforms, can spur economic dynamism and social progress and place the country on firmer ground, as it makes a decisive transition into a middle-income economy and beyond.

The State of the Economy Report of the IPS is the flagship publication of the Institute. It is a publication that attempts to provide a broad overview of the Sri Lankan economy while highlighting policy options to move the Sri Lankan economy forward to a higher growth trajectory with a human face.

"We started this as an annual publication in 1992 and this is the 23rd year of its publication. Every year the publication has a theme which varies from broad macro topics such as 'Post Conflict Economy' to sectoral topics like 'Plantation Sector' to micro topics like 'Empowering the Poor'," Kelegama said.

"Last year we focused on 'Rising Asia: Opportunities and Challenges for Sri Lanka'. This year we focus on 'Economic Reforms - Political Economy and Institutional Challenges'," he said.

Deputy Minister of State Enterprise Development, Eran Wickramaratne said the government has to face many internal and external challenges. The economy of India and China are slowing down and how long this will last has to be seen. Sri Lanka is facing current account and budgetary deficits.

"We need to focus on a vibrant export policy. There has been some movement in the exchange rate. There has been a huge time lag in this regard. The immediate priority is to focus on foreign reserve stability. We need to also focus on attracting more foreign direct investments," he said.

The Deputy Minister said the rational for bringing State Owned Enterprises under one ministry was to reduce the burden on the tax payer who has to pay for extravagant travel costs and political interference.

This move is misunderstood as a drive towards privatisation. One size fits all theory does not work. "We will look at each institution separately to boost productivity. Deficits in management skills will be addressed through innovative structures without which the SOEs cannot be turned into profitable institutions," he said.The private sector invests in training which is not the case in public sector. Investing in training is vital to enhance productivity. Deputy Director, IPS, Dr. Dushni Weerakoon said infrastructure alone without broader reforms will take the country nowhere. Export growth has been marginal. Measures to sustain economic growth is inadequate. In the past few years foreign funding came with non-concessional borrowing. Foreign direct investments were drying up. The growth process needs to change but there are many constraints in the labour market with low productivity in sectors such as agriculture. Foreign inflows have dropped during the past seven months. Inflows to government is low this year compared to last year. Long term loans dropped from US $ 1,119 million last year to US$ 579 million this year. There are huge operational losses in SOEs. Sri Lanka's fiscal deficit expanded 240 percent in the first six months of this year. Core inflation has increased year-on-year.

The external sector performance in the first seven months of this year has been lacklustre. Export earnings have been stagnant. “There needs to be an increase in foreign capital inflows in next three to four months if not we will have to go for a standby agreement with a donor. Fiscal policy should be an immediate priority for reforms which should be introduced in the next Budget. Steps should be taken to enhance revenue and rationalise spending”, she said.

Reforms should focus on raising productivity and efficiency in SOEs. The labour force is declining with around 60 percent in the informal sector lacking social security.

There is low female labour force participation with less social security. Agricultural productivity must increase. Second generation reforms are far more complex and difficult to implement than first generation reforms. Urgent reforms by weighing options and implementing what is feasible is paramount, Weerakoon said.

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