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Dr. N.M. Perera's Policies and Achievements as Finance Minister

Reviewed by SAMAN KELEGAMA

Dr. N.M. Perera was a colossal figure in the Sri Lankan political sphere. Among his many roles, the role he played as the Minister of Finance during the periods 1964/65 and 1970-75 stands prominently. The policies that Dr N.M Perera (henceforth NM) articulated and implemented during his second term of office truly reflected his ideology and realities of that time. Prof. Buddhadasa Hewavitharana, the author of the book, was closely associated with the policy making process as the Economic Advisor to the Ministry of Finance during 1970-75. In this book, he recollects the political economy of the policy making process in order to explain the underlying thinking and objectives of the policies.

The coverage of issues is vast but they have been methodically arranged into 4 chapters, viz., Management of External Finances: Policies & Measures; Management of Internal Finances: Policies & Measures; Economic Development & Growth: Policies & Measures; and Building Socialism & a Socialist Economy: Policy Perceptions & Approaches. The author has gone through a vast array of literature including his own writings/notes at that time to extract important material to compile this book.

The book starts with the inherited economic crises of the United Front government in 1970 — a foreign exchange crisis and a large domestic financial imbalance. NM as the Finance Minister was not prepared to accept the stringent conditionalities of the IMF. For the first time, several 'Letters of Intent' of the IMF that the previous regime had agreed to was tabled in Parliament where there was prior commitment for a certain set of economic policies. A number of previous short term borrowing bills had to be settled with the IMF. NM was of the opinion "small beggars cannot be big choosers" (p.33) and if the country refused to honour these bills, it would be treated as a bankrupt nation. He did not want this to happen and went on to state: "we cannot brush aside and completely ignore the International Institutions; we can repudiate their terms only if we are prepared to face the far reaching dislocations" (p. 07).

NM saw the transformation to a socialist society to be determined not by heavy dependence on international financial institutions but by the extent to which the country was willing to make sacrifices and increase its productive work. He always looked at economic management from a long term perspective and thus pursued a policy of containing present consumption via the practice of austerity or 'tightening the belt'. A plethora of measures were implemented to address both the external and internal deficits and a massive effort was made towards domestic resource mobilization for economic development. Accordingly, a system of higher taxation (capital levy, wealth tax, etc.), income ceilings and forced and voluntary savings were introduced, accompanied by price control and rationing of essential commodities. The exchange control laws were tightened and extended to cover trade malpractices and asset transfers.

External Deficit

The author identifies the formation of the State Gem Corporation as a shining example of NM's strategy to address the foreign exchange shortage. As far back as 1937, NM was instrumental in setting up a Select Committee of the State Council to inquire into the Gem Industry and was also a member of that Committee. From the mid-1960s, when he was the Finance Minister for a short period, NM had an idea of formalizing gem business in the country when he argued in the then budget speech that the annual output from the gem industry could be in the range of Rs. 100 million although the customs recorded only Rs. 3.5 million worth of exports. He argued that the bulk of it may have been smuggled out and fed the black market operations in foreign exchange. In turn, the government not only lost foreign exchange but also revenue because of the inability to tax as there was no proof of income received.

The Gem Corporation was set up to "recapture this foreign exchange that the country was getting deprived of" (p. 08). NM "prioritized foreign exchange gains over local tax revenue gains in the trade-off between foreign exchange earnings and tax revenue" (p. 12). Among other incentives offered, the Convertible Rupee Account (CRA) introduced in 1973 acted as a powerful incentive for increasing gem exports via the SGC. The rate under the Foreign Exchange Entitlement Certificate (FEECS) system inherited from the previous government (introduced in 1968) was adjusted to support this initiative. According to the author, by these measures the prevalent gem cutting monopoly was diminished, the farcical rigged auctioning was broken, and organized gem smuggling and related black marketing in foreign exchange and goods was crushed. Gem exports rose steeply from a mere Rs. 3.4 million in 1971 to Rs. 152.8 million in 1973 to Rs. 234 million in 1974, making gems the third largest export income earner and the lead item in Sri Lankan non-traditional exports.

Another method by which NM attempted to address the external imbalance was to set up an Export Import Bank (EIB). The genesis of this was inspired by the socialist idea of liberating the country's financial system from the control and influence of foreign banks. Accordingly, a new EIB was to be created as a jointly-owned venture with the government owning 51% of the capital and 49% to be owned by the nine foreign banks that were in operation. This idea was proposed from the perspective of servicing the non-traditional exports, supporting exporters who did not have access to commercial banks at that time, introducing export guarantee systems, etc. A Committee Chaired by the author argued against it as the timing was not correct given the very small size of the non-traditional sector. Moreover, there was objection from the bankers, particularly, the Bank of Ceylon which had a large lucrative foreign trade division. NM accepted these realities and decided to abandon the idea of setting up an EIB.

Internal Deficit

The author notes "revenue increased at a slower pace than expenditure and the gap between the two rates widened due to financial imprudence ..... Several years monetary expansion....... had by 1970 created a cumulatively increasing inflationary pressure and an escalation in prices" (p. 19). The country was basically living beyond its means and corrective measures were urgently needed.

A revenue enhancing exercise was launched not by discovering new sources but by making existing ones yield more revenue through innovative methods in tax collection. Introduction of the PAYE (pay as you earn) system, raising tax rates on luxury and semi-essential goods, expanding tax coverage via an innovative demonetization exercise were noteworthy measures. As a part of mobilizing savings, a ceiling on disposable income was imposed to contain consumption and collecting the income above the ceiling as a contribution to compulsory savings. The objective was to divert income from consumption to a process of saving and investment through the budget.

In the monetary history of Sri Lanka, the demonetization exercise was unique where the primary purpose was to bring in tax evaders to the tax net. At that time, demonetization was conceived as the only measure that could possibly bring tax evaders to the tax net. It required the prevalent large denominated currency notes (Rs. 100 and Rs. 50) to be surrendered in exchange for new notes and in the process, details of the owner were passed on to the Department of Inland Revenue. Acting on this information, it was possible to rope in additional sums of tax collection. The author provides an interesting account of the preparatory work and the social response to this exercise.

Promoting savings received top priority in NM's budgetary management. He gave emphasis to non-inflationary financing of the budget deficit and for this purpose he saw increasing savings as an essential ingredient. Although measures such as demonetization mobilized private savings, and income ceilings to contain consumption and engage in compulsory saving had some impact on saving, there was a need for an overall institutional framework and policy to mobilize more savings. The existing saving institutions were handicapped by their cumbersome procedures for depositing or withdrawing money and by their inability to mount aggressive savings mobilization through attractive schemes. Thus, the National Savings Bank (NSB) was established by merging the Post Office Savings Bank, the Ceylon Savings Bank, and the Savings Certificate Branch of Post Master General. The bank interest rates were raised to cap this initiative and thus "fulfilled a pre-requisite for building-up a viable market for savings of all sections of society" (p. 27).

NSB was not the only institution to support budgetary management. The State Distillery Corporation (SDC) was established in 1971 to increase public revenue among other objectives. Earlier, the Excise Department (under the Ministry of Finance) was managing the State Distilleries and it was not run on a commercial basis. The author served as the Chairman of the Committee to overlook this transition and played a key role in forming the new Corporation. NM's initial idea was for the Corporation to take over the entire distilleries and make it the sole monopoly of distilling arrack. The Committee felt this was a too radical approach and advised against it and NM following the Committee's recommendations made it take over only the commercial functions of the State Distilleries. The author documents steps taken to energise the new Corporation by training toddy tappers, combating illicit liquor, etc. Many of the objectives were achieved and today the SDC remains a major source of revenue to the government.

1973 Oil Price Hike

NM's guiding principle was 'long-term interest of the country before short term popularity'. Often at the risk of unpopularity with Cabinet colleagues and the people, he pursued this policy. The second measure of rice at subsidized price that the United Front government introduced had to be scaled down and eventually withdrawn from the rationing system. In 1973, at the time of the first oil price hike, import of subsidiary foodstuff was banned to reduce the trade deficit. The concept of 'self reliance' gathered full momentum in 1973. NM firmly believed that Sri Lanka can cushion against all external threats if the country develops its own resources and enters a path of self reliant growth.

Local import substitution industries could not catchup with demand due to well known problems of the limitations of import substitution industries and the government became very unpopular with shortage, queues, etc. Revenue protection was uppermost in NM's thinking; when the import price of sugar and flour rose and "profit margins and revenue came under threat, the Minister did not hesitate to raise the sale price of these items in order to protect revenue" (p. 22).

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NM was convinced that channelling of increased resources for welfare expenditure in the context of limited growth of revenue impairs the availability of resources for development. However, he did not take a pure technocratic approach to curtailing welfare measures, but attempted to replace universal welfare with provision of welfare on a selective basis. Withdrawal of the free ration from the tax payers and introducing the two-tier pricing system for sugar are a few examples.

The author notes that these measures were not very successful as they were one step behind the escalating world food prices.

Development and Growth

Chapter 3 deals with Economic Development & Growth. The strategy for dealing with the problem of raising resources for investment to achieve development was to increase savings by containing present consumption via the practice of austerity. Income ceilings, compulsory savings, cuts on welfare expenditure, and a 'climate of austerity' were to provide the enabling framework.

The growth, investment, and productivity nexus as illustrated in standard economic theory (*Harrod-Domar model*) was very much in NM's mind when he argued that wages should be tuned to productivity levels and low productivity should be addressed by increasing work intensity. "For the investment that is made by mobilizing resources to succeed, its productivity must be high" (p. 33). Sri Lanka's wages were out of proportion to her productivity at that time and this fact was recognized by the ILO mission in 1971 headed by Professor Dudley Seers. NM proposed 'Workers Councils' to increase productivity. The author identifies this as a first step towards socialism. Worker-participation in management can generate a process of weakening the wage-labour based consciousness and raising the level of social consciousness to a point where eventually the workers can take over the management (p. 59). NM in fact initiated an awareness programme on this where the author played his role as the Economic Adviser.

That productivity was uppermost in his mind comes out clearly when the author discusses the estate sector. When Land Reform was introduced in 1972 NM looked at it in terms of increasing productivity and not from a populist angle. NM was concerned about the break-up of economic units under possible land fragmentation and the adverse impact on productivity. The author notes: "The impression I have is that the Minister viewed the proposed land reform with much reservation, although he did not go public about it" (p. 43).

In this Chapter, the author covers a number of issues such as the take over of the Plantation Companies in 1975. But what is noteworthy is how some of the policies that NM wanted to pursue got diluted due to ideological differences between the LSSP (of which NM was the leader) and the SLFP (key political party of the United Front coalition). For instance, capital expenditure allocations which came under the Ministry of Planning were not in accordance to the expectations of the Ministry of Finance. The author highlights the uneasy relationship between the Ministry of Finance led by NM and the Ministry of Planning, where most crucial issues were handled by the Secretary to the Ministry, Prof. H.A. de S. Gunasekera, and his unsuccessful attempts to reconcile the differences. The failure of the Five Year Plan (1972-1976) to take-off the ground could also be partly attributed among other factors to this conflict of the two Ministries.

Socialist Economy

The last Chapter is on Building Socialism & a Socialist Economy. In a socialist economy social consciousness emerges as the integrating force of the socialist process with planned economic development process. In essence, it is the driving force of a political economic process. NM always argued that a radical transformation of the economy cannot be done unless the level of social consciousness is high. He warned the JVP that there are no easy shortcuts to socialism. A heightened social consciousness was necessary to motivate different groups in society so as to mobilize them effectively to make a success of the implementation of the Five Year Plan, which was the means of achieving the development objectives.

The author highlights the problems encountered in creating social consciousness in a coalition political set up and where the social consciousness was low. Then the author moves on to highlight policies and measures of socialistic forms that had strong redistributive elements (pp. 53-55). The popular concept in the 1970s 'redistribution with growth' was close to NM's thinking even before it was advocated by Robert McNamara – the then Chief of the World Bank.

Reflections

The author has enriched the narrative with wit, humour, and some anecdotes. Moreover, the documentation of his interaction during the policy formulation process with a galaxy of LSSP leading lights of that time, viz., Colvin R De Silva, Bernard Soyza, Hector Abhayavardhana, Doric De Sousa, and Osmund Jayaratne adds colour to the narrative.

An investigative reader may look into some data. For instance, to what extent did the NSB assist non-inflationary budgetary financing?; to what extent did the demonetization exercise enhance government revenue ?; how effective were the income ceilings and compulsory savings in curtailing consumption and promoting savings? These are not mentioned in the book. Thus, to comprehend some of the points highlighted by the author it would be essential to delve into the Budget Speeches and Central Bank reports of 1970-75 period and this is left to the interested researcher. But giving such data analysis may not have been the intention of the author from the beginning. As stated in the concluding remarks: "This book is not about evaluation of the totality of policies and activities" (p. 60).

It is imperative to note that both the external and internal deficits became major issues for NM and he gave priority to rectifying them by repaying short term debt, tightening import controls, and engaging in a massive domestic resource mobilization effort. He attempted this strategy at a time when the terms of trade deteriorated from 260 in 1970 to 145 in 1975 (44 % decline), international oil prices soared from 147 in 1972 to 826 in 1975 (price index of oil with 1969=100). It was also a time when the Bretton Woods system of orderly exchange rates collapsed creating chaos in currency management. On the domestic front, the 1971 insurgency had disrupted the supply side of the economy, the 1972 republican constitution had re-emphasized "economic independence" and less external dependence, 1974 was marked by a severe drought, etc. These factors both from the external and internal fronts posed a serious challenge to NM's strategy and the Five Year Plan.

In this negative economic environment whether the strategy of austerity that NM pursued went too far needs to be discussed in detail. For instance, Ronald Herring, in an article in the *Economic and Political Weekly* in 1987, identified the Sri Lankan economy at that time as the most controlled and restricted economy outside the Soviet bloc. Whether the policy response to the situation was the most appropriate also needs to be examined. For instance, would a flexible exchange rate policy instead of a fixed exchange rate with import controls have reduced the burden on the masses in terms of shortages and high prices ?

That the social consciousness movement did not make an impact was clearly seen in the 1977 electoral verdict when the political left was completely wiped out from parliamentary positions. Thus while the overall objectives and goals may have been appreciated, people were not prepared to forgo consumption for nearly 5 years for the sake of future development.

Economic historians will judge the 1970-75 period according to their ideological bias. Critics will dismiss the policies of this period stating that they were too restrictive and inward looking and prevented Sri Lanka emulating the high growth of East Asian Tigers and made it a latecomer in global integration. The supporters will say that some of these policies laid the foundation for strengthening the domestic production base, and had more time been given, Sri Lanka would have come out of austerity for a full-scale development take-off. Whatever the judgement is, Economic Historians can do a detailed assessment of this important period in Sri Lanka and assess NM's contribution given much of the valuable information given in the book. For one thing is clear from the author's narrative, i.e., NM did not fail to temper his ideologies with pragmatism when such was necessary and the result was some home grown wisdom and innovative thinking. NM was a rare kind of statesman when compared with most of the present day politicians. He valued scholarship, was prepared to listen and learn and change his mind when required.

This is an altogether engaging book and a must read to all those who are interested in the progress of the Sri Lankan economy over a period that is now dismissed by some commentators as a 'dark era'. The book is indeed a valuable addition to the current literature on the Sri Lankan economy.