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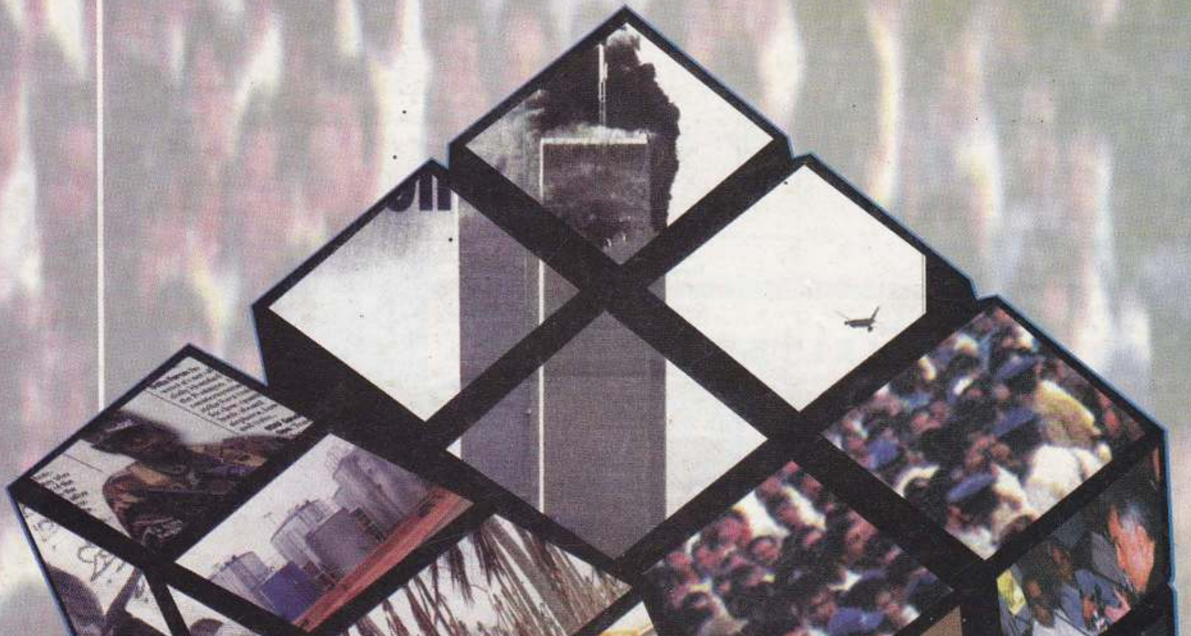
# ECONOMIC REVIEW

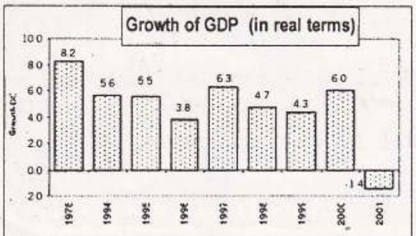
March / April 2002



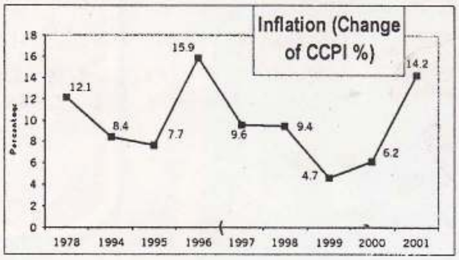
# ECONOMY OF SRI LANKA

## Crisis to Consolidation

# SOME VITAL INDICATORS OF SRI LANKAN ECONOMY





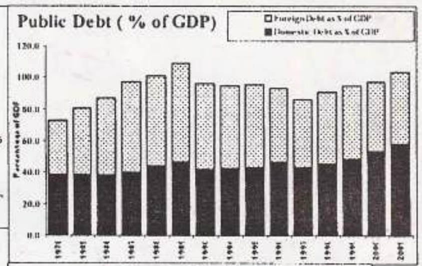


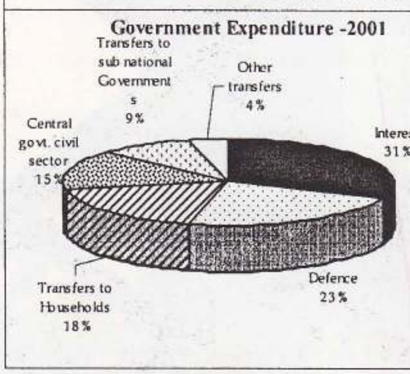

## PRICE & INFLATION

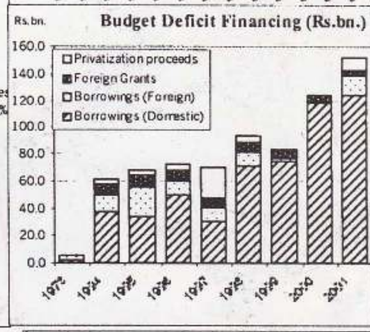
The annual average headline inflation rate measured by the increase in the Colombo Consumers' Price Index (CCPI) which covers the consumption basket of low-income families in the Colombo Municipality. The inflation was 14.2 per cent in December 2001 compa compared to 6.2 per cent in December 2000. Prices in international markets of major imports such as sugar, big onions, dried fish and milk powder and the prices of locally manufactured goods and services such as rice, coconut products, vegetables and electricity etc. had a significant impact on domestic prices.

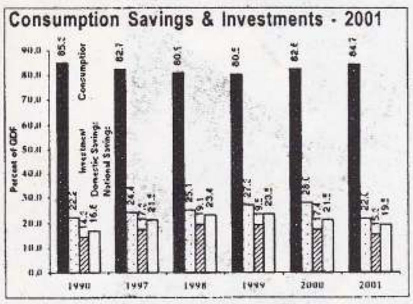
## GROWTH OF GDP

Sri Lanka Economy in 2001, plummeted with severe set back in major sectors recording negative growth rates. Economic growth, which was 5.6 per cent in 1994, has declined to such an extent (1.3% for the year 2001) for the first time. This negative growth outcome could be explained as a result of a number of external and internal factors, which some of them were out of our control.

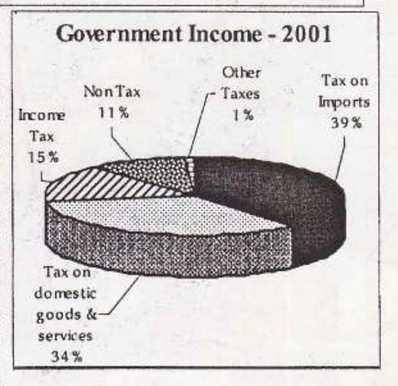

## CONSUMPTION, SAVINGS & INVESTMENTS

The relative share of the consumption in expenditure rose marginally from 76% in 2000 to 79.3% in 2001. Meanwhile, the National Saving/GDP ratio recorded a decline continuously from 23.5% in 1999 to 21.5% in 2000 and to 19.5% in 2001.Similar declining trend was observed in domestic Saving/GDP ratio as well. Increased government dissaving reflected in the rising current account deficit was the major contributory factor for this decline. As a result the gross domestic capital formation declined by 17.1% in 2001 reducing the Investment/GDP ratio from 28% in 2000 to 22% in 2001.

## GOVERNMENT FINANCE

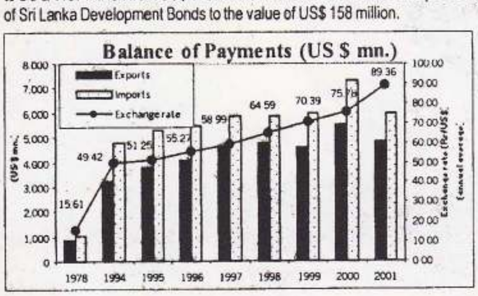
While revenue has withered away, expenditures have soared making budgetary management difficult during the last several years. The end result has been a widen budget deficit more than what was expected. The budget deficit for the year 2001 reached to (Rs 152,219 million) 10.8 as a percentage of the GDP against expected target of 8.5 per cent. The actual deficit in 2000 was 9.9 per cent.

Substantial reductions in revenue from trade-oriented taxes were recorded while the poor performance in public enterprises, which resulted in a decline in non-tax revenue. Revenue collected from the GST, stamp duty and excise taxes did not realise as expected. Meanwhile, current expenditure overshoots the original budget estimates of (Rs 281.4 billion) 19.5 per cent of GDP by 1.3 per cent of GDP. While the defense expenditure was the main contributory factor for higher expenditure, the interest cost for the gov ernment overdraft balance, unsettled import bills and subsidies etc. also made a high impact.




## BALANCE OF PAYMENTS (BOP) & EXCHANGE RATE

**Balance of payments account is one of the most important indicators of an** economy. The global recession and the events of Sept. 11 in the USA wreaked havoc with our economy and the demand for Sri Lanka exports plummeted. Hence, export earnings deteriorated to US $ 4,817 million from US $ 5522 million recording a 12.8 per cent drop. However, as a result of enforcing of import surcharge, revision in import tariff charges and mounted freight charges after Katunayake attack by LTTE, a sharp drop in imports brought down the import bills. As a result, the trade account of the BOP improved in 2001. The trade deficit was narrowed down to US & 1157 million from US$ 1797 million in 2000. These factors helped to register a surplus of US$ 220 million in 2001 compared to a deficit of US$ 522 million in 2000. This was partly mobilized through the issue of Sri Lanka Development Bonds to the value of US$ 158 million.




### Overall Balance

However, the surplus of US $ 220 million was much lower than the original estimation of BOP surplus of US $ 340 million mainly due to delays in selling government stake in Sri Lanka Telecom.

### Gross Official Reserves

Meanwhile gross official reserves rose to US$ 1338 million at the end of 2001 against US$ 101049 million in 2000, which was sufficient to cover 2.7 months of imports.

### Exchange Rates

Sri Lankan Rupee was allowed to decide its exchange rate in a free-floating exchange rate regime from 23rd January 2001. This allows to determine Sri Lanka Rupee exchange rate by market forces. As a result, the rupee was depreciated by 8.6 per cent immediately and by 11.3 per cent over the year compared to 2000. The exchange rate shot up to 93.16 per US Dollar as a result. The rate at the end of year 2000 was Rs 75 per US Dollar.

*Source:* Central Bank of Sri Lanka

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THE ECONOMIC REVIEW is intended to promote knowledge of and interest in the economy and economic development process by a many sided presentation of views and reportage, facts and debate. THE ECONOMIC REVIEW is a community service project of the People's Bank. Its contents however are the result of the editorial considerations only and do not necessarily reflect Bank policies or the official viewpoint. Signed feature articles also are the personal views of the authors and do not represent the institutions to which they are attached. Similar contributions as well as comments and view points are welcome. THE ECONOMIC REVIEW is published monthly and is available both on subscription and on direct sale.

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## Features



## SPECIAL REPORT

# ECONOMY OF SRI LANKA

### Crisis to Consolidation



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# "A TURNAROUND IN THE WAR-TORN ECONOMY AND ESTABLISHMENT OF DEMOCRACY REMAIN OUR MAJOR CHALLENGES" - Minister Bandula Gunawardana

Exclusive Interview

*Minister of Rural Economy and Deputy Minister of Finance Hon. Bandula Gunawardana despite his busy schedule which include the unenviable task of mapping out strategies to kick-start our economy from its present downturn and initiating various programmes to resuscitate the rural economy in effort to realize its enormous potential under the purview of his newly carved out Ministry of Rural Economy, took time-off to talk to Economic Review a publication which has always been very close to his heart. In an exclusive interview given to Dr S.L. Tilakasiri, Deputy Chief Editor, Economic Review and Deputy Director Research, People's Bank while taking stock of the economic scenario on the eve of the budget he talked about the hard options available for us at this crucial juncture. Excerpts:*

**Economic Review:**

***Various views and opinions have been expressed on the performance and constraints of the Sri Lankan economy during the previous decade. As a Minister holding important portfolios (Rural Economy and Deputy Finance Minister) in the UNF Cabinet and as a keen student of the Sri Lankan economy how would you assess this situation?***

***Hon. Deputy Minister of Finance:***

The economic growth rate cannot be considered an universally applicable tool of measurement of the growth of the economy. However, many economists recognise the economic growth rate as the common indicator of the overall economic performance of a country. It indicates the percentage point at which the Gross Domestic Product has grown in relation to the previous year. Fundamentally, it generally reflects the overall performance of agricultural, manufacturing and services sectors.

According to data given below only during two occasions the growth rates of our economy has fallen below 2%. In 2001 for the first time in the post-independence history, Sri Lankan economy has experienced a negative growth. It has been reported that this decline could be around 0.6 % or more. During the entire post 1977 period the only other period the economic growth suffered a severe setback i.e. below 2% was 1987. In all other years, growth has been at a higher rate.


Source: Central Bank of Sri Lanka

Several factors have contributed for this unprecedented downturn. One of them is the global economic recession and the rapid increase in oil prices. Besides, internal factors such as attack on Katunayake airport, the debacle arising from the Elephant Pass attack, bad weather conditions and the poor management of the economy.

In this context, the budget which is the main tool of directing the state fiscal policy could not be contained within its estimates for 2001 and distortion occurred. For example estimated income declined by Rs 30,458 million (this resulted from the reduction of envisaged income from few sources such as the GST by Rs 9,198 million, excise duties Rs 3,404 million National Defence Levy Rs. 4004 million and export duties Rs 8,418 million). Further, massive outlays had to be allocated to meet the increased salary bill of about 850,000 state employees, 300,000 pensioners. Besides, massive expenditures incurred on increased subsidy payments to Samurdhi recipients and fertilizer subsidy of Rs 9,837 mn. Notwithstanding the social benefits of such expenditures, the resultant budget deficit rose to 10.5% from the estimated 8.5%.

This situation was further aggravated as a result of non-realisation of income from the privatisation of institutions such as the Sri Lanka Telecom. Inflation went up further as a result of domestic borrowings to bridge the budget deficit. Causing a further burden on the budget the debts of some public institutions recorded sharp increases. (Ceylon Petroleum Corporation Rs. 21,500 mn. Ceylon Electricity Board Rs. 15,600 mn., Co-operative Wholesale Establishment Rs. 8,320 mn, Department of Railway Rs. 2,300 mn. and Sri Lanka Transport Board Rs. 2,100 mn) In this context public debt which stood at Rs. 550.1 bn. in 1994 rose to Rs. 1,430 bn in 2001. Accordingly, during the corresponding period the GNP – debt ratio increased from 95.7% to 101.5%.

In this background, another serious development unprecedented in the history of Sri Lanka has arisen. The debt instalments and interest payments that should be paid by us exceeded the overall income of the Government. Although the total income of the Government is Rs 235 bn. Rs. 295 bn. has to be paid as debt instalments alone.

The scrutiny of information available at the Department of Public Debt reveals the alarming proportions of this situation. In addition to the debt obligations, several other obligations also remain to be fulfilled by us.

(a) Rs. 14 bn. has to be paid in 2002 for arms bought on credit,
(b) Another Rs 13 bn. on Letter of Credit payments to local banks,
(c) Rs 35 bn. obtained for governments recurrent payments from local Banks as Bank overdrafts.

For this, an interest of Rs 6.5 bn. has to be paid.

This is the real picture of the Sri Lankan economy as of now that goes hand in hand with the minus economic growth rate.

***Doesn't the balance sheet of domestic State Banks represent the same picture? Aren't they also related to the overall performance of the economy? In comparison with other countries of the world, do you observe any distinct characteristics in our economic scenario?***

Yes, you have raised a good point. – Some immature politicians argue that the proceeds of the non-performing debts of state banks could be utilised to finance the payment of our debt instalments. This is a baseless argument. Even if all the non-performing loans of the state banks, instalments and interest and loans of which instalments are due for more than 3 months are taken together the final figure is Rs 45 bn (this includes Rs 22 bn. due to People's Bank and Rs 23 bn due to Bank of Ceylon). In any bank in the World such non-performing loans exist. But the question is the amount of non-performing debt in relation to total debts. This is 7% in developed countries while in developing countries it is about 12%. However, the ratio prevailing in our state banks 15.22% cannot be considered a healthy trend. In private banks of Sri Lanka, this is about 9%

Even if these total loans of Rs 45 bn is recovered by magic (no one can do this miracle instantly) how do we pay back Rs 300 bn. the huge debt in our national economy? The simple logic of saying that the total recovery of our bad loans would solve our economic crisis remains far from reality.

***It is often stated that the weaknesses in the management of the economy have resulted in this situation. Do you agree with this view?***

An analysis of statistics reveals that the buildup for the debacle of 2001 was created sometime back. There is evidence from various sectors to show that the weaknesses of economic management contributed greatly to this situation.

(a) There are serious weaknesses in the agreements and implementation of the privatisation programmes.
(b) Certain transactions related to the war have resulted in adverse consequences. Queries relating to transparency in tender procedures have surfaced. At the same time resulting deficits have threatened the existence of enterprises
(c) Politically motivated expenditure and wastage remains another matter of concern. Although Cabinet portfolios were reduced numerically, expenditure has not reduced in reality.
(d) Ministry of Finance and its management was complicated. There was no finance Minister responsible to the Parliament. Often as a practice, few public servants made all decisions in consultations with the Minister of Finance.

This messy situation resulted in an economic crisis, which in turn created a political crisis. As the culmination of these developments, the then government collapsed and the present government assumed power.

***As the Minister of Rural Economic Affairs and Deputy Minister of Finance, you have shouldered a very challenging responsibility. The massive task of kick starting the economy, which has been inactive to a certain extent. Can you elaborate the short term and long term strategies you propose to adopt to overcome this situation?***

We have declared that the country is faced with three major challenges. Firstly, the implementing macro economic policies in the context of a war situation remain our number one challenge. The huge burden of the war on our economy is in the tune of Rs

80 bn. on the annual government budget.

Secondly, we face the challenge of economic downturn *i.e.* bring about a turnaround from – 0.6% and taking to the economy to a plus growth rate. Achieving at least a 4.5% growth rate in 2002 and take the economy to a 7-10% growth scenario during the next five years.

Third challenge we are faced is the establishment of democracy so that to create a new political culture in the country.

Rate of investment remains around 3.5%. It is important to promote private sector (domestic and foreign) to raise investment. I believe that we should declare a three year investment promotion drive. During this 3 year (2002-2005) investment promotion period, it is necessary to provide incentives and inducements to private entrepreneurs in unprecedented levels in the history of Sri Lanka. A scheme should be devised to provide non-traditional incentives to all categories of investors and investments so as to promote investments infra structure development and fixed capital formation. It has been estimated that around Rs 600 bn. of undeclared money exists in Sri Lanka. All this should attract into the process of investment. Instruments such as certificates of deposits and treasury bills are outdated devices. In my personal view, in case monies are invested in vital sectors such as capital goods, industry, cultivation of land, re-cultivation or in land development machinery and transport equipment opportunities should be afforded to the people with undeclared monies, without any queries, to make investments. Likewise, there is a large quantity of money retained by our citizens domiciled in foreign countries. We must get this monies remitted to Sri Lanka.

Other incentives too should be provided to them. It is necessary to gradually reduce the 35% tax rate year by year and systematically. Equally, it is also necessary to create an investment friendly socio-economic environment. I believe that by the next budget a package of incentives should be given to the investors in agricultural, industrial and services sectors, having considered the requirements of each sector.

As far as the agriculture sector is concerned an innovative thinking and new approach is called for. It is required to follow a pricing policy, which will give a reasonable price to the farmer while keeping the prices within the consumers' reach. There are several issues peculiar to the agricultural sector. The major issue among them as I see is the productivity of the land. Approximately 40% of our labour force concentrated in the agricultural sector. However, the contribution of the agricultural sector to the GNP still remains around 18%. Since an adequate level of production commensurate to the units of labour is not realised a problem of productivity exists in this sector. Therefore in order to raise productivity and at the same time to solve the problems of marketing in the agricultural sector, it is necessary to introduce a new programme that will direct traditional agriculture to one of export orientations. I believe that the present Minister of Agriculture (Hon. S B Dissanayake) possess the capacity to carry out necessary changes in the agricultural sector.

In the industrial sector, the export industries are faced with great challenges. In 2005, the Multi-fibre agreement will cease to operate and the quota system will be terminated. The biggest challenge in this front is as to how we are going to sustain our markets with the termination of quota system in 2005. In order to remain competitive in the market and retain buyers in our fold the issues such as modernization and continued quality improvement of the garment sector need to be addressed. Free flow of imported goods (especially from countries such as China and Russia) also pose a threat to our small and medium scale industries. In this context, they also need some protection. At the same time, a tendency of closure of industries is also prevails. This closure is caused by a number of factors - political and non-political. In order to prevent such closures we must think

In the services sector tourism has the highest potential. It is possible to earn more foreign exchange, create more employment opportunities and make a higher income, if the prevailing conditions in the industry are improved. We may be compelled to go for a Free Port concept in order to ensure a growth in the service sectors such as Banking, Insurance and other service sectors (specially Banking services, Port and air services). A new scheme is being formulated for this purpose.

***The government has already launched the 100 day accelerated Programme. Do you believe that our economy will be in a suitable shape for a rapid leap at the end of this Programme? Besides, you have shouldered a new cabinet portfolio on Rural Economy at this juncture. How could you elaborate your role in this context?***

I think the government's 100 Day Programme has succeeded in kindling massive expectations among the public. What is accumulated over a period of seven years cannot be cleared within mere 100 days, unless a miracle happens. No financial resources are made available for the 100 Day Programme. What was intended by the 100 Day Programme is the introduction of certain changes without any financial allocations. The period is run through by a vote on account. Budget will be presented on 22nd of March. Only after the Sinhala New Year *i.e.* after the budget that the country will have some impressive experience. Under the 100 Day Programme schemes that do not require funds and which involves low capital expenditures are being implement. For example under the 100 Day Programme of the Ministry of Finance, auctioning of properties of debtors below Rs. 10 Million was postponed for 6 months. We have also decided to reintroduce a 40 per cent custom duty surcharge to protect small-scale industrialists and to import a very small quantity of rice (12,500 m/tons) as a remedy to the escalation of prices. The surcharge of 20% on coconut based products has been removed to prevent the rapid rise of coconut prices. The 100 Day

Programme of the Ministry of Finance is totally aimed at the preparation of a budget that would be geared towards development without heavily burdening the people.

A series of activities of the new Ministry of Rural Economic Affairs have been planned under the 100 Day Programme:

1) We conduct rural marketing outlets for the marketing of rural products with Ministry funding. One of such outlets was held at the Vihara Mahadevi Park. One each will be conducted in Kalutara and again in Colombo.

2) We have also launched a programme called "Turunu Sevana Market Promotion Drive" which will provide marketing facilities and employment opportunities to hundreds of persons who are engaged in planting of connected exotic plants and flowers. This can be called an environment friendly self-employment programme. Facilities will be made available to the unemployed youth to sell their products such as plants and flowers at building constructed along the highways. A trade promotion center that will function round the clock also will be established.

3) An another noteworthy experiment we have ventured in this establishment of the first ever Printing Industrial Village of Sri Lanka on the surplus land available at the State Printing Corporation Complex at Panaluwa. Factories for printing and ancillary industries will be established at this site. Already applications have been received for the establishment of industries such as production of corrugated boards using waste paper and manufacture of albums, digital printing, and paints, stationary and manufacturing envelope and manufacture of file covers.

4) Action is also being contemplated on the possibility of moving away the agricultural wholesale trade from Pettah, so as to effect a change in the monopoly enjoyed by the Pettah market. We intend to build several wholesale economic centres in the outskirts of Colombo utilizing the bare crown lands available on the lines of the one that operates at Dambulla, with the co-operation of the Private Sector. The twin objective of this exercise would be to give good returns to the rural producer and quality products to the consumer.

5) It is expected to establish an exhibition and marketing center to facilitate marketing of rural produce in the premises of the Exhibition and Convention Center located in Colombo. A large scale emporium will be established along Colombo-Katunayake highway to accommodate handycrafts and textile manufacturers, handloom industrialists, minor export producers and fancy goods manufacturers. This will be in line with the export development village programme. What is aimed at is the formation of a 100% share capital company comprising of producers and manufacturers of export crops and exportable goods. The large number of shareholders in this Company may be exotic fish culturists, mushroom cultivators, flori-culturists, comprised of those planting seedlings and lace makers. Despite the establishment of such a Company, they have no knowledge about the export trade or its potential. To make it a success we shall establish another Company. The capital of this Company will be provided by the Ministry of Rural Development (10%), Export Development Board (10%), the Company to be established (30%) and existing exporters (50%). Thus, the second Company will consist of exporters, rural producers and the government. This Company will export to the export Company of the exporters, and in the process, they will get a better price. They will also be entitled to a share of the profit. This concept slightly differs from that of export village concept. Under this new concept, two companies operate in combination. We are discussing this matter, with the Export Development Board, which has expertise in this field.

6) We are thinking of providing equipment credit to the rural folk who do not have capital. We have farmers who depend on hired tractors, carpenters who hire lathe machines, welders who hire welding plants, fitters and gem cutters who hire machines, fishermen who hire boats. In order to alleviate this rural based poverty which arises from lack of capital Banks tend to provide cash loans. For example when a loan of Rs. 100,000 is granted to an unemployed rural youth, he utilises part of its proceeds to give his daughter in marriage, a part to repair his house. Although he is indebted to the value of Rs. 100,000 at least not even Rs. 25,000 is utilised for his venture. At the end, there is a debt burden of Rs. 100,000. An equipment loan cannot be considered a subsidy. Tractors, carpentry tools and masonry tools will be provided to the potential workers on credit. It is an interest free loan and only a service charge will be levied. They will be required to pay this loan within three year period. In case of default, the tools thus provided will be confiscated. This is an interest free hire-purchase system and once the loan is settled he will be the owner of the capital in three years time or becomes a capitalist with the ownership of his capital goods. The DFCC Bank, which earlier catered to the needs of this segment, has deviated from the path after privatization and seems to concentrate on large scale enterprises. Therefore, at present discussions are under way in order to explore the possibility of establishing an Enterprise Development Bank. The existence of Rural Development Banks does not serve this purpose since they are not oriented towards enterprise development. They remain politicised institutions. Since these Banks are based on new concepts the innovative youth power

should be utilised to enliven these organistions. The services of the talented unemployed graduates could be utilised in this project. This programme is expected to be implemented with tools obtained from a Foreign Company under a foreign aid package. A programme of distributing of these tools in the villages across the Ministry will be considered.

7) This will be followed by the establishment of an Enterprise Development Bank. There are certain projects that crave for funds and faced with capital problems. A need exists for a National Bank for small and medium enterprises. It is necessary to make a speedy march. It is somewhat difficult to make the inert organizations active. Thus we have been compelled to think of a new institution notwithstanding the existence of banks in the rural sector.

***We have seen you as a vociferous Parliamentarian with strong views on the specific role and the key position of the state in the Sri Lankan Economy. You have also advocated the need for a strong state sector and this stance of your's remains contrast to the policy espoused by the present government. As of now, ironically you have been called upon to undertake a task of the extremely difficult job of directing the economy in line with the directions and recommendations of the institutions such as the World Bank and International Monetary Fund which were targets of your past criticism). How do you confront this situation?***

***At present India is implementing a programme of disinvestment. Through this programme it is envisaged to give a fillip to the private sector by reducing size of the state sector. Voluntary retirement scheme for the public sector employees also under way. Will Sri Lanka too will opt for a such scheme in the near future?***

During the past, most of my analyses were based on the then available data. However, it is very obvious that there is an incompatibility between data and the reality. The question here is the reliability of these data. According to my earlier analysis, an analysis of the public debt crisis was based on the accepted statistics of public debt. However, it becomes apparent that there is a debt that the books do not reveal. Only after coming here I came to know that there is an overdraft of Rs. 35 bn. Statistical information on unemployment represent the rate of unemployed excluding North and East (one third of the country). I cannot say to what extent some responsible institutions twist the statistical data for political objectives.

Achieving of higher growth, is no doubt, remains the basic factor that reduces unemployment, increases income and eradicates poverty. However, it is universally accepted that the mere creation of employment alone does not necessarily contribute to the reduction of poverty. A strong intervention of the government in this regard is essential. Therefore, contrary to the situation prevailing in the developed countries, in countries like ours, the government must actively intervene in order to maintain a compulsory social security net to direct the market. There are no jobs for those who seek them; meanwhile there are no skilled people for the available jobs. No qualifications for available jobs and no jobs for available qualifications. This is a structural imbalance of our education system. The country needs a massive educational reform programme to do away with this structural imbalance. The reason is that there is a wide quantitative improvement in vernacular and free education, number of students has grown to 4.0 mn, number of schools to 10,000 and number of teachers to 196,200. Despite this quantitative improvement, no qualitative improvement or structural change in education has taken place.

Under the current context, the maintenance of state institutions remains a vital issue. The major public institutions in Sri Lanka incur losses running to billions. Ceylon Electricity Board, Ceylon Petroleum Corporation, Sri Lanka Railway, Central Transport Board all these entities are maintained by the tax payers' money. All these burdens are shouldered by the public. These losses are not born either by the government or by politicians. The whole of Sri Lankan nation is subjected to this exploitation.

It is high time that we moved away from this traditional state sector concept. Although unpalatable, the resource utilization within this sector takes place in an inefficient manner. Efficiency, productivity, cost effectiveness and competition are almost becoming the catch words of the modern world. A small country like Sri Lanka cannot stand in isolation. I do not advocate for a lumpanised open economy for Sri Lanka. Today the task that lies ahead us is to face up challenges with the objective of building up a strong economy. Modernisation is essential for a real turnaround in the economy.

It should be made efficient, productivity should be raised, opportunities to raise incomes. Traditional industries such as plantation and coconut industries are facing with a management problem. Due to this problem, coconut industry has become vulnerable today. Today some entrepreneurs have cultivated 1500 acres of coconut land under splitter irrigation system in the Mahaveli Zones. The National Exports Association provides water to 1500 Ha. of coconut plantation with the value of water required to cultivate one hectare of paddy. Economising water use they have planted coconut that yield in 2 1/2 years, by using modern technology. The present government has a policy to raise the income flow to the village.

Money incomes should go up to suit the rural economy. What it means is overcoming poverty? Source of income should be expanded. At present, there is a wide international market for organic agriculture products. There is a wide market for ayurvedhic medicine and medicinal plants. At the same time, there is a challenge as the World Food Organisation states that this country will face food shortage in 2005. To face this challenge it is necessary to organise an accelerated programme of food production.

# Invigorating the Anaemic Economy

**PART I**

**The Anaemic Economy - 1995-2001**

Economic management in the last seven years, far from laying the foundation for a viable economy, had on the contrary weakened the fundamentals and steered the economy to mediocre performance first and to a virtual standstill in 2001. The lack lustre performance demonstrated by moderate economic growth, falling external assets, slowing of export growth, yawning budget deficits, rising public debt, shrinking public investment, falling share prices, continuous currency depreciation and rising prices in the six years 1995-2000 culminated in an economic crisis of alarming proportions from which there is no easy recovery. The deterioration of the economy over this period is clearly illustrated by the following facts and figures published in official documents.

**Declining Economic Growth**

The average annual economic growth in Sri Lanka in the six years 1995-2000 was 5.1 per cent which was lower than 7.5 per cent in Maldives, 6.4 per cent in India and 6.0 per cent in Bangladesh. It is noteworthy that Sri Lanka had the lowest growth rate of all South Asian countries in the agricultural sector in this period — only 1.9 per cent — whereas Pakistan had 5.2 per cent, Bangladesh 3.9 per cent and India 2.5 per cent. Sri Lanka's industrial growth in these six years of 6.4 percent was lower than that of Maldives, Bhutan, Bangladesh and India. Economic growth in 2001 was minus 0.6 per cent and 2001 may well be the only year with negative growth in the country's history. This sharp drop cannot be ascribed to the global downturn, particularly the US recession, as some other countries, which export much to the US, show much higher growth. India for example, which sells nearly a quarter of its exports to the US is estimated by the *Economist* to have had 5.2 per cent growth in 2001 and China which too exports about the same proportion to the US was estimated to grow at 7.5 per cent. The average annual economic growth in the seven years 1995-2001 is 4.3 per cent. Both agricultural and industrial production declined. In the first ten months of last year, tea and coconut output had fallen by 3.4 per cent and 5.9 per cent respectively and private industrial production had plummeted by 9.4 per cent in the 12 months to October 2001.

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It has been pointed out by some that the GNP doubled between 1994 and 2000. It is true that the GNP increased by 114 per cent in this period but that is GNP at current factor cost prices. GNP at constant factor cost prices or in real terms rose by only 34 per cent. In the seven years 1988 to 1994 GNP at current factor cost prices increased more — by 160 per cent — and GNP at constant factor cost prices increased by 35 per cent.

**Falling Domestic Food Production**

Domestic food production shows little progress. Paddy production in 2000 of 2,859,000 metric tons was only 1.7 per cent higher than the 2,810,000 metric tons in 1995 and it was expected to fall further in 2001 because of the prolonged drought. Production of subsidiary foods has declined on account of free trade policies and liberalized imports in the last six years; the fall in production between 1995 and 2000 was as follows: potatoes by 41 per cent, chilies by 34 per cent, black gram by 32 per cent, green gram by 27 per cent, cowpea by 25 per cent, red onions by 12 per cent, maize by 11 per cent and Soya beans by 75 per cent. Only big onions, groundnuts and kurakkan appear to have increased in production in this period. The drought would have caused a further drop in subsidiary food crop output in 2001. Employment and income of thousands of farmers who cultivate these crops have been adversely affected.

**Weakening Export Growth**

The average annual export growth rate of Sri Lanka in 1995-2000 was 9.8 per cent and it was lower than 15.1 per cent of Bangladesh, 12.5 per cent of Nepal and 10.7 per cent of Bhutan. Although exports rose by 19.8 per cent in 2000, they have declined in 2001. In the first ten months of 2001, exports in dollar terms have declined by 9.1 per cent over the corresponding period in 2000. The principal export — textiles and garments — has dropped by 11.4 per cent and agricultural exports by 5.8 per cent. Tea prices in dollar terms were 17.5 per cent lower in October than a year ago. Minor agricultural exports show an alarming trend; all except pepper, nutmeg and cinnamon declined in export volume in the last six years. Between 1995 and 2000, export volume fell by 98 per cent in other oil seeds, 97 per cent in coffee, 91 per cent in cocoa products, 80 per cent in arecanuts, 74 per cent in cashew nuts, 66 per cent in sesame seed, 58 per cent in cardamoms, 47 per cent in vegetables, 38 per cent in unmanufactured tobacco, 31 per cent in essential oils, 14 per cent in cloves, 12 per cent in betel leaves, 3 per cent in fruits and 67 per cent in others. The drought is likely to have caused a further drop in production in 2001. Several minor agricultural exports like coffee, cardamom, sesame seed, other oil seeds, cocoa products and cashew nuts may cease to be exported in the near future if the current trends continue.

**Drop in Tourist Arrivals & Migrants Transfers**

Tourist arrivals which declined from 436,440 in 1999 to 400,414 in 2000 or by about 8 per cent are expected to drop further particularly as a result of the global downturn and the fear created by terrorist attacks at Katunayake airport. In the first ten months of 2001 tourist arrivals were 10.5 per cent less than in the corresponding period in 2000, while migrants transfers (net) were 3.3 per cent lower. The country's foreign exchange earnings from both sources — tourism and migrants remittances are likely to show a marked drop in 2001.

#### Large Current Account Deficits and Fall in External Assets

Sri Lanka's average annual current account deficit in the balance of payments in 1995-2000 was 4.1 per cent of GDP which was higher than India's average deficit of 1.2 per cent of GDP and Bangladesh's 2.0 per cent of GDP. In 2000 for example, the current account deficit was $ 989 million or 6.0 per cent of GDP caused mainly by a large trade deficit of $ 1798 million. The current account deficits have been filled mainly by using the country's official foreign exchange reserves which fell from $ 2063 million in 1995 to $ 1202 million in September 2001 or by 42 per cent. Actually, official foreign exchange reserves fell to as low as $ 942 million at the end of March 2001 — the equivalent of 1.6 months' imports. The IMF standby of $ 131 million in April however boosted the reserves to $ 1202 million by September — the equivalent of 2.3 months of imports which is still rather low. Total external assets, *i.e.* including those of commercial banks have fallen from $2902 million at the end of 1995 to $ 2131 million at the end of 2000 and risen slightly to $ 2240 million by October, 2001.

The large current account deficits are also a major cause of the depreciation of the rupee from $ 1 = Rs. 54.0475 in 1995 to US $ 1 = 74.3235 in 2000 and US$ 1 = Rs. 92.7400 in November 2001. The constantly depreciating rupee tended to increase prices of all imported goods and raise the general price level in the country.

#### Trickling Foreign Investment

The liberal tax reliefs and other generous concessions offered by the government had not been successful in attracting foreign direct investment (FDI) on a large scale. The total amount of FDI received by Sri Lanka in the six years 1994-1999 amounted to $ 1142 million in contrast to the $ 22,451 million received by Malaysia (which has a population of 22 million, a little bigger than Sri Lanka's 19 million). Sri Lanka has received only about one-twentieth of the FDI Malaysia had got. The highest annual amount of FDI Sri Lanka received, in the six years was $177 million in 1999 (which was lower than the $ 187 million in 1993) but it declined to $ 173 million in 2000. FDI inflow is likely to be less in 2001 on account of the global downturn and uncertainty created by both terrorist attacks on the airport and the general elections. It is also important to note that FDI contributed to only 5.6 per cent to the gross fixed capital formation in Sri Lanka in the six years as compared to 18.3 per cent in Malaysia. Investment in all countries is financed mainly by domestic savings; the expectation of substantial FDI inflows has led to the neglect of measures to raise domestic savings.

#### Outflow of Portfolio Investments and Collapse of the Share Market

The all share price index of the Colombo Stock Exchange declined from as high as 987 at the end of 1994 to 572 at the end of 1999 and then to 503 in mid-November 2001. The main reason for the fall is the withdrawal or net sales by foreign investors — by Rs.1.5 billion in 1998, Rs.0.9 billion in 1999 and Rs.3.4 billion in 2000 — due to lack of confidence.

#### Rising Prices

Consumer prices in Sri Lanka increased at a higher rate than all the other South Asian countries in the six years 1995-2000. They increased by 8.9 per cent a year on the average in contrast to 8.8 per cent in Pakistan, 7.8 per cent in Bhutan 7.1 per cent in Nepal, 6.2 per cent in Bangladesh and 5.5 per cent in India and 3.3 per cent in Maldives. They rose by 6.2 per cent in 2000 and were rising at around 14 per cent per annum in 2001 or double the rate in 2000. The annual average price increase in November 2001 was 14.2 per cent as compared to 6.2 per cent in November 2000. A major reason for price increase is the large-scale deficit financing. Cost of credit rose from 1995 to 2000. Central Bank figures show that the Bank Rate has risen from 17.00 per cent to 25.00 per cent, Inter-Bank Call Loan rate from 14.00-28.00 to 20.25-32.00 and the Weighted Prime Lending Rate from 17.80 per cent to 21.46 per cent in this period. In 2001 interest rates appear to have been artificially lowered despite heavy government borrowing presumably to help the government.

#### Yawning Budget Deficits

Deficit financing is a regular feature in South Asia. The country which has been having the largest budget deficits in the period 1995-2000 is Sri Lanka; its average annual budget deficit was 9.0 per cent of GDP which exceeded those of all other countries. Pakistan 6.5 per cent, India and Bangladesh 4.8 per cent, Nepal 4.3 per cent, Maldives 3.4 per cent and Bhutan 0.8 per cent. This large-scale deficit financing in the last six years bears testimony to the poor fiscal management by the Sri Lankan authorities. The budget deficit in 2000 was 9.8 per cent of GDP and the target deficit for 2001 according to the Budget Speech, is 8.5 per cent of GDP, but the actual figure is expected to be 10.5 per cent of GDP. The budget deficit in 2001 is estimated at Rs. 149 billion much higher than the estimated budget deficit of Rs. 123 billion. The deficit had increased rapidly with the pre-election concessions and reliefs granted to win over the people: increase in salaries by granting an interim allowance of Rs.1,200 to all public servants including teachers and Rs.750 for all pensioners from 1st October, increase in Samurdhi benefits by Rs.100-200 a month and the allocation of Rs.150 million to provide loans to beneficiaries, new consumer subsidies for wheat flour and gas and reducing the price of kerosene by Rs. 2.00 a litre; abolition of import duties on raw materials, reduction of tariff on cement from 25 to 15 per cent and reduction of port tariffs on milk powder and milk food by 18 per cent, on fertiliser by 19 per cent and reduction of export tariff on textiles by 34.8 per cent and coconut products by 31 per cent; abolition of the diesel tax and Save the Nation contribution and the reduction of the National Security Levy from 7.5 per cent to 6.5 per cent and the turnover tax on bank loans by one percent and compensation of Rs. 21.3 million to the victims of civil riots at Mawanella.

The yawning budget deficit was being financed in the usual manner by borrowing. Government borrowing from the banking system amounted to Rs. 45 billion although the Budget estimates indicated that there would be no bank borrowing. The large-scale bank borrowing is one of the major causes of inflation, which as mentioned earlier is increasing at the rate of around 14 per cent a year. It has also resulted in the increase in government's domestic debt by Rs. 154 billion from Rs. 625 billion at the end of September 2000 to Rs. 779 billion at the end of September 2001; government's debts to the banks rose by Rs. 61 billion from Rs. 165 billion to Rs. 226 billion in this period.

## Rising Public Debt

Government debt has reached high and worrisome levels. It rose from Rs. 552 billion at the end of 1994 to Rs. 1219 billion at the end of 2000 or 97 per cent of GDP and to Rs.1,372 billion in August 2001. With the rapidly increasing deficit and borrowing to fill it, public debt had exceeded the GDP for 2001. Higher the public debt higher the interest; in 2000 interest payments were Rs.71.2 billion and they accounted for one-third of government revenue. They were estimated to rise over Rs.90 billion by the end of 2001 or nearly 35 per cent of revenue or over 6.3 per cent of GDP. Higher interests normally lead to higher taxation to increase revenue.

## Emasculation of Public Investment

In accordance with the neo-liberal philosophy of withdrawal of the state from economic activity, public investment has been reduced from 7.9 per cent of GDP in 1995 to 6.4 per cent in 2000. Budget Estimates expected to raise it to 7.4 per cent of GDP in 2001 but this was too optimistic. The target for 2000 in the previous Estimates was 8.1 per cent but the actual turnout was 6.4 per cent. Further capital expenditure is likely to have been reduced drastically to meet the cost of the pre-election concessions and reliefs. Containing or reducing capital expenditure relatively means less investment in the economic and social infrastructure, which will tend to slow economic growth. Public investment does not crowd out private investment; on the contrary, it stimulates private investment both by improving the infrastructure and providing contracts and sub-contracts in state development projects. Downsizing of the public sector resulted in the loss of employment to 168,884 employees; total public sector employment fell from 1,325,164 in 1994 to 1,156,280 in 2000 disproving the claim that there was no retrenchment in the public sector in the last six years.

## Downturn in Business and Unemployment

Free imports in the open economy has resulted in the weakening or closure of many small and medium industries producing import substitutes. The Small and Medium Entrepreneurs' Lanka Organization (SMELO) had informed the government that more than 745 small and medium scale enterprises had closed down during the last six months of 2001. It stated further that every month at least hundred of small enterprises were shutting down due to the absence of proper economic polices to safeguard these industries. In the shoe industry for example, it was reported that half of the ten big producers had closed down while Bata was suffering losses and further, many of the 1000 small producers were surviving with difficulty. Free imports of tyres and tubes, sanitaryware, hardware and many others were also affecting local manufacturers adversely. To make matter worse, the fall in demand as a result of the US recession had serious effects on the garments industry. The Sri Lanka Chamber of Garments Exporters has reported that 250 out of the 850 factories involved in garments exports are currently operating below 50 per cent capacity and some of the factories were paying half-month wages. The import duty concessions extended by the US to Mexico and the Sub-Saharan African countries and the likely concessions to Pakistan were expected to hurt Sri Lankan garments exports further. The Chamber had warned of the possible closure of at least 50 factories in the following weeks on account of falling orders. The Chamber therefore had requested assistance from the government in the forms of using the cess on garments exports to pay salaries of their workers, suspension of loan repayments and reduced interest rates, rebate on electricity charges in terms of capacity utilization, refund of war risk premia on Marine and Airfreight and reduction of the terminal handling charges. Tourist hotels too had sought state assistance to overcome the difficulties they were facing on account of the fall in tourist arrivals.

The Labour Department reported on "unprecedented" number of applications seeking permission to closure or lay off staff from firms struggling against the economic downturn. There had been 35 such applications in the last three months of 2001, mainly from firms in the apparel and tourism sectors. There may have been many other cases — not reported to the Labour Department — of staff being asked to stay at home on paid leave. Some economists estimated Sri Lanka's unemployment exceeded 10 per cent of the labour force and it was likely to rise with the global downturn and the falling demand for Sri Lanka's exports.

## Chicken and Three-Wheelers!

The increasing population and the increase in employment and income tend to result in increase in consumption and increase in imports. The population increased from 16.6 million in 1988 to 17.6 million in 1993 and then to 19.4 million in 2000 while per capita GDP rose by 6.2 per cent between 1988 and 1993 and by 6.9 per cent between 1995 and 2000. Thus, the increase in consumption including chicken and increase in imports including three-wheelers is not a new phenomenon — it is a process which has gone on for years. It is not only the number of three-wheelers, which have increased, but also the number of motor cars, buses, lorries, vans and motorcycles. The number of new registration of motor vehicles in the six years 1995-2000 was 543,757. This does not mean that there were no motor vehicle imports in the previous years. In fact, the new registrations in the six years 1988-1993 was 503,297. It is not only motor vehicles but all imports increased over the years. The total value of imports increased from $ 5311 million in 1995 to $ 7320 million or by 38 per cent but the total value of imports rose from $ 2233 million in 1988 to $ 4011 million in 1993 or by 80 per cent. Does the greater increase in imports in the earlier six years indicate that they were more prosperous than the later six years?

The interesting point, however, is that the increase in imports in 1988-1993 was accompanied by an increase in the official foreign exchange reserves by $ 1397 million whereas the increase in imports in 1995-2000 appears to have been financed partly by using the foreign exchange reserves which fell by $ 861 million in the period. Official reserves rose from $ 278 million in 1988 to $ 1675 million in 1993 but they dropped from $2063 million in 1995 to $ 1221 million in October 2001. Apart from using up foreign exchange reserves to the extent of $ 861 million, the authorities increased foreign borrowing by $ 236 million between 1995 and 2000. The pursuit of amateurish policies based partly on political expediency, and partly on preference for foreign enterprise over indigenous enterprise and downsizing the state's role in guiding, building up and protecting the economy to complement private enterprise (as in East Asia) economic mismanagement at all levels, the absence of a full-time Minister of Finance and widespread corruption, cronyism, lawlessness and injustice had all contributed to the economic crisis.

## PART II
## Invigorating the Economy

The new government is facing a daunting economic situation of declining production and investment, negative growth, falling exports, tourist arrivals, migrants transfers and external reserves, yawning budget deficit, rising prices and trade unions agitating for higher wages. The challenge before the new government therefore is to arrest the economic decline, remedy the shortcomings, stabilize the economy and push it onto the path of development by sound economic management. The objectives are clear: to increase investment, production, exports, tourism and external reserves, to reduce the budget gap, arrest the inflationary rise in prices and deal with the trade unions, but the crucial question is whether the legacy of incompetent economic management, and the prevailing adverse external environment will permit quick solutions.

### The Budget

The first thing the new government has to do is to prepare the Budget for 2002, for without it the government will not be able to spend money this year. In preparing this budget the government needs to provide adequate funds for current as well as capital expenditure of government without creating a large budget deficit. One of the major reasons for the economic mess today is the excessive budget deficits exceeding 10 per cent of GDP in 2000 and 2001. Excessive deficit financing needs to be reduced and this can be done by cutting unnecessary or low priority and wasteful expenditure on the one hand and increasing revenue on the other. Some of the unnecessary and wasteful expenditure which can be cut without any adverse effect on the economy or the people are the new luxury buildings in Kotte, fleets of a dozen or more motor vehicles used by ministers and unnecessary travelling, subsidized meals for Members of Parliament and high rents paid to luxury buildings used as ministry offices, but these are not enough. Consequently, measures need to be taken to raise revenue. Tax revenue has declined from 17.8 per cent of GDP in 1995 to 14.5 per cent in 2000 as result of tax reductions when the escalating war expenditure warranted higher taxation. Average import duty for example was reduced from 9.6 per cent in 1994 to 7.0 per cent in 1999 and then to 4.5 per cent in 2000. This is a very low ratio when compared to developed countries. The ratio of tax revenue to GDP exceeds 50 per cent in Sweden, 40-50 per cent in Denmark, Finland, Belgium, France, Italy, Netherlands and Norway, 30-40 per cent in Germany, Britain, Canada and Switzerland and 20-30 per cent in US, Japan and South Korea. Tax revenue must be increased and the most feasible ways seem to be an increase in a progressive way, income taxes and increase on a selective basis, import duties, excise taxes and goods and services taxes. Taxation should be progressive and the burdens should not be imposed on the lower income groups as far as possible. Normally, a new government would not like to increase taxes, but the fiscal situation is such that it does not have an alternative. It should at least begin by eliminating the current account deficit or the excess of recurrent expenditure over revenue, which was 3.4 per cent of GDP in 2000.

There are several other ways of reducing expenditure, but they are long-term measures and are not feasible in the first budget. Military expenditures accounting for about 17 per cent of the total expenditure (Rs. 71 billion in 2000 alone) can be reduced only by halting the war against terrorism and this is likely only through protracted negotiations. Besides, rehabilitation and employment-creation for the demobilized soldiers are likely to absorb a good part of the savings from ending the war. Subsidies and transfers account for about 10 per cent of the total expenditure but being sensitive items, they too cannot be reduced from the word go. The Samurdhi benefits for example are enjoyed by half the country's population when only a quarter are in actual poverty; this scheme needs to target only those living below the poverty line but this will be bitterly opposed by those already enjoying the benefits. Appropriate measures to tackle this problem can be formulated — but not immediately. Subsidies to loss-making state-owned corporations can be stopped but it will result in unemployment — a prospect not to the liking of a new government. It is therefore necessary to take measures to increase the efficiency of state-owned enterprises to enable them to generate a surplus for government revenue. What is most important is to appoint independent and commercially oriented boards of directors to these enterprises and to stop politicizing them as in the past. Both India and China are restructuring their weak state-owned enterprises — not privatizing them as we have been doing; state-owned corporations in countries such as Taiwan and Singapore generate substantial revenue to the government; they are assets not liabilities and a source of income to which we have not paid enough attention.

Foreign loans and grants are generally for public investment and further are project related and they are normally not extended for recurrent expenditure and budget support. The government should negotiate them for some of their new projects and programmes, but they are unlikely to help the government in reducing the current budget deficits although they may help to reduce inflationary bank borrowing.

### Economic Growth

Perhaps the most important determinant of economic growth in Sri Lanka is rain: good rainfall generally results in high growth and drought spells low growth. If the current thunderstorm rains and the North East monsoon rains result in a good Maha crop, the new government can start on a firm footing. If power supplies and production are not interrupted by the failure of the South west monsoon this year, that will contribute to higher production. No one can predict what the rainfall will be this year, but unless there is adequate rainfall the current trend of declining production of paddy, subsidiary crops, tea, rubber, coconut and spices as well as industrial output will continue. The second major determinant of economic growth is the external demand for our exports, which determines the export prices and our export earnings. Exports are equal to about one-third of the GDP. Generally, high expansion of exports, like good rainfall, tends to promote high growth. A study of the figures of structure of the Gross Domestic Product and its annual changes indicates that economic growth is affected mainly by three factors: paddy output (depending on local rainfall), tea exports (depending on rainfall but more on world market) and textile and clothing exports (depending on the world market demand).

**Key Determinants of Economic Growth 1990-2000**
**(% Annual Changes)**

| Year | Change in Real DGP Growth | Change in Paddy Sector | Change in Tea Sector | Change in Factory Industry Sector |
|---|---|---|---|---|
| 1990 | 6.2 | 21.3 | 12.6 | 10.2 |
| 1991 | 4.6 | -5.9 | 3.2 | 9.5 |
| 1992 | 4.3 | -2.0 | -25.7 | 13.0 |
| 1993 | 6.9 | 9.6 | 29.6 | 11.3 |
| 1994 | 5.6 | 4.7 | 4.4 | 8.8 |
| 1995 | 5.5 | 4.7 | 1.6 | 10.0 |
| 1996 | 3.8 | -26.7 | 5.1 | 7.3 |
| 1997 | 6.3 | 11.2 | 7.1 | 10.3 |
| 1998 | 4.7 | 18.3 | 1.1 | 7.6 |
| 1999 | 4.3 | 6.6 | 1.3 | 4.5 |
| 2000 | 6.0 | 4.2 | 4.0 | 9.3 |

*Source:* Central Bank Annual Reports

There were four years in the nineties which experienced high growth of 6.0 per cent and above — 1990, 1993, 1997 and 2000 — five years which had below 5 per cent growth — 1991, 1992, 1996, 1998 and 1999 — and two years with growth between 5.0 and 6.0 per cent — 1994 and 1995. In the high growth years, all the three sectors — paddy, tea and clothing — combined to bring about high growth in three years: 1990, 1993 and 1997; in 2000, paddy and tea showed moderate growth but clothing compensated for that by achieving high growth. In the moderate growth years too, it was clothing exports, which showed high growth while paddy and tea experienced moderate growth. Actually, tea did badly in 1995, but it was offset by the jump in clothing exports. Coming to the low growth years, high growth of clothing failed to offset the marked fall in paddy production in 1991, 1992 and 1996 and the decline in tea production in 1992 and low growth in 1991; in 1998 and 1999, paddy production recovered but production of tea slowed down and prices actually fell in 1999; clothing exports too showed a moderate growth in both years, particularly 1999. Thus, the economic picture for 2002 will be shaped by rainfall as discussed above and the world economic situation, which determines the fate of our exports.

### Adverse External Environment

The global downturn and the terrorist attacks in the US and the war against terrorism, according to the World Bank, are expected to result in a low economic growth of 1.4 per cent in the developed countries in 2001 and about the same in 2002. Economic growth in the US is estimated to fall from 1.0 per cent in 2001 to 0.6 per cent in 2002 and in the Euro area from 1.5 per cent to 1.0 per cent. The developing countries which achieved an economic growth rate of 5.5 per cent in 2000 are expected to have only 2.9 per cent growth in 2001 and about the same in 2002. This means slower growth in the world for Sri Lanka's exports than even now. In the first ten months of 2001, Sri Lankan exports in dollar terms, were 9.1 per cent less than in the first ten months of 2000: agricultural exports were 5.8 per cent lower and industrial exports 9.6 per cent lower, with textile and apparel exports 11.4 per cent lower. Further, prices of exports are now lower than last year: dollar prices of tea, for example, in October 2001 was 17.5 per cent less than a year ago and the unit value of total exports in July 2001 was 11 per cent lower than a year ago.

With the downturn deepening, indications are that our exports will continue to decline in 2002 too.

The World Bank estimates a fall in private capital flows to developing countries too, on account of the downturn and terrorist attacks in the US and war against terrorism, from $ 240 billion in 2000 to $ 160 billion or by 33 per cent in 2001. The picture is unlikely to show an improvement in 2002. Foreign direct investment to Asia alone is estimated to decline by 12 per cent this year. Both developed and developing countries experiencing low growth will be less able to invest abroad. The major foreign investors in Sri Lanka are the NICs in Asia such as South Korea and Singapore but they are all experiencing difficulties with the sharp fall in their electronic exports to the US and consequently will have less capacity to invest abroad. Singapore in fact as shown earlier had a negative growth of 2.2 per cent in 2001 — the worst performance in the country's 36-year history and is estimated to experience between negative 2.0 per cent and positive 2.0 per cent in 2002, in contrast to 9.9 per cent growth in 2000. The number of people made bankrupt reached a record 2904 in 2001. South Korea is expected to have less than 2 per cent growth and Hong Kong negative growth of minus 0.2 per cent. Japan, which continues to be in deep recession and will have a negative growth of 0.8 per cent in 2002, too will be investing less overseas. In addition to foreign private capital, official development assistance too is expected to fall this year and the next with main donors mired in the slowdown. Currently aid claims only 0.22 per cent of the GNP of developed countries far short of the 0.7 per cent goal agreed to by the international community, but even this low figure is likely to fall further. Japan, the largest giver of ODA has cut its ODA budget for 2002 by 10 per cent. The global slowdown and the terrorist attacks are also expected to cause a sharp decline in tourism. Tourist arrivals in Sri Lanka in the first ten months of 2001 were 10.5 per cent lower than in the corresponding period in 2000. Uncertainty and fear of war in the Middle East may reduce the demand for foreign workers; in fact migrants' transfers are already declining: net inflows in the first ten months of 2001 show a fall 3.3 per cent. It appears as if Sri Lankans may not find employment opportunities in the Middle East as before and this will tend to aggravate the problem of unemployment.

**Domestic Investment**

If the external situation is unfavourable, can we stimulate the economy by increasing domestic consumption and investment which account for about two-thirds of the GDP; Consumption is already high and it accounts for 83 per cent of the GDP: besides, further increase in consumption will result in more imports and strain the balance of payments and reduce our external reserves. As it is the high level of consumption which reduces the resources available for investment, the appropriate approach is to not to increase but reduce consumption in order to expand investment. Sri Lanka's investment has been about 25 per cent of GDP in the last six years whereas that of East and South East Asian countries has been 35 to 40 per cent before the currency crisis. This relatively low level of investment has resulted from the low level of gross domestic savings in Sri Lanka, averaging about 17 per cent of GDP in recent years as compared to 30 to 50 per cent in East and South East Asian countries. Some of these countries have been receiving substantial foreign direct investment too, particularly Singapore, Hong Kong, Malaysia, but FDI has accounted for only about 7 per cent of the gross fixed capital formation in Thailand and below 3 per cent in Taiwan and South Korea in the nineties, bearing testimony to the importance of domestic savings. One of the surest ways of increasing savings is to achieve budget surpluses by measures to reduce current expenditure and to raise revenue which were discussed earlier. Current budget deficits, as shown earlier, are about 10 per cent of GDP. Budget surpluses would enable the government to make further improvements in the economic and social infrastructure and at the same time to expand the production base of the economy by establishing industrial undertakings which are shunned by the private sector, not to compete with private enterprise but to complement it.

Private investment may be deterred by the unfavourable external environment, particularly its effect in reducing exports and foreign capital inflows, but there is much scope for import substitution industries. It is unfortunate that for several years, the authorities concentrated on export industries and neglected import substitution industries, instead of encouraging both as Japan, and East and South East Asia have been doing. Further, import substitution industries of today can become the export industries of tomorrow as some of our early import substitution industries like garments, biscuits, rubber products, ceramics and leather products have demonstrated. Import substitution industries, like domestic food production, however, may not be able to get off the ground if imports are allowed freely: they need to be protected by selective restrictive measures and supported by concessional credit and subsidies at least in the initial stages. The developed countries like the US protect their weak industries even today, for example, steel, textiles, clothing, automobiles, sugar, groundnuts and tobacco. As the world market for exports has weakened, we have no alternative but to develop and expand import substitution industries to provide employment and income to the rising unemployed while conserving foreign exchange and increasing government revenue through higher import duties. It is difficult to see why we are importing cement, building glass, sanitaryware, hardware and rubber goods on a large scale when we can produce them here. What is blocking import substitution industrial development is our "free trade" mindset and our mistaken belief that import substitutes are necessarily of poor quality. Can anyone really say that our import substitutes like biscuits, chocolates, garments, ceramics and rubber and plastic goods are inferior? The new government should therefore review our industrial policy, taking into account the external situation, not only with the objective of conserving foreign exchange but also of expanding the country's production base to create employment and income and accelerate growth.

### Inflation

One of the major reasons for the inflationary rise in prices — 13-14 per cent a year — is the increase in import prices, by as much as 16 per cent in 2000, on account of higher prices in the supplying countries and depreciation of the rupee. Although we are powerless against price increases in the world market, we could stabilize the rupee by increased production and sound fiscal policy. Another is the excessive budget deficit, which we must try to reduce in order to stabilize prices. Yet another is inadequate production and excessive middlemen's margins in items like vegetables and fruits. As the production of potatoes, chillies, pulses, red onions, maize and others have fallen in the last six years, vigorous efforts need to be taken to step up their production. It is to bring down their prices that the cooperatives, Markfed and the Marketing Department were used to provide competition by the authorities in the past. It is not too late for the new government to at least revive Markfed and the cooperatives which played an important role in ensuring reasonable prices to the consumer as well as the producer. The role of cooperatives was neglected under the free market policies of recent years but the extensive use of the CWE to purchase and sell grains, vegetables and fruits is clear proof that the free market had not been a success; the role of the cooperatives needs to be restored. In fact one of the principal reasons for the demand of trade unions for higher wages is the high cost of living and this can be tackled to some extent by arresting inflation, increasing production and sale of vegetables and fruits through Markfed and the cooperatives in competition with private trade. The successful efforts made by the new Minister of Commerce and Consumer Affairs to reduce the prices of milk powder, tyres, batteries, cooking gas and diesel oil by persuasion rather than by fiat are laudable; price reduction of more items is envisaged by the Minister in the same way in the near future.

It will be difficult however, for the new government to resist higher salaries and wages, particularly if the Salaries Commission in fact recommends their increase. Further, a part of the salary increase has already been given by way of the interim allowance of Rs.1,200. As an increase in salaries and wages in the public sector will enlarge the budget deficit, the authorities may have no alternative but to find the required funds from higher taxation. The authorities should not insist that the private sector too pays these higher wages as a large number of firms are in difficulties because of the world economic downturn and are clearly unable to pay them. In the tea sector for example, it is not possible to pay higher wages when world tea market prices are falling; in fact, they have, as shown earlier, declined by 17.5 cent in the last 12 months. Export prices are also falling in other agricultural exports and garments and some factories have been closed down.

### The IMF

The new government will find it very difficult to implement the reforms prescribed by the IMF in March 2001 without creating public unrest. For example, it may not be in a position to raise prices of petroleum products when the trade unions are already complaining of the high cost of living; it may not be able to undertake reforms in the labour market to facilitate greater mobility if the trade unions which have presumably supported the governing party at the election, are opposed to it. It will, for reasons discussed earlier, not succeed in freezing public servant's salaries and wages and it may find it difficult to privatise Shell and Telecom shares if the same trade unions do not support it. Besides, the stock market may not be favourable in the context of the global downturn. It behoves the new government therefore to convince the IMF of its difficulties and attempt to modify the reforms agreed to by the previous authorities. The IMF, it is reported, has become less rigid in its orthodox recommendations, and there is no reason why it should not appreciate the difficulties of the new government and approve new policy measures it may formulate while releasing the balance $ 122 million of the tranche and recommending other donors to release loans amounting to $700 million withheld on account of the unsound policies.

Make no mistake, the balance of payments is going to be critical this year with the continuation of the global economic downturn, recession in Japan and uncertainty and fear created by terrorism. Our exports will continue to face bleak export markets and our export earnings are likely to decline. This will be compound by the reduced inflow of migrants' transfers on account of the uncertain situation in the Middle East and the decline in tourism and foreign capital inflows. Unless imports are restricted, these adverse factors are bound to enlarge the deficit in the balance of payments and reduce our external reserves. In such a situation we may not have an alternative other than borrowing from the IMF. It is of crucial importance therefore to prepare the groundwork now regarding negotiations with the IMF. The government will have to face the dilemma of placating the IMF with at least some unpopular reforms in order to obtain assistance on the one hand and avoiding public unrest by taking such measures on the other. A middle path needs to be worked out with the help of the leading economists and negotiators to keep both sides happy.

It is hoped that the IMF, on its part, will follow the advice of Stanley Fischer, the former first deputy managing director at the IMF and its chief crisis manager until last August, given in his article on "What I learned at the IMF" in the **Newsweek** special edition December 2001-January 2002 as follows.-

"The role of the international institutions should be to support and advise, not to hector and impose. To that end financial support should not have too many strings attached. For the IMF this means confining conditions to what is necessary to get the macro economy back on an even keel and to get financial and other key markets working properly".

# Governance & the Economy

## *Sri Lanka's Challenge*

**The Background**

The need to reverse the stagnation in the country's economy and to set it on the path to recovery and growth is a constant refrain that is heard in Sri Lanka today. The cry, whilst it is legitimate, tends to overlook the reality that effective governance is a condition precedent to ensuring that the decline in the economy is reversed and it is placed on and nurtured in the path to growth. There is, all too often, a tendency to place effective governance and economic growth on parallel paths and to ignore the close nexus that exists between them.

It is the underlying premise of this discussion that the above perceptions that have guided efforts at economic development in Sri Lanka in the past have, in no small measure, adversely affected the pace of economic growth and contributed to its later decline. Hence, the objective of this discussion is to underline the co-relation as between restructuring of governance in Sri Lanka and its essays in economic development and to suggest several critical steps that should be taken to effect such a restructuring.

It is not that the Sri Lankan discourse has by-passed matters of restructuring of governance. More than a decade and half has passed since discussions on restructuring of governance came to be common place in Sri Lanka. This preoccupation with the issue of restructuring of governance was triggered, mainly, by the outputs of the Administrative Reforms Committee in 1986-1987. Hardly a day passes without a reference in the media, a pronouncement from different levels in political institutions, a representation from a public sector trade union or a plea from a civil society organisation – all referring to the need for restructuring of governance. However, whilst references, pronouncements, representations and pleas are repetitively commonplace, there has been no commensurate achievement. The recommendations of the Administrative Reforms Committee remained, in the main, confined to its reports. Subsequent essays in reforms in governance in the mid-Nineties fared no better.

**Dr. H. Shelton Wanasinghe**

The archaic institutions, systems, structures and processes of governance – together with their human resources underpinning – have, thus, succeeded in their efforts at survival. As a result, Sri Lanka, in 2002, continues to be burdened with institutions, systems, structures, processes and personnel that are irrelevant to the current demands of economic and social development. Not only are they irrelevant. They constitute a major impediment to the country's aspirations to reverse its decline and to position itself on a path to growth.

The ability of institutions, systems, structures and processes to survive is an indicator of the strength of the vested interests that support them. These vested interests dominate the polity and the bureaucracy and, at times, are even seen in segments of the private sector that derive benefits from their ability to manipulate them. The nature of these vested interests is illustrated in several examples.

Given the disparity between job aspirants and job availability in the market, the public sector is viewed by the political cadres as the employment provider of last resort – enabling them to gain political advantage through the provision of public sector jobs. The relevance or otherwise of the positions in question to the requirements of the current functions and tasks of governance becomes an issue of irrelevance to political decision-makers.

The administrative system is replete with institutions and structures that are no longer relevant in the context of a market-led economy, a devolved polity and the primacy of citizen's choice as the basis for ensuring equity in the provision of public goods and services. Political cadres, as could be expected, brush aside the issue of relevance so that these structures that both generate employment for supporters and confer a 'power status' to the political elite could be maintained. The bureaucrats have an equally strong interest in the continuance of irrelevant structures to ensure the continuance of employment.

Archaic bureaucratic systems and procedures that both delay and add to the costs of economic operations are, similarly, left unchanged due to opposition from both political cadres and bureaucrats who have vested interests in their continuance – the former because of the opportunity that they provide for granting of political favours and the latter because of the continued job opportunities that they offer.

The effect that the above have on deficits in the government budget, on the potential levels of taxation and, hence, on the economy are issues that are ignored by both these sets of vested interests.

It has not been uncommon to notice a high level of euphoria for restructuring of governance as Governments change. However, the initial euphoria for changes and reforms that would contribute to restructuring of governance tends easily to slide in to the accommodation of the existing systems and structures. The hard decisions that are inevitable in a process of restructuring are avoided. After a lapse of time, existing institutions, systems, structures, processes are found to be comfortable. Innovation connotes a fear of the unknown. It is also fraught with risk as well as demanding of time and effort. There is, thus, a slide into maintaining the status quo - unless an adequately strong countervailing thrust is brought to bear on them by the highest levels of the government or the organisations of the civil society or the private sector. None have been able to do so up to now.

The outcome is that the critical links between the level of effectiveness of governance and the pace and quality of development has continued to receive inadequate attention. The essential, and already delayed, restructuring of the institutions, processes and practices of governance as well as the development of the human resources that underpin them remain on the back-burner.

Within this context, it is germane to identify several of the critical issues that need to be addressed in an exercise in the restructuring of governance in Sri Lanka.

### The Role of Governance

The current ineffectiveness of governance flows from a continuing confusion as to perceptions of the current role of governance in Sri Lanka. The lack of clarity has its roots in layers of perceptions that have grown over the years. Over the post-independence decades, different situations in the colonial inheritance, in the immediate succeeding decades, in the post-1956 period as well as in the post-1977 years has contributed to this mix of perceptions. Each succeeding contribution came to be interwoven with those that were already there – yielding a 'patchwork quilt' of perceptions. In no period was there an attempt made to articulate anew the changed role of governance. Overhangs from the past eras continued to wield their influence despite demonstrated irrelevancies. What was attempted at each stage was to graft fresh roles on to existing structures. The inevitable outcome has been confusion.

Hence, the first step in a process of restructuring of governance is to clearly define the roles of governance. This should be in response to the current and medium term demands of economic and social development in Sri Lanka and the expectations of its citizens.

The citizens, concerned as they are with the realities of their daily lives, view 'development' as a holistic outcome. Such an outcome, underpinned by economic growth, is expected to provide them with

- Rising income levels and an increasing access to gainful employment;
- Expanded access to opportunities for education and skill development that are in line with advances in technology; as well as
- A steady improvement in the quality of life in terms of health status, environment and infrastructure.

An equally strong expectation of the citizens is that 'development' should result in a society in which –

- Their interests as consumers and as members of the workforce are adequately protected through regulation;
- Their environment rights are safeguarded;
- Law and order is effectively maintained and human rights are protected; and
- The legislative and executive institutions of the polity function with due heed to the democratic aspirations of the citizens.

Obviously, there is a priority need for a clear definition of the roles of governance. This constitutes a priority task for the Government – with the active participation of the Opposition in the Parliament, the institutions of the Private Sector and Organisations of Civil Society. Clarity as to the roles of governance, based on agreement and consensus is a pre-requisite for providing a stable base for the setting up of the structures of the polity and the bureaucracy.

### Overlap and Proliferation of Institutions

The Sri Lankan polity has, since 1987, evolved into a tri-level structure comprising the Centre, the Local Community and the Regions. However, there has been a failure to achieve any rational consensus on the specific roles and functions at each of the three levels. There has been a continued entrenchment of the culture of political and administrative centralisation that has been an overhang from the colonial regime and had been refined by successive post colonial governments.

This situation has been aggravated by the proliferation of overlapping institutions at the Centre itself – each contending for 'a piece of the turf' of public policy management, policy implementation and the delivery of public goods and services – to the bewilderment of the citizens.

The negative results that flow from the current situation are several. They include

- Avoidable excessive expenditure of public funds on unnecessary institutions and personnel thereby placing heavy burdens of taxation on the economy;
- Conflicts amongst political cadres as to specific roles and functions;
- Delays in the transaction of public business; and
- Procrastination in the making of public policy decisions and delays in implementing them.

Thus a priority activity in the restructuring of governance would be

- The carrying out of a clear and detailed specification of the functions and tasks of governance at each of the three levels of the devolutionary polity;
- The identification of the minimal structure of institutions and organisations at each level that are required to perform the specified functions and tasks; and
- A systematic scrutiny of all ad-

ministrative institutions that exist currently at each of the three levels in order to terminate those that are no longer relevant for the discharge of the new roles of governance.

Unless such a rigorous exercise is carried out Sri Lanka would continue to be burdened with a dysfunctional structure of governance that would be a constant impediment to effective economic management.

**Public Policy Management**

A cohesive, pro-active and objective process of public policy management that is transparent as well as the structures, processes and human resources that would support such a process are an essential pre-requisite to effective governance. Equally important are implementation arrangements at the micro level that could, in the contextual realities in the different spatial areas, ensure co-ordination as amongst the different interventions that emerge from the macro policies.

There have been major lacunae in regard to both pre-conditions over the post-Independence period. Ensuring that these pre-conditions exist is a challenge that has to be faced in any exercise in restructuring governance in Sri Lanka. In meeting this challenge, those who would plan and implement the restructuring of governance would do well to heed the current inadequacies in Sri Lanka's public policy management.

- Public policy management continues to be a reactive and an ad hoc, rather than a proactive, process. It also continues to be a unidimensional and fractured activity rather than a cohesive exercise that provides for the inter-relationships amongst the multiple concerns of development.
- The absence of a cohesive process of public policy management is contributed to by the proliferation of ministries at the Centre with sectoral concerns being arbitrarily distributed amongst several ministries. The multiplicity of ministries, each with a narrow span of responsibility, encourages them to be drawn to micro-manage the agencies that fall within their ambit – at the expense of their primary responsibility of policy management.
- Effective policy management is also hampered by the absence of an effective focal point that could articulate inter-sectoral relationships in issues that come before the Cabinet of Ministers for decision – a task that could be performed by an appropriately structured and staffed Cabinet Secretariat.
- Public policy issues have grown in complexity. Hence, those who carry responsibility for policy management need to be adequately equipped in terms of analytical skills as well as of the grasp of the wide spectrum of the specialised knowledge that relates to public policy issues. The organisations responsible for policy management are deficient in this regard. This results from their inability to attract the best talent in the market, aversion to using forms of personnel induction that would bring in the required talent, and inadequate capacity development.
- A further weakness in policy management lies in the fragmented nature of the implementation arrangements. They operate in isolated compartments that are designed to serve the interests of narrow bureaucratic structures and not in institutional arrangements that would optimise the potential for an overall response to the multi-facetted development needs of the citizens.

**An Agenda for Restructuring**

As seen from the preceding discussion, the ineffectiveness of governance continues to be a major negative factor in Sri Lanka's development equation. It is imperative that a comprehensive agenda of reforms be initiated and resolutely carried through as a matter of urgent priority. Given the neglect of the required reforms for two decades and more, it is inescapable that the agenda could no longer be incremental but would need to be radical.

Whilst the analysis of the details of such a radical reform agenda would, given its length, be out of context in this discussion, it would be appropriate to set out the key elements of the agenda. This would underline its far-reaching and radical nature.

In planning any exercise in restructuring governance, it is necessary to recognise the close interactive nexus that exists between the political and administrative sub-systems of governance. This is a factor that is, more often than not, ignored as an inconvenience. As a result the reform efforts that are launched tend to be lopsided, as they do not provide for reforms in both sub-systems in tandem. The structures and processes of the political sub-system, in which considerable vested interests abound, is treated as sacrosanct and patchwork changes are attempted in the administrative sub-system. The outcomes, naturally, are sub-optimal.

This approach needs to be reversed. Any reform agenda, if it is to yield the desired outcomes, should cover both the political as well as the administrative sub-system.

The future enhancement of public policy management demands a radical reform in the institutional structures and processes at the Centre where the responsibility for the role lies.

- Such a process of reform would call for a redefinition of the role of Ministries at the Centre with the new focus being on policy management.
- The new role of the Ministries cannot be effectively discharged unless their staffing patterns change in favour of policy professionals in preference to the large numbers of 'generalists' who currently clutter these structures.

**contd. on Page 31**

# Long Term Prospectives for Rural Employment and Poverty Programmes

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### Background & Introduction

Sri Lanka, being a low-income developing country, while committed to implement a structural adjustment programme, is attempting to strike a balance between growth and equity. In achieving these dual objectives, the policy encourages the private sector dominance in the productive economic activities, while the State continue to invest in human development activities. Those who are not generally benefited through the open market policies, are supported through welfare safety nets.

### Socio Economic Environment

During the first three decades since independence, Sri Lanka opted for a strategy of self-reliance, marked by a dominant State intervention in economic activities and heavy import substitution . However the country failed to achieve a major shift in economic development as witnessed in the developing countries in the Asian region during the 1970s/80s. Responding to the delay in development, the government in 1977 removed some of the structural constraints to accelerate economic development by introducing a programme of economic reforms. The reforms aimed at narrowing the gap with the newly industrialized economies relied on private sector driven, export-oriented mode of development.

From a predominantly agrarian economy (agricultural products tea, rubber and coconut-represented in 1980, 61.8% of total exports), over the years has turned into a successful exporter of manufactured goods (72.7% of total exports in 1997). As much of today's exports of manufactured goods such as apparels, are based on imported inputs, this underscores Sri Lanka's foray into international markets.

The average GDP growth during the last two decades since the economic reforms has been in the order of 5%. In the five years to 1997, it has risen to 5.6% , though commendable, the pace of growth is insufficient to sustain the catch-up the phenomenon expected to propel the country into the fold of the Asian tigers. On the positive side, the progress registered by Sri Lanka in containing population growth translates into more favourable indices of economic expansion per capita.

On the negative side, the country has been impeded for more than 15 years by a persistent secessionist conflict that has all but annihilated economic life in the North and North-eastern provinces, at the cost of a great share of the Government's budget. Exports of manufactured goods and the foreign direct investment are largely driven by the quota system prevailing under the Multi-Fibre Agreement. As the latter are due to phase out within the next decade, Sri Lanka will face tough competition from her South east Asian neighbours, aggravated by the combination of a vast pool of cheap labour and the recent competitive devaluations.

The policies adopted, both socially and economically has brought out mixed results. Two decades later, the country has recorded an appreciable progress. GDP per capita increased in 1997 to US $ 837 which places the country amongst the middle income developing countries. More notably, the country has continued to enjoy remarkably high rates of adult literacy, overall school environment, and a life expectancy at birth comparable to much richer industrialized countries.

### Unemployment

The unemployment rate in the country has declined to 9.5 percent in 1998 from about 15% in 1990. Total unemployed labour force is estimated to be 0.62 million, of which 0.28 million are men and 0.34 million are females. As a percentage, persons employed in agriculture have declined from 46.8% in 1990 to about 37% in 1998. Occupational categories of agriculture, livestock and fisheries are dominant in the rural sector.

As observed , employment –generation in the country outside agriculture sector has accelerated with high investment, both by the government and private sectors. The large public expenditure programmes, i.e. Accelerated Mahaweli, Free Trade Zone , and other construction projects, etc. , had been pushing up employment generation till mid-1980s and lost vigour and dynamism thereafter. The labour growth rates of the economy and non competitiveness in agricultural production correspond with the sluggishness and stagnation in the general investment/growth in the country.

(a) Participation rate of the Labour force has increased from 49.1% in 1993 to 51.9% in 1998. The rates have improved for both males and females.

(b) In absolute terms, the total currently employed labour force has grown by 614,825 between

1993 and 1998 a net annual increase of 122, 965. The unemployed labour force has declined by 207,713 during this period and a net reduction of about 41,540 annually.

(c) The share of labour force in agriculture has declined rapidly from 46.8% in 1990 to 37% in 1998 . The total number employed in agriculture has fallen from 2.36 million to 2.06 million, reflecting a withdrawal of nearly 13% from agricultural employment.

The ongoing work on poverty clearly indicates the overlap between unemployment, under-employment and poverty. Unemployed are not necessarily poor and the employed are not necessarily "not poor" . Many employed are unable to meet the basic needs of their families. Surveys indicate that nearly 90% of the households had their main income-earners classified as being employed. The poor, for the most part are the "working poor" . On the other hand, households with main income carners falling within the category of the unemployed and 'not in labour force' , comprised around 10 percent of the total poverty group.

**The Sectoral Pattern of Poverty**

The incidence of poverty in Sri Lanka was 27% in 1985/86, 22% in 1990/91 and 21.1% in 1995/96 using the lower (reference) poverty line (Table). The depth of poverty, which was 6.5% in 1985/86, reduced to 4.8% in 1990/91 and further declined to 4.5 in 1995/96. The severity of poverty, too, showed a similar pattern, declined from 2.3% in 1985/86, to 1.6% in 1990/91 and 1.4 in 1995/96.

The sectoral pattern of poverty shows that the incidence of poverty was highest in the rural sector, 24%; followed by the urban sector 18% and the estate sector 13%, in 1990/91. Though this pattern continued, in 1995/96 the incidence of poverty declined to 22.8% in rural sector followed by urban sector 12.3% and estate sector 11.8% in 1995/96. The depth and severity indices of poverty, too showed a similar pattern, with the rural sector suffering the greatest poverty. 4.8% and 1.5% respectively followed by the urban sector, 2.3% and 0.76% respectively ; and the estate sector, 2.5%, and 0.7% respectively.

The inter temporal pattern of poverty showed that poverty declined between 1985/86 and 1991/92 and these gains were further consolidated during the period 1991/92 and 1995/96. The all island incidence of poverty fell by 18% , between 1985/86 to 1990/91 and 5.6% between 1990/91 to 1995/96, the depth of poverty by 26%, and the severity of poverty by 30% during 1991/92 and by 11% between 23% in the rural sector and by 12% in the estate sector, but increased by 11% between 1990/91 and 1995/96. At the sectoral level, the incidence of poverty decreased by 23% in the rural sector and by 12% in the estate sector , but increased by 11% in the urban sector between the period 1985/86 and 1990/91. Some of these gains were consolidated further during the period 1990/91 and 1995/96, where urban poverty declined by 33% , Rural by 6.5% and Estate by 6.3% . Measuring the depth and severity of poverty, reveal that conditions improved in the rural and estate sectors but deteriorated in the urban sector. The most striking finding is that the severity of poverty in the estate sector decreased by 56% over a short period of 5 years between 1991/92 to 1995/96. The main reason for the fall in poverty in the estate sector is most likely to be the action of politically powerful trade unions and of pro-worker minimum wage legislation introduced by the government. In the urban sector, however, the general economic development and improved employment opportunities in industry and service sector contributed mainly for the reduction of poverty in that sector.

**TABLE-1**

**POVERTY IN SRI LANKA, ALL ISLAND AND SECTORAL NOVEMBER-DECEMBER 1995, JANUARY 1996**

| | Sample Size | Average Monthly Consumption Expenditure per capita (Rupees) | Incidence of poverty | Depth of poverty | Severity of poverty | Gini Coefficient of construction inequality |
|---|---|---|---|---|---|---|
| Ultra – Poverty Line= 717.09 rupees per person per month | | | | | | |
| Sri Lanka | 4,921 | 1,345,75 | 21.10 | 4.47 | 1.44 | 0.33 |
| Urban Sector | 936 | 1,774.78 | 12.27 | 2.34 | 0.76 | 036 |
| Rural sector | 3.615 | 1,283.70 | 22.84 | 4.87 | 1.58 | 0.32 |
| Estate sector | 370 | 1,076.16 | 11.86 | 2.48 | 0.74 | 0.18 |
| Poverty Line= 860.51 rupees per person per month | | | | | | |
| Sri Lanka | 4,291 | 1,345.75 | 32.79 | 8.20 | 2.94 | 0.33 |
| Urban sector | 9.36 | 1,774.78 | 21.48 | 4.84 | 1.62 | 0.36 |
| Rural sector | 3,615 | 1,283.70 | 34.84 | 8.85 | 3.19 | 0.32 |
| Estate sector | 370 | 1,076.16 | 27.12 | 5.25 | 1.67 | 0.18 |

**Note**:

Estimates are based on data from the first three months of the Household Income and Expenditure Survey, 1995/96, conducted by the Department of Census and Statistics. The survey was conducted in all parts of the country except the North , Eastern province, where the security situation precluded survey enumeration.

*Source:* HIES- 1995/96, Athurupana Harsha- Unpublished 1998.

TABLE 2

**INCIDENCE OF CONSUMPTION POVERTY BY SECTOR, NOVEMBER-DECEMBER 1995 – JANUARY 1996**

| | Incidence of poverty ( Lower Poverty Line) % | Incidence of Poverty (Higher Poverty Line) % |
|---|---|---|
| Sri Lanka | 21 | 35 |
| Urban sector | 12 | 21 |
| Rural Sector | 23 | 39 |
| Estate Sector | 12 | 27 |

Source: Aturupane, Harsha and Dileni Gunewardena , Poverty estimates for Sri Lanka , 1995/96.

TABLE 3

**RETURNS TO LABOUR, LAND AND NET PROFITS FROM RICE AND CHILLI CULTIVATION IN ANURADHAPURA , MAHA 1993**

| | RICE | CHILLI |
|---|---|---|
| | (PER HECTARE ) | |
| Return to land (Rs) | 7,231.0 | 14,365.0 |
| Income to family labour (Rs) | 8,595.0 | 21,308.0 |
| Person-days | 36.0 | 92.4 |
| Return per person-day (Rs) (2/3) | 236.9 | 230.7 |
| Gross return (Rs) | 29,883.0 | 51,619.0 |
| Total cost (Rs) | 30,123.0 | 50,160.0 |
| Net Profit (Rs) (5-6) | 240.0 | 1,459.0 |
| Profit rate(%) (7/6)* 100) | -0.8 | 2.9 |

Source: Non-plantation Crop Sector Policy Alternatives-Working Paper, 1995, the World Bank

### Rural Poverty

Sri Lanka is a rural economy in transition . Policy rigidities are coupled with economic problems in widening the gap between urban and rural areas. The impact of free trade and good side of liberalization has affected the lifestyles and income patterns of the majority living closer to the growth centres while rural economies dominated by non-plantation domestic agriculture suffered from 'bad' effects of liberalization and globalization.

A large majority of poor people in the country live in rural areas. The depth and severity of poverty are also highest amongst rural households. Individuals living in rural communities experience a variety of economic and social constraints, including shortfalls in access to productive assets like land and water, gaps in physical infrastructure like power, transport and communications, imperfectly functioning product and input markets, incomplete flows, inadequate technology and weak institutional arrangements.

Rural poor receiving a major share of income from agricultural activities encounter numerous economic problems. These problems are compounded and aggravated by their low human capital development, and have limited access to other forms of capital. The rural non-plantation agriculture have turned into a livelihood of many of them who failed to attract employment in the other sectors of the economy.

### Return to Factors of Production in Agriculture

Low return to factors of production in the rural non plantation agricultural sector appears to be a recent phenomenon. The gradual dismantling of the inward-looking tariff policy and the reduction of State protection to domestic non- plantation crop production, particularly to rice, which is still a major source of rural employment, accounting more than half of the rural employment, affected the livelihood and welfare of a large segment of farmers in rural areas.

Trade liberalization , though improved the consumer welfare and resource use, that decreases the profitability of many of the import competing crops. The reduction of profitability led to the reduction in production of certain agricultural crops and the farm incomes of certain group of farmers. This has serious implications to poverty amongst farmers who cultivate certain import competing crops in the rural sector.

To illustrate the nature of crop profitability in import competing non-plantation agricultural products, the World Bank Study (1995) have used two alternative definitions: (1) return land and (ii) return to family labour. Return to land is computed by taking out all costs (traded and non traded and family labour) except land from gross return (yield multiplied by price) . Return to land per hectare is Rs. 7,231 from rice and Rs. 14, 365 from chilli (Table 3) which shows that chilli production provides twice as much return per hectare as paddy production. The return per person day hectare shows that paddy provides higher return than chilli (Rs. 236 against Rs. 231). The two alternative measures of returns give two opposing views as to the efficiency of resource use in paddy and chilli production. However, it is important to note that investment on paddy and chilli production includes not just land and family labour but also other inputs purchased and used by the farmers. Therefore, the total cost of production is the investment during a season and net return is what farmers earn on that investment. The net profit as a percentage of total costs shows that chilli earns about 3 percent return on investment whereas return from paddy is slightly negative (0.8%) . On an average chilli earns a margin of 4% over paddy.

### Land Tenure

There are several limitations to the functioning of the land market in Sri Lanka. These limitations reduce the ability of the land market to allocate to its best use. Furthermore, most land is government owned. In consequence , tenants seeking alternative migration and reduces opportunities for new entrepreneurs willing to take risks and invest in more profitable activities in agriculture.

Land distributed by Government under a variety of "protected tenure" schemes, like land settlement schemes, colonization schemes and village expansion schemes, do not contain freehold rights. These lands cannot be sold, offered as collateral to Banks and financial institutions, or seized or foreclosed for debt repayment. Even where freehold rights exist , the practice of land titling is weak among poor families. This prevents land ownership being clearly demarcated among heirs.

Inability to sell land has meant that over time, through inheritance, land holdings have become highly fragmented. More than two-thirds of smallholdings are estimated to be less than 2 acres in size. Miniature farm holdings of this size are normally unable to produce an adequate income to sustain a family above the poverty line. Lack of private property rights constrain miniature farmers from selling their uneconomical holdings and relocating in pursuit of off-farm wage employment.

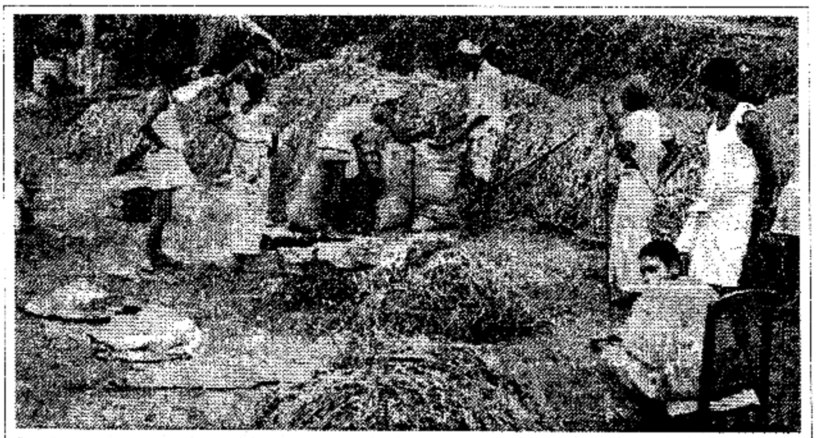
#### Labour Market

There are several regulations in the labour market in Sri Lanka. These regulations, which apply only to formal working relations, contribute to increase substantially the cost of labour to the private sector. Production of fruits and vegetables is a labour intensive activity and the high returns associated with cultivation of these crops should be substantially lower when the real private cost of labour is taken into account. Due to the high managerial requirements of activities such as production of fruits, vegetables and flowers, it is unlikely that the sector could develop without referring to formal labour contracts.

Another consideration with respect to the labour market is the apparent scarcity of labour for the agricultural sector. An indication of this is given by the increases in real wages observed in the economy. Real wages in paddy cultivation increased at an average rate of 1.1 percent per year (deflated by the Colombo CPI) during the period 1979 to 1993 (an overall increase of 16.3 percent). During the same period, increases in real wages were 1.4 percent per year for tea cultivation and 2 percent per year for the construction sector unskilled workers. (Sri Lanka Poverty Assessment).

#### Credit Market

NGOs An inadequate supply of credit to rural non-plantation crop sector is considered as an important constraint in agricultural development . Lack of credit, market rigidities and resultant high transaction costs put rural small holder farmers beyond the reach of credit. In rural areas there are three types of credit institutions, viz. (I) formal (ii) informal and (iii) a hybrid of informal and formal. The formal sector occupies mainly the two State Banks. The provision of credit through State Banks to domestic non-plantation crop sector in constrained due to large non-performance of small loans. Over the year "Loan forgivers" policy of the government , made the formal financial market credit operations additionally difficult. Several money lenders largely occupies the informal credit markets in rural areas. The volume of credit, however, is not well established. The high risk of operations and restricted supply pushed the interest rates of credit considerably high. The hybrid system is new and upcoming , occupies a small share of the rural credit market operating through and Co-operatives such as Thrift and Credit Societies.



Imperfections in credit markets also constrain production . Poor farmers encounter difficulties in obtaining credit for investment from formal financial institutions due to lack of collateral. This constraint has been partially eased by the availability of credit from government poverty alleviation programmers, rural development projects, NGOs and special lending schemes of Banks. However, a considerable proportion of credit needs of the poor (about 50%) are met from local money lenders. Interest rates charges by money lenders are very high, often exceeding 100% per year, so that poor families borrowing from such sources are likely to be further impoverished in the process.

#### Long Term Perspectives for Poverty Alleviation

The expansion of non-plantation crop sector is constrained by a number of market and non-market factors. A sound set of policies may require to move rural agriculture forward in the face of globalization and competition encountered through cheap imports. The effect of the market policies to the producers may affect negatively and the withdrawal of labour force from rural non plantation agriculture and deterioration of incomes of segment of agricultural workers appear inevitable to the short-term strategy to prevent further deterioration of farming incomes of rural households may prevail by encouraging those households to seek employment in off-farm employment.

Poverty-levels in Households, where at least some members are engaged in rural non-farm activities are generally lower than among households depending solely on agriculture, especially paddy. Ownership of rural enterprises and employment in rural industries normally yield higher returns than work on miniature farms.

Off-farm work also assists families to enhance incomes, diversify risk and reduce vulnerability. The expansion and growth of economic opportunities in rural non-farm activities are likely to be key ingredients in the future battle against poverty.

Expansion of economic opportunities for poor people in rural and services face several major obstacles.

**Shortfalls in physical infrastrucutre**

Inadequate infrastructure is the principal bottleneck to the future development of the rural non- farm sector. A considerable proportion of rural areas (over 70%) lack electricity. This severely restricts the range of equipment, machinery and tools that can be used in rural industries and services. In the absence of power, production activities are compelled to operate at a technologically primitive level, lowering productivity, output and incomes.

Rural areas experience large shortfalls in the coverage of modern communication methods. For instance, less than 15% of rural communities have telephone services or a (sub) post office. Even in areas where telephone services are available, these are often unreliable, with aged, low quality lines and equipment. Maintenance and repair services are also weak. The shortage of telephone and postal facilities hinders the development of rural industries and services above the level of small and cottage enterprises catering to localized markets. It also limits information available to the poor concerning economic and social opportunities outside their local community.

There are important gaps in the availability of transport in rural areas. The country has a large and extensive road network, with about 100,000 km of road length. The major proportion of these, approximately 80%, are rural roads. This network of roads provides reasonably comprehensive access to rural communities and villages. However, a small proportion of villages (between 5%- 10%), located in difficult terrain like jungle areas and tops of steep mountains, are isolated. These remote villages, many of small size with about 50 families or less, are among the poorest communities in the country.

Despite the extensive network of access roads, rural communities experience considerable difficulties in transportation. Bus transport is irregular in routes. However, many private buses do not operate according to reliable schedules and regular time tables, making it difficult for poor families in rural communities to utilize the road network to access output markets, production inputs and social services outside their immediate neighbourhood. Further, many rural roads are of low mobility, poorly located and sited, inefficiently designed and constructed, and weakly maintained. Travel is inconvenient and costly in terms of lost time, making it difficult for poor individuals in village to engage in economic activities outside their neighbourhood.

**Weak technology adoption and utilization.** Rural industrial activities typically contain low technology. Machinery and tools are mainly operated and the level of automation is low. Many cottage industries operate with only hand crafted tools.

There are several reasons for the low levels of technology. Many producers operate in non- competitive markets, and lack motivation to adopt better technologies. Enterprises located in rural areas do not have convenient access to technology. Sometimes technology adoption involves costly financial outlays which are beyond the capacity of rural enterprises. Rural areas also lack skilled staff to use technology-intensive equipment and tools.

**Low product quality.** Related to the low level of technology adopted, the quality of products manufactured in small rural enterprises are poor. The consumers of such products are usually low income households and are not quality conscious. However, this keeps prices and profit margins low. Many small scale rural producers lack ideas of quality control and technology upgrading. This prevents establishments from improving product quality, increasing output and accessing wealthy and sophisticated markets in towns and cities.

**Shortfalls in raw materials and resources.** Rural industries encounter considerable difficulties in obtaining regular, assured supplies of raw materials and production resources. The cost of raw material and inputs are also high, due to factors like inefficient resource extraction and raw material production processes and weak transport systems. For instance, industries manufacturing wood based products are constrained by lack of timer. Agro-processing enterprises operate well below capacity due to a shortage of agricultural raw material, like fruits and spices.

**Lack of market information and poor market access.** Information flows between villages and external communities are limited so that rural producers have scant knowledge of market opportunities outside their neighbourhood. Small enterprises also often lack marketing awareness and skills. Mobility between villages and towns is time consuming and inconvenient because vertical linkages of the road network are weak. This hampers rural enterprises from accessing prosperous urban markets to sell their products and to obtain inputs, especially tools, equipment and finance.

**Conclusion**

The peasant farmers in the non plantation crop sector, maintains a mystical attachment to land and prefer to cultivate paddy. Thus, some of the factor markets do not operate in an expected manner as rationality of farmers rooted in their perception and value systems. However, several options are available to improve income-earning capacities and to enhance employment opportunities in the rural sector. Removal of structural rigidities in factor markets and improvement of rural infrastrucutre will be a way forward to generate additional employment opportunities in rural areas and to improve income levels of the rural poor.

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# Money Laundering

## *An Overview*

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***According to a recent estimate, worldwide money laundering activities amounts to approximately US $ 1 Trillion a year. These illicit funds, one they get "cleaned", allows criminals to finance their criminal activities. It distorts economic decision-making, aggravates social ills and threatens the integrity of financial institutions. Today, money launderers have success to the speed and ease of modern electronic finance.***

***This paper is mainly written for the benefit of the Bankers who should become aware of these dangers of money laundering which is fast increasing in dimension.***

### WHAT IS MONEY LAUNDERING ?

Money Laundering is the process by which the existence, source or application of illegal income is sought to be concealed by those engaged in illegal activity. It is the process by which the launderer disguises the illegitimate nature of his income and makes it appear legitimate. In other words in refers to any transaction or series of transactions or other arrangements which seek to disguise the source of proceeds of illegal activities and the consequential conversion of such proceeds to a form that makes it appear to have originals from a legitimate source. Banks and other financial institutions may unwittingly be used as intermediaries for the transfer, deposit or investment of illegal money.

### ACTIVITIES THAT CONSTITUTE MONEY LAUNDERING

Specified unlawful activities that result in illegal income are :

- Drug Trafficking
- Tax Evasion
- Illegal Gambling
- Embezzlement
- Racketeering
- Illegal Prostitution
- Mail & Telephone /Fax Fraud
- Terrorism
- Illegal Arms dealing
- Corrupt Public Officials
- Credit Card Swindling
- Black mailing

### WHY BANKS & FINANCIAL INSTITUTIONS USED FOR MONEY LAUNDERING?

Bank and other Financial Institutions are used by the criminals to convert cash into forms that are easier to handle, to carry out transactions that are easier to hide its criminal origin and finally to move funds even across borders in an apparently legal way.

The integrity of the banking and financial services depends heavily on the perception that it functions within a framework of high legal, professional and ethical standards. Therefore, if funds from criminal activities can be easily processed through a particular Financial Institution, it could give a negative impact on customers, other Financial Institutions and the Regulatory Bodies.

### HIGH RISK INDUSTRIES

The nature of the business of a customer can be used as a yardstick to classify an account as "High Risk". For Example –

- Non-Bank Financial Institutions (Money changers or Money Transmitters)
- Travel Agencies
- Casinos
- Art & Antique Dealers
- Brokers /Dealers
- Real Estate Agencies
- Import/Export Trading Houses
- Jewel/Gem/ Precious Metal Traders
- Off-shore subsidiaries of Corporations and banks
- Car/Boat/Plane Dealerships
- Leather goods stores
- Used Trucks/Auto Parts manufacturers

### HIGH RISK PRODUCTS

Another yardstick is the kind of product the customer requests. "High risk" products are those products which allow customer to readily convert cash into a monetary instrument and /or any product/service which allows a customer to readily move value from one jurisdiction to another.

Eg. – Funds Transfers
Controlled Payment Drafts
Global Foreign cheques Clearing Services
Travelers Cheques

### Three Stages of Money Laundering

Money laundering generally involves a series of multiple transaction used to disguise the source of financial assets so that the assets may be used without embarrassing or exposing the launderers who are seeking to use them.

#### Stage 1- Placement

The money launderer introduces his/her illegal profits into the financial system, by breaking up large amounts of cash into smaller sums and deposit directly into Bank accounts or by purchasing monetory instruments such as money orders, cheques and drafts.

#### Stage 2 – Layering (clearing)

The next stage is clearing stage where the illegal proceeds are moved between many accounts through layers of complex financial transaction thus creating a web of transactions so that they are separated from their illegal origin.

Eg– False letters of credits
Asset Backed Transactions
Payments for goods and service on false invoices.

#### Stage 3 – Integration or re-circulation

Finally the proceeds are brought back to or re-enter the legitimate financial system. At this stage the launderer provides a legitimate explanation of his/her wealth and choose to invest in : Real Estate, Stocks and Bonds, Mutual Funds, Art Work, Capital construction projects.

### CONSEQUENCES OF MONEY LAUNDERING

Money Laundering is necessitated by the requirement of the drug and arms traffickers, blackmailers, terrorists, credit card swindlers etc., to disguise the origin of their criminal or "dirty" money

* I would greatly appreciate the assistance given to me by Miss Manuja Narangoda, Mrs. Kumari Lawrance and Mrs. Chandima Perera, Law Officers of the Peoples' Bank in preparation of this paper.

so that they can avoid detection and the consequent risk of prosecution when they use it. Therefore, the problem of money laundering has been in existence, in one form or another, for hundreds of years. Some of the important factors that have made its serious problems are :-

(a) Rapid economic globalization
(b) Relaxation of capital control
(c) Emergence of new economies
(d) Sale of state owned enterprises
(e) Development of new financial instruments and technology.

Anti money laundering efforts, which are designed to prevent or limit the ability of criminals to use their ill-gotten gains, are both critical and effective components of anti-crime programmes.

Money Laundering has potentially devastating economic, security and social consequences. It provides the fuel for the drug dealers, terrorists, illegal arm dealers, corrupt public officers and others to operate and expand their criminal enterprises. Modern financial systems, in addition to facilitating legitimate commerce also allow the wrongdoers to transfer millions of dollars instantly using advanced technology. Money is laundered through currency exchange houses, stock brokerage houses, Gold Dealers, Casinos, Auto Mobile Dealers, Insurance Companies and Trading Companies. Private Banking facilities, Offshore Banking, "Shell" Co-operations, Free Trade Zones, Wire Systems and trade financing, can make illegal activities. In doing so, the money launders can manipulate not only the financial system in the country where they are resident but also those in other countries where they have their dealings.

**Exposure of Emerging Markets**

Money laundering is a problem not only to the worlds major financial markets and off shore centres but also to emerging markets. Any country integrated into the international financial system runs the risk of becoming a vulnerable target for money laundering activity. **Increased efforts by the authorities of the major established financial markets and offshore financial centres to arrest this activity encourages the money launders to shift their activities to emerging markets.** There is evidence of increasing cross-border cash shipments to markets having *relaxed* arrangements for detecting, recording and arresting cash placements in their financial system.

**Undermining the legitimate Private Sector**

Money launders often use "front" companies which mixes the proceeds of illicit activity with legitimate funds in order to mask the ill gotten gains. In some cases these "front" companies having access to large sum of illicit funds allows them to subsidize their products and services below market rate and are able to offer products at prices below the cost of production of legitimate manufacturers.

Often this makes it difficult for legitimate businesses to compete against these companies thus creating a situation of private sector business being pushed out by criminal organizations thereby resulting in a negative macro-economic effect. Often, the management principles of these criminal enterprises are not consistent with traditional free market principles of legitimate business.

**Undermining the integrity of financial markets**

Money Laundering has an effect of undermining the integrity of financial markets. If large sums of laundered money are deposited at financial institutions and disappear suddenly, without notice through various modes of transfers of funds, it can result in liquidity problems and runs on deposits of such institution. Financial crisis at BCCI in 1990s and collapse of Barings Bank in 1995 are examples.

**Loss of control of economic policy**

A former Managing Director of the International Monetary Fund, Mr. Michel Camdessus has estimated that the **magnitude of money laundering in the world is between 2% and 5% of the world gross domestic product or approximately six hundred thousand million US Dollars.** In some emerging money markets, these illicit proceeds can dwarf Government budgets resulting in a loss of control of economic policy of such Governments. Money laundering can also effect currencies and interest rates adversely as launders prefer to reinvest funds where their schemes are less likely to be detected rather than where rates of return are higher. In short, money laundering may result in inexplicable change in money demand and increased volatility of international capital flows, interest and exchange rates, thus making it different to achieve the desired sound economic policies.

**Effect on Economy, Revenue and Privatization efforts**

Money laundering causes economic distortion, instability and loss of Government Tax revenue. Money launders generally, are not interested in profit making from their investment. They are more concerned in protecting their proceeds. For example they may finance entire industries such as construction and hotels not because of actual demand but because of short term interest of the launderers. When these industries do not suit them, they abandon them causing a collapse of these industrial sector in the country and also great damage to the economy. It also can be used to outbid legitimate buyers of state owned enterprises when they are on sale consequent to introduction of economic reform though privatization by certain Governments. This privatization initiative, though economically beneficial at times, can serve as a vehicle to launder ill-gotten funds. It was revealed that in the past, large industries, Holiday resorts, Banks etc., have been purchased by these criminals in order to hide and launder their illicit proceeds.

**Reputation risk and social costs**

Money Laundering can tarnish the reputation and image not only of a financial institution but also of the entire Nation, especially in today's global economy, thereby diminishing the development and the economic growth of that institution or Nation. Once the financial reputation of an industry or a country is damaged its revival not only becomes very onerous but also requires significant government resources to rectify such damage. Furthermore, it increases the cost of the Government consequent to increased law enforcement and health care expenditure (drug addiction). It has a negative socioeconomic effect in that it transfers economic power from the market, Government and citizens to criminals thus having a corrupting effect on all aspects of the society.

**Effects of Money Laundering on correspondent Banking**

➢ Some Banks have established correspondent relationship with high risk foreign banks. These foreign banks may be "shell banks" with no physical presence in any country for conducting of business with their clients; Or

Offshore banking with related license to do business with persons outside licensing jurisdiction; Or

Banks licensed and regulated by jurisdictions with weak anti money laundering controls that invite banking abuses and criminal conduct. Because these banks have limited resources and staff, they use their correspondent banking accounts to conduct their banking operations.

➢ Some of these high risk foreign banks that are denied their own correspondent accounts at US Banks can obtain the same access to the US financial system by operating correspondent accounts at a foreign bank that already has a US Bank account. Therefore, bankers should address their minds to this money laundering risks associated with "nested" correspondent banking.

### International regulations to combat money laundering

➤ In 1989, the leaders of a group of Seven (Canada, France, Germany, Italy, Japan, UK and USA) convened a Financial Action Task Force (FATF) consisting of 29 members.

Membership includes, the European Commission and Gulf Cooperation Council, Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

The FATF issued in 1990 "The Forty Recommendations" which today has become a comprehensive set of measures to regulate anti money laundering standards. It covers the criminal justice system and law enforcement and sets out principles for action and allow the countries a certain amount of flexibility in implementing these principles to suit their particular circumstances and laws. Many countries have made political commitments to combat money laundering by adopting these recommendations with improvements where necessary.

Some of these recommendations are :-

a) Criminalizing the laundering of the proceeds of serious crimes,

b) Enacting measures to seize and confiscate the proceeds of such crime,

c) It also requires financial institutions to identify all clients and to keep appropriate records and also to report suspicious transactions to the Competent Authority of that country.

What is a suspicious transaction ? It is one that requires a closer examination, in order to confirm that it is legitimate and not a part of a money laundering activity. It may be **unusually** large, complex and have an unusual operational aspect or have no approved economic purpose.

➤ The FATF introduced a major project in 1999 known as the Non-Cooperative Countries and Territories (NCCT). The first report of this body published in June, 2000, had identified 15 countries with serious money laundering problems. They are, the Bahamas, Cayman Islands, the Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, the Philippines, Russia, St. Kitts and Nevis, and St. Vincent and the Grenadines.

➤ In February, 2001 the FATF had issued a progress report on these fifteen countries and noted that the Bahamas, Cayman Islands, Cook Islands, Israel, Liechtenstein, Marshall Islands, Panama have enacted remedial legislation to combat money laundering activities.

➤ At its plenary meeting in June, 2001, the FATF reviewed the progress made by these countries on Anti Money Laundering activities and whilst removing the countries viz. The Bahamas, Cayman Islands, Liechtenstein, Marshall Islands, and Panama from the NCCT List added six more countries to the said list blacklisting them as havens of money laundering activities. These countries are Egypt, Guatemala, Hungary, Indonesia, Myanmar and Nigeria.

These new members which have been included in the list of NCCT were cited for various failings including lack of proper legislation or supervision. The President of the FATF Mr. Joe Maria Rolden had remarked "We see that this initiative has triggered significant improvements in Anti-Money Laundering system throughout the world."

➤ Efforts by FATF to introduce regional groups and initiatives in Africa and South America have led to the establishment of the Eastern and Southern Africa, Anti Money Laundering Group (ESAAMLG) and the Financial Action Task Force on Money Laundering in South America (GAFISUD). Other prominent regional FATF-style bodies are the Asia/Pacific Group on Money Laundering (APG) the Caribbean Financial Action Task Force (CFATF) and the Council of Europe PCR-EV Committee.

➤ Organizations involved in combating money laundering that have observer status with the FATF include the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the International Monetary Fund (IMF), the Offshore Group of Banking Supervision (OGBS) and the United Nations Office for Drug Control and Crime Prevention (UNODCP). Many of these international Organizations have formulated major anti-money laundering initiatives.

➤ In 2000 INCSR (International Narcotics Control Strategic Report) after assessing money laundering activities in more than 175 countries classified them into three categories on a priority basis.

**(a) Countries/jurisdictions of primary concern**

| | | |
|---|---|---|
| Antigua & Barbuda | Hong Kong | Panama |
| Australia | Hungary | Paraguay |
| Austria | India | Philippines |
| Bahamas | Indonesia | Russia |
| Brazil | Isle of Man | Singapore |
| Burma | Israel | Spain |
| Canada | Italy | St. Kitts and Nevis |
| Cayman Islands | Japan | St. Vincent |
| China | Jersey | Switzerland |
| Colombia | Lebanon | Taiwan |
| Cyprus | Liechtenstein | Thailand |
| Dominica | Luxembourg | Turkey |
| Dominican Republic | Mexico | United Arab Emirates |
| France | Nauru | United Kingdom |
| Germany | Netherlands | United States |
| Greece | Nigeria | Uruguay |
| Grenada | Pakistan | Venezuela |
| Guernsey | | |

**Countries/jurisdictions of concern**

| | | |
|---|---|---|
| Albania | El Salvador | Niue |
| Argentina | Gibraltar | Palau |
| Aruba | Guatemala | Peru |
| Bahrain | Haiti | Poland |
| Barbados | Honduras | Portugal |
| Belgium | Ireland | Romania |
| Belize | Jamaica | Samoa |
| Bolivia | Korea | Seychelles |
| British Virgin Islands | Korea, North | Slovakia |
| Bulgaria | Latvia | South Africa |
| Cambodia | Macau | St. Lucia |
| Chile | Malaysia | Turks & Caicos |
| Cook Islands | Marshall Islands | Ukraine |
| Costa Rica | Monaco | Vanuatu |
| Czech Republic | Netherlands Antilles | Vietnam |
| Ecuador | Nicaragua | Yugoslavia |
| Egypt | | |

**(b) Other countries/jurisdictions monitored**

| | | |
|---|---|---|
| Afghanistan | Iran | Niger |
| Algeria | Jordan | Norway |
| Angola | Kazakhstan | Oman |
| Anguilla | Kenya | **Papua New Guinea** |
| Armenia | Kuwait | Qatar |
| Azerbaijan | Kyrgyztan | Saudi Arabia |
| Bangladesh | Laos | Senegal |
| Belarus | Liberia | Slovenia |
| Benin | Lithuania | Solomon Islands |
| Bermuda | Macedonia | **Sri Lanka** |
| Bosnia & Herzegovina | Madagascar | Suriname |
| Botswana | Malawi | Swaziland |
| Brunei | Maldives | Sweden |
| Cameroon | Mali | Tajikistan |
| Cote d'Ivoire | Malta | Tanzania |
| Croatia | Mauritius | Togo |
| Cuba | Micronesia FS | Tonga |
| Denmark | Moldova | Trinidad & Tabago |
| Eritrea | Mongolia | Tunisia |
| Estonia | Montserrat | Turkmenistan |
| Ethiopia | Morocco | Uganda |
| Fiji | Mozambique | Uzbekistan |
| Finland | Namibia | Yemen |
| Georgia | Nepal | Zambia |
| Ghana | New Zealand | Zimbabwe |
| Guyana | | |

### Sri Lankan Scenario

The Bureau of International Narcotic and Law Enforcement, USA referring to the level of money laundering in Sri Lanka had made following remarks:

"There is no conclusive evidence that money laundering is occurring on a large scale. The increasing amount of heroin transiting and being sold within the Country, however, world indicate that drug-related money movement takes place, specifically between India and Sri Lanka. The Cabinet has approved new legislation for consideration by Parliament in 1977, which includes anti-money laundering provisions and drug related asset forfeiture. Sri Lanka implemented strict bank secrecy laws earlier in the decade, and even offered numbered bank accounts to attract hard currency. However, transactions related to drug trafficking are excluded from the secrecy protection. Common means of money movement include invoice manipulation and underground banking particularly between India and Sri Lanka. These underground or "hawala" channels are used extensively by businessmen as well as drug traffickers throughout India, Pakistan and the rest of South Asia. Sri Lanka's liberalized foreign exchange and investment policies would seem to make "hawala" schemes attractive only to individuals seeking to launder or hide the origin of money, and not to persons conducting legitimate business transactions".

01. The Sri Lankan Authorities are now becoming increasingly concerned about all the possibilities of usage of our financial services system for money laundering activities in the absence of specific legislation. **The Draft Legislation prepared on money laundering is annexed hereto.** According to this draft the Central Bank would be the supervisory authority.
- Any person who obtains information or has reason to believe, in the course of his business or employment that the property of any other person has been derived from any illegal activities is obliged to inform the supervisory authority of such knowledge.

02. The financial activities defined in the schedule of the said draft are given below :
- Lending (including personal credits, lending on the mortgage of movable or immovable property, factoring with or without recourse, financial or commercial transactions including forfeiting).
- Finance leasing
- Provision of Venture risk capital
- Money transmission services
- Issuing and administering means of payment (e.g. credit cards, travelers cheques and banker's draft)
- Guarantees and commitments
- Trading for own account or account of customers in –
  - Money marked instruments (cheques, bills, certificates of deposits etc.)
  - foreign exchange
  - financial futures and options
  - exchange and interest rate instruments; and
  - transferable instrument
- Underwriting share issues and the participation in such issues
- Money broking
- Stock brokering
- Investment business
- Deposit taking
- Insurance business transactions
- Buying and selling immovable property
- Bullion Dealings
- Casinos and other gambling and betting services
- Financial intermediaries.

03. Under the draft Act, any person (a) who knowing or having reasons to believe that any property has been directly or indirectly derived from unlawful activity or (b) engages in any transaction in relation to such property or (c) receives, possesses, brings into Sri Lanka or transfers out of Sri Lanka any such property, commits the offence of money laundering.

Therefore, it is seen that the offence of money laundering would apply to those persons who commit the offence of money laundering and acquire property using such proceeds and to third parties who deal with such property knowing or having reason to believe that such property is derived from unlawful activity. **Thus in practical terms the proposed law casts a very heavy burden on the prosecution who has to establish the predicate offence as well as to prove that the subsequent transaction is connected to the predicate offence**. In the case of the Bribery Act, there is a rebuttable presumption that all unaccounted assets are deemed to be acquired by unlawful activity. Such provisions would ease the burden placed on the prosecution.

In the draft legislation such provisions is absent and therefore, it would be no exaggeration to say that no practical purpose would be achieved by this law, unless this presumption is brought into the statute.

04. However, some salutory features of this draft legislation are :-
- The obligation cast on person who know or have reasons to believe that any property has been acquired through the proceeds of unlawful activity, to pass on that information to the supervisory authority.
- Vesting on the Supervisory Authority (Central Bank) with number of statutory powers to enable them effectively to monitor the offence of money laundering which includes calling for information documents etc., from any financial institution and to examine and inspect any records maintained in such financial institutions.
- Provision enabling the Supervisory Authority to obtain an order from the Magistrate to compel any person involving in money laundering to produce any document in his possession for purpose of investigation.
- Provision enabling the Supervisory Authority to issue an order to freeze the account, property or investment prohibiting any further transaction.
- Provision to confiscate all properties belonging to any person convicted by a Court of Law for any offence of money laundering.
- The proposed Act also expressly recognizes money laundering as an extraditable offence.

**Protective measures to be taken by Banks against money laundering**

01. (a) To design internal control policies and procedures which would enable to identify/detect potential illegal or damaging transactions and to reject them to prevent fraud and money laundering activities.

(b) To designate a Senior Executive Officer as Money Laundering Compliance Officer who would report to the Regulator (Central Bank) if there are any reasonable grounds to believe that the property involved in any transaction is derived directly or indirectly from any unlawful activity which in view of the compliance officer could lead if unchecked, to money laundering activity.

(c) To monitor periodically the records of financial transactions conducted by the high risk industries who are customers of such institutions.

(d) To comply with the instructions of the Central Bank and to permit any authorized officer of the Central Bank to examine any account or document pertaining to any suspicious transactions.

(e) Assist the Central Bank by producing any record of suspicious transaction for examination purpose.

(f) To maintain records of financial transactions of the institution for period of five (5) years.

02. It is of prime importance for any Bank to recognize and report transactions that are of suspicious nature. Under the Draft Legislation, it is the duty of any person who has a knowledge of any offence of money laundering to report to the supervisory authority.

03. Any single event or a series of activities over a period of time which causes an observer to query the validity could be termed a suspicious transaction. In other words any activity or transaction which to the eye of the Bank officer appears to be unlawful or out of context in the circumstance, within which it is observed can be treated as a suspicious transaction. Some of the questions that should be considered by the Officer might be :-

- Is the size of the transaction consistent with the normal activities of the customer ?
- Is the transaction rational in the context of the customer's business or personal activities?
- Has the pattern of transactions conducted by the customer changed?
- Where the transaction is international in nature, does the customer have any obvious reason for conducting business with the other country involved ?

04. All Financial Sector businesses have a clear obligation to ensure -

- That each relevant employee knows to which person he or she should report suspicions ; and
- That there is a clear reporting chain under which those suspicious acts will be passed without delay to the Reporting Officer.

Once an employee has reported his/her suspicion to the "appropriate person", or a higher authority, he has fully satisfied the statutory obligations and is no more responsible.

05. Reporting lines should be as short as possible with the minimum number of people between the person with the suspicion and the authority.

(a) The speed, confidentiality and accessibility to the authority is important.

(b) A Bank may choose to require such unusual or suspicious transactions be drawn initially to the attention of banks supervisory management to ensure that there are no known facts that will negate the suspicion before further reporting.

05. All reports should be documented and procedures listed in appropriate manual and job description.

06. All suspicious transactions reported to the authority should be documented. In urgent cases, this may follow an initial discussion by telephone. All the reports should include the full details of the customer and as full statement as possible of the information giving rise to the suspicion.

**WARNING SIGNALS**

- A customer who is reluctant to provide complete information regarding the purpose of the business, prior banking relationship, officers or directors, or its location.
- A business that refuses to provide information that is required normally to qualify customers for credit or other banking services.
- The customer's background is inconsistent with business activities.
- Financial statements are not prepared by an accountant although the business or corporation is large.
- A business that is reluctant to reveal details about its activities or provide financial statements, or whose financial statements are noticeably different from those of similar business.
- A customer who is unwilling to provide personal background information when opening an account or purchasing monetary instruments above a specified period.
- A potential customer who is reluctant or refuses to furnish reference, or the references cannot be verified or contacted.
- A customer who has no record of past or present employment but makes frequent large transactions.
- Corporate accounts where deposits or withdrawals are primarily in cash rather than cheques.
- An account that sends and receives wire transfers without an apparent business reason of when inconsistent with the customer's business or history.
- An account that receives many small incoming wire transfers or makes deposits using cheques and money orders, and almost immediately wire transfers all such deposits excepts for a token amount to another city or country when such activity is not consistent with the customers business or history.
- A customer who maintains an inordinately large number of accounts for the type of business he is purportedly conducting and/or uses an inordinately large number of fund transfers between or amongst these accounts.
- A large volume of cashiers cheques, foreign money orders, and/or wire transfers is deposited to an account where the nature of the account holders business would not appear to justify that activity.
- Unusual cash purchase of foreign money orders, drafts and cheques.
- Frequent exchanges of small value currency notes for large ones and vice versa.
- A non customer or a customer receives incoming wire transfers for large amounts with instructions from the Bank to "pay upon proper identification"
- A customer who deposits into his bank account a substantial amount of Traveler's cheques in large denominations and in sequential order.
- When the client uses the account for a short period of time
- Frequent cash transaction involving sums just under specific cash reporting limit (smurfing)
- Guarantees for security, of loans made by unknown third parties particularly in foreign jurisdiction.
- Use of offshore account in circumstances where the clients' commercial or financial needs do not justify such service.
- Over depositing of high value assets in client account as margin for relatively straightforward commercial or legal services.
- Unnecessary use of intermediaries for the purpose of routing money through third party accounts.

## "KNOW YOUR CUSTOMER" CONCEPT AND DUE DILIGENCE

Business of Banking unlike other businesses needs basic information about its customers and their type of business. Bankers are under a legal obligation to know their customers and their businesses from the time of entering into a relationship with the customer. **In Lloyds Bank Limited Vs. E B Savory and Company**, Lord Wright said "It is now usual practice of bankers not to open accounts for a customer without obtaining a reference and without inquiry. To failure to do so at the opening of an account might well prevent the banker from establishing the defence in the case of conversion. **The Privy Council in Commissioner of Taxation Vs. English, Scottish and Australian Banking** said "the test of negligence is whether the transactions of paying in any given cheque coupled with the circumstances antecedent and present was so out of the ordinary course that it ought to have aroused doubts in the minds of the Bankers."

It is therefore, one of the main functions of a Banker to know his customer well. The Financial Services Authority in the United Kingdom has issued certain guidelines that may be used in testing the concept of "know your customer". The FSA rules states that relevant bank must take reasonable steps to deploy information it has about the financial circumstances of a customer, and features of the transaction entered into with or for the customer throughout relevant parties of the Bank (know your business information).

The individual identity comprises of the name and all other names used, addresses of which such individual can be located, date of birth and nationality, all subsequent changes of the customer's name, address of which the Bank becomes aware. Therefore, evidence of identification should be obtained :

- For all parties to an account or a business relationship
- The ultimate beneficial owner of funds being invested
- The principal signatories to an account; and
- All third parties who are permitted to use an account from time to time or provide funds for investment or deposit

For the purpose of evidence in respect of the name of the individual the following documents may be obtained. Further they should be clearly compared with the originals.

a) Evidence of Name -
   - Current signed passport
   - Aliens registration certificate issued by the Government on sight of own country passport
   - National Identity Card
   - Inland Revenue Tax Notification

b) Evidence of Address -
   - Making an electoral register search or a credit reference agency.
   - Requesting the sight of local authority assessment notice (upto three months old)
   - Requesting sight of tax assessment (valid for the current year)
   - Electricity Bill
   - Land Line phone bill
   - Address checks made using computerized internal or external application database
   - Bank statement or passbook containing address
   - A recent original mortgage or tenancy statement from a recognized lender – or a Title Deed
   - Police or Grama Sevaka Certificate confirming residence.

All Banks should strive to conduct **due diligence** in order to prevent such Banks being used for criminal purpose. Due diligence enables the Bank to comply with established laws, practices, regulations and , thereby reducing its vulnerability to money laundering activities and also protecting its good name. Therefore, it is of vital importance to a Bank or a Financial Institution to adopt following due diligence procedures to prevent themselves from becoming victims of fraudulent transactions.

(a) Strict identification and scrutiny procedures at the time a client opens and account. This includes knowing the true identity of a customer including that of the beneficiary.

(b) the customer's business or his professional activities, his sources of income, wealth and assets, specific sources of money that is the subject matter of the transaction at the Bank.

The Bank should develop monitoring system of the type of transaction in which any customer normally engage. If such customer belongs to a high risk category, then enhanced monitoring is essential.

Monitoring procedure would be the most important aspect in the prevention of money laundering. Internal systems of the Bank must be in position to identify and monitor the transactions that appear to be suspicious. A banker must assess the risk inherent in doing business with the specific type of Account. All transactions that exceed money limitation set for such type of operation should be reviewed. Significant increase in the activity in any account should be monitored.

The Bank also should conduct on going education programmes for the Bank staff in respect of money laundering techniques and their prevention, changes in applicable laws and regulations and type of transactions that may require investigations. All new employees should be provided with guidelines concerning anti money laundering procedures.

Ann T Vitale, former Managing Director and Deputy General Counsel of the Republic National Bank of New York states that "one of the most important elements of successful anti money laundering programme is the commitment of the senior management, including Chief Executive Officer and the Board of Directors to the development and enforcement of the anti money laundering process."

### CONCLUSION

Money Laundering is a serious crime that can happen anywhere, any time and in any manner. It has been the concern of many Governments due to the criminal money, in the hands of terrorist organizations, underworld operators, illegal arm dealers, drug traffickers etc., being infiltrated into Financial Institutions of those Governments and being recycled in nefarious activities after being "cleaned".

Therefore, it is our responsibility as Bankers to eliminate it at all costs and safeguard, not only the Financial Institutions but also the economy and the State.

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# ELECTRICITY PROBLEMS
## Power Planning based on Economic Considerations

Prof. K.K.Y.W. Perera
&
Weerasekera M. Bandusena*

### 1. Introduction

Sri Lanka is confronting an electricity shortage, evidently threatening the growth expectation of the economy. The country has been experiencing power shedding during several years in the recent past. There exits a vast diversity of views among professionals, business community, general public, and politicians on the causes behind this problem and the solution paths. Lack, inadequacies or deficiencies of planning are among the widely and frequently cited reasons. The power shortage and the resultant load shedding programme are said to reflect however, a complex mixture of political, managerial, and technical reasons which have been compounded by natural factors. It would be extremely important therefore to correctly identify the real causes behind the problem, because without identifying the real causes, realistic solutions cannot be attempted.

This paper accordingly has twofold objectives; to investigate whether the planning in the power sector has been deficient, erroneous or defective, and to depict the problem and remedies. In order to achieve these objectives, this paper attempts to -

- Examine the short term, medium term and long term scenario of the electricity supply and demand,
- Articulate the methodology used in the country for power sector planning,
- Evaluate the past plans and forecasts against real situations,
- Assess whether any divergence from plans have had any significant impacts on electricity supply,
- Identify causes for such divergence,
- Percieve future risks, and
- Propose remedies.

**Table 1:**
**Approximate Capacity of the Power System in Sri Lanka in January 2002**

| | Nominal Installed capacity (MW) | Effective capacity (MW) |
|---|---|---|
| *CEB Hydro* | *1147* | *904* |
| *CEB Thermal* | *507* | *166* |
| *Independent (private) Power Producers* | *137* | *123* |
| *Total* | *1791* | *1193* |

*Source :* Long-term Generation Expansion Plan 2002-2016 and other sources of CEB

### 2. Present state (January 2002) of Electricity Supply and Demand

Power demand in the country is growing rapidly, and is predicted by the Ceylon Electricity Board (CEB) taking GNP, population and other factors into account. Annual predicted demand increase works out to approximately 8% per year.

The grid connected power generating system of Sri Lanka in January 2002 had a gross installed capacity of 1791 MW, but the effective capacity is only about 1200 MW. The Ceylon Electricity Board (CEB) currently owns the majority of generating capacities of the country consisting of nominal hydro capacity of 1147 MW and a thermal capacity of 507 MW. **Table 1**: Approximate Capacity of the Power System in Sri Lanka shows the installed and effective capacities of the Sri Lanka power system including power generation capacity of the private producers.

### 3. Methodology used by the CEB for power sector planning

#### 3.1 Planning Cycle
#### 3.1.1 Demand

The annual power planning cycle begins with load (demand) forecasts. In power sector planning exercises, economic growth and development are explicitly recognized as fundamental prerequisites for achieving an increase in living standards and equity. Accordingly, assumptions about economic growth and development are considered as important determinants of electricity demand. It would be important to elaborate on two uses of the word 'demand' in its application to electricity, as the 'difficulty in meeting the electricity demand' is central to the issue addressed in this paper. They are (i) the peak power demand during day [Kilowatts (KW) or Megawatts (MW) and (ii) the time integration of such power demand (area under the curve) is termed energy (Kilowatt hours (kWh) or Mega Watt hours (MWh). ***Figure 1:*** *Daily Load Curve* illustrates the electricity consumption pattern in a typical day in 2000 in Sri Lanka with the sharp evening peak, and ***Figure 2:*** Electricity demand forecasted 1994 compared with realization in 2001 (Source: CEB) shows the peak demand (base case) forecast of the Ceylon Electricity Board (CEB) carried out in 1994, which predicted that the peak load would be 1428 MW in 2001 (the base case). In actual terms, the peak demand behaved around 1445 MW in 2001.

#### 3.1.2 Supply : Plan for new generating plant additions

#### 3.1.2.1 Cost to CEB vs Cost to Economy

CEB is mandated to provide an adequate supply of electricity in the most reliable manner at the cheapest cost to the economy. The CEB Act No.17 of 1969 states "It shall be the duty of the Board to develop and maintain an efficient coordinated and **economical** system of electricity supply for the whole of Ceylon (Sri Lanka) ......"

The Power System Expansion planning in Sri Lanka has been by the CEB based on the principle of delivering an anticipated need (forecast demand) for electrical energy at "least cost" to economy, **but not at the least financial cost to the CEB.**

Thousands of possible power plant installation sequences consisting of different thermal and hydro plants coming up in a time frame of over 15 years are analysed for this purpose. The least cost **sequence** of power plants is there after chosen.

This has made it necessary to use sophisticated capacity expansion optimization tools. The main planning tool in the development and analysis of optional generation plans is the Wien Automatic System Planning Package (WASP 111+) developed by the International Atomic Agency and extensively used in many developed and developing countries worldwide. The objective function of WASP is to minimize the present

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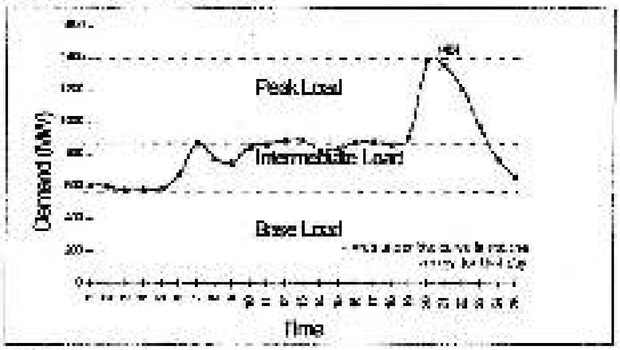
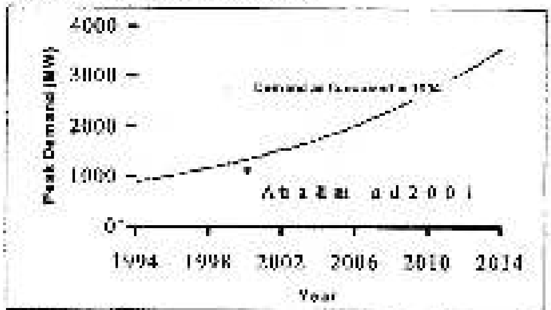
The authors wish to acknowledge contributions by Ms Kamani Jayasekera, Chief Electrical Engineer (generation planning) and other officials of the CEB

Figure 1: Daily Load Curve




Source : CEB

Figure 2: Electricity demand forecasted 1994 compared with realization in 2001




Source : CEB

value of power system expansion costs over some planning horizon subject some given levels of user defined constraints such as the system reliability. The optimum generation mix to meet the demand for power and energy in a particular study period is evaluated using programming techniques for comparing the costs of alternative system expansion policies. In simple terms, it attempts to minimise the cost of investment, operation and maintenance and the cost to the economy of power cuts (cost of energy unserved). The cost of energy unserved (power cuts) to the economy of the country is generally taken to be in the order of ten times the sale price of electricity. This heavy penalty on unserved energy reinforces in the model to plan for near zero power cuts.

In order to meet the forecast demand, the planners have to formulate the most economic sequence of plants (Diesel, steam, hydro etc.) to be commissioned serially in the future years. Each possible sequence of power units added to the system is evaluated in the planning exercise by an expected cost function comprising capital investment costs, salvage value of investment costs, fuel costs, non fuel operation and maintenance costs, and cost of the energy not served. The plant sequence with the minimum cost is interpreted as the optimal expansion plan. It should be reemphasized here that what is minimized here is the expected cost, including those of the plants already running. Expectation comes mainly because one does not know the rainfall with certainty. Therefore, only an expected cost in probabilistic terms is possible, even though the demand is taken as deterministic.

**Figure 3: Least Cost Planning**

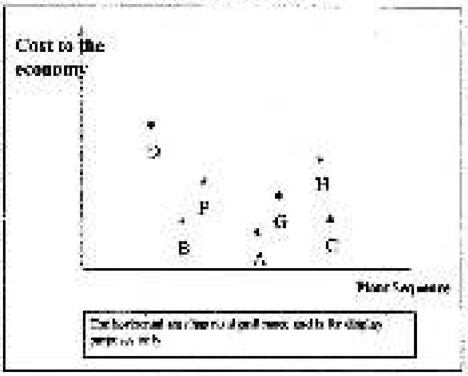



**Figure 3** hypothetically represents the concept of least cost planning. Sequence A (which represents a whole sequence of power plant additions at different times) has the least cost and is recommended from a planning perspective. However, sequences B and C are also near optimal solutions and if preferred on social, political, or environmental grounds which have not been quantified, such a sequence may be chosen based on judgement. The present power sector planning methodology therefore, provides the policy makers with set of near optimal options, but not only one single optimum solution.

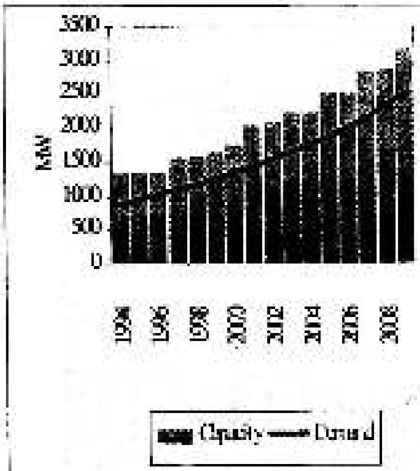
## 4. How good were the plans and their implementation?

For the purpose of this paper, the actual performance of the power sector in the recent past would be evaluated against the following categories of possible reasons which could be considered have been attributable to the present crisis.

The plant sequence drawn up in 1994 by the power sector planners is given in **Figure 4:** Generation Capacity Additions – Plan 1994. The demand projected here for 2002 was in fact realized by 2002 but the shortages occurred due to delayed or non implementation of the planned generating plants.

A peak demand of approximately 1500 MW is realized in year 2002. According to the CEB estimates in 1994, the country's electricity demand, the medium scenario, in the year 2002 was predicted to be 1525 MW which is very close to what is realized. However, plant commissioning was advocated to meet even the high scenario, i.e. 1759 MW by 2002. In order to meet this demand, plans had been drawn up to add 738 MW to the system increasing the total installed capacity upto 1862 MW (**Table 2 : Plan** Proposed in 1994 – for the Period 1995 – 2009). However, it was possible to add only 312 MW to the system during the period which increased the effective capacity to the level of 1436 MW, which reflects a much lower supply level than both forecast and actual demand. It is very clearly noticeable that non implementation of the proposed Upper Kotmale hydro power plant and the Coal fired thermal plant and the delayed implementation of the Kukule hydro power plant. Further, the 110 MW combined cycle plant was not fully operational at the beginning of 2002, which limited the actually realized capacity to 1326 MW, thereby resulting in an obvious and significant power system capacity

**Figure 4: Generation Capacity Additions – Plan 1994**




| Year | Hydro additions | Thermal additions |
|---|---|---|
| 1997 | | Gas turbine 60 MW |
| | | Diesel 170 MW |
| 1998 | | Gas turbine 22 MW |
| 1999 | | Combined cycle 68 MW |
| 2000 | Kukule 70 MW | |
| 2001 | Upper Kotmale 153 MW | Coal (Trinco) 150 MW |
| 2002 | | Gas turbine 22 MW |
| 2003 | | Coal (Trinco) 150 MW |
| | | Refurbished GT 63 MW |
| 2004 | | Refurbished GT 63 MW |
| 2005 | | Coal (Trinco) 300 MW |
| 2007 | | Coal (Trinco) 300 MW |
| 2008 | Gin Ganga 49 MW | |
| 2009 | | Coal (Trinco) 300 MW |

Source: Long-term Generation Expansion Plan: 1994 – 2009, CEB

**Table 2 : Plan Proposed in 1994 – for the Period 1995 – 2009**

PLAN PROPOSED IN 1994 – FOR THE PERIOD 1995 - 2009

| *Plants to be installed by 2002 as per plan* | | *Actual 2002* |
|---|---|---|
| Gas Turbine | 110 MW | 0 (out of order) |
| Diesel | 190 MW | Diesel: 212 MW |
| Combined cycle | 68 MW | 110 MW(JBIC GT Part) |
| Kukule Hydro | 70 MW | 0 |
| Upper Kotmale hydro | 150 MW | 0 |
| Coal | 150 MW | 0 |
| | <u>738 MW</u> | <u>312 MW</u> |
| Effective capacity available in 1994 = 1000 MW | | |
| Capacity if plan realised = 1000 MW + 738 MW =1738 MW | | Capacity actually realised = 1000 MW+312 MW = 1312 MW |

| | |
|---|---|
| Low demand | = 1441 MW |
| *Base case* | *= 1525 MW* |
| High demand | = 1759 MW |
| Actual demand 2001 | = 1445 MW |
| Shortage of Power 2001 | = 133 MW |
| Expected Shortage of Power 2002 | = 213 MW |

shortage This plainly suggests that the power shortage has its origins in implementation issues but not in defective planning.

The Long Term Generation Plan is formulated in the form of a rolling plan, in order to off-set the impacts of the deviations from the planned path due to delays and inactivity etc on the power supply expectations, the plan is reformulated from annually. The implementational deviations and delays indicated in **Table 2** have lead to generation plant shortages and introduction of more expensive plants which could be commissioned quickly but at a cost..

Further, the power system was unable to (i) meet the demand in a dry year (ii) to allow for outage of the largest generator and, (iii) allow for typical forced (unexpected) outages of other generators, which have been provided for in the planning exercises.
Specifically, the supply capacity of the power system was severely limited mainly owing to the following reasons:

(i) Delay of commencement of construction of the two combined cycle power plants (165 MW + 163 MW) planned to be installed at Kelanitissa,
(ii) Delay of timely completion and commencement of Kukule hydro power project
(iii) Prolonged delay in implementing Upper Kotmale Hydro power project
(iv) Continued controversy on implementation of a coal power plant
(v) Below average rain fall due to four consecutive failures of north east monsoons
(vi) Due to the large number of un-metered electricity supplies (approx. 350,000), electricity losses appear to have increased.
(vii) Total estimated losses between generation and billed sales increased to an approximate level of 23% of gross generation, which is excessive.

These have acted as very significant and immediate contributory factors to the power problem which has been experienced by the country since year 2000. Consequently, the CEB was compelled to purchase emergency power, despite its inconformity with the least cost planning concept, and at a heavy cost to the CEB, environment and the economy.

**5. Future challenges and issues**

Forecasts carried out by the CEB indicate that the peak load demand rises at an approximate annual rate of 8% which amounts to an incremental generating capacity of about 120 MW to be annually added to the system presently. This additional requirements (some of which are not in the plan but introduced to avoid power cuts due to delays in implementation of the plan) are presently planned to be achieved as follows:

| | | |
|---|---|---|
| Mid 2002 | : | 165 MW - Combined cycle JBIC |
| 2002 – 2003 | : | 280 MW temporary emergency power purchases |
| Mid 2003 | : | 20 MW diesel plant at Horana |
| June 2003 | : | 22 MW Sapugaskanda diesel plant, |
| Mid 2003 | : | 163 MW combined cycle AES |
| End 2003 | : | 70 MW kukule hydro power plant |
| Jan 2004 | : | 200 MW of Medium term power |
| End 2005 | : | 300 MW Combined Cycle Plant |
| End 2007 | : | 105 MW Gas turbine<br>150 MW Upper Kotmale Power Plant |
| End 2010 | : | 300 MW Coal Power Plant |
| End 2012 | : | 300 MW coal power plant |
| 2013 | : | 300 MW Coal Power Plant |
| End 2015 | : | 300 MW Coal Power Plant |

Overall, it is estimated that Sri Lanka will need to add approximately 1,500 megawatts (MW) of new generating capacity by 2010. By the year 2010, 8,000 GWh will have to come from thermal sources out of the total requirement of approximately13,000 GWh **(Figures 5, 6)**. This indicates a more than 100% increase in the annual energy contribution from the thermal systems which is presently amounting to about 3500 GWh.

There are two issues associated with this plan, which need special policy attention; the capital investment needs and the fuel costs.

Massive investments in the generation, transmission and distribution of energy will be needed to meet the growing demand. The bulk of these investments is needed to upgrade (i) the system capacities to meet the future demand and (ii) the quality of services of the electricity sector. The estimated financing needs for the seven years from 2001 to 2007 is of the order of US$ 3000 million – some US$ 430 million (around Rs 40 billion) per year on average. A large part of these investments is expected to come from the private sector and in the form of foreign assistance.

With increasing share of the thermal based generation indicated above, the fuel costs currently amounting to about Rs.12 billion per year for electricity will rise to about Rs.22 billion by the year 2010 (and to about Rs.40 billion by the year 2016), at the current parity rates. This will be a very steep increase which will result in a significantly heavy incremental foreign exchange

**Figure 5 : Energy Balance Forecast**

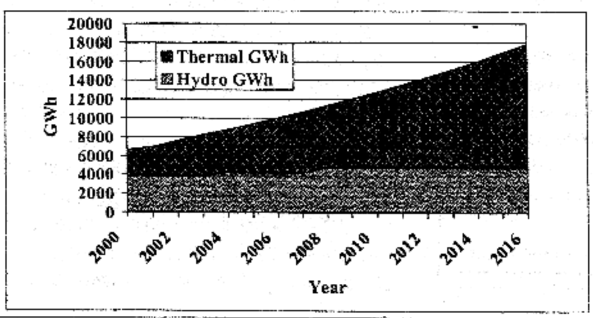
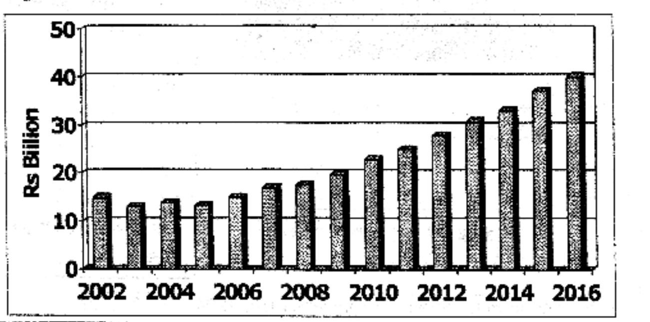



**Figure 6 : Fuel Cost Forecast**



drain out of the country associated with a tremendous burden on the balance of payments and **a severe risk on the energy security of the country**. Energy security can be ensured through local adequacy which is inherently associated with varied forms of indigenous energy resources, energy conservation and efficiency of use. Therefore, we must actively look for alternate local resource based power generation which will reduce oil and coal imports and increase energy security of the country.

### 6. Conclusions

The power sector problems have their origins in non achievement of implementation targets. The power demand planning by CEB throughout 1990s has been proper. Sequences of new generation plants planned have been adequate and appropriate. Implementation of the Long Term Power Generation Plan has been poor and delayed perhaps due to dilution of ownership and responsibility as many players had entered the decision making and procurement process. The future additions to power generation capacity of the country will be mainly thermal based. This will necessitate significantly heavy incremental foreign exchange drain for importing oil or coal, resulting in serious problems of managing the balance of payment and the parity rate, while also threatening the energy security of the country. The economic value of energy generated by any alternative energy source in the future will therefore be very significant and accordingly, the country should actively look for developing domestically available alternative energy sources and thereby increasing the diversity of energy sources also. This should proceed in parallel with increasing traditional energy generating sources.

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**Contd. from page 16**

- The focus on policy management would require a drastic reduction of the number of Ministers at the Centre. The reduced number of Ministries should, in order to provide institutional continuity, be based on a medium to long-term division of sector policy areas in to portfolios.
- As a critical stage of the policy formulation process would be the reconciliation of inter-sector relationships, the establishment of an appropriately staffed and authoritatively mandated Cabinet Secretariat would be a key element of the reform agenda. The new Cabinet Secretariat should also assist the Cabinet of Ministers in the monitoring of the impact of policy decisions.
- The continuing regulatory responsibility at the Centre would also require the establishment of independent regulatory institutions. These, created under Statutes that cast on them accountability for their regulatory role, should, if they are to be truly independent, be accountable to the Parliament—and not to ministries with sector responsibility.
- Whilst a parliamentary institution is required for continuous policy discourse and approval as well as for the provision of the legislative underpinning that is necessary for policy management, it should, whilst being appropriately representative of all interests and spatial areas, be considerably smaller in size as compared with its current counterpart.

Several related changes are required concerning the roles and functions at the Centre. These include

- The withdrawal of the State and its administrative organisations from the micro-management of economic activities;
- The shift of the role of the government in the social sectors of health and education from one of provision to one of empowering of access; and
- The abolition of the resultant administrative organisations.

The reform agenda would, naturally have implications for human resources in the administrative system and their management. The changes in human resources management should be such as to ensure that there is continuous matching of skills in inducting personnel to jobs. This would call for several changes to personnel systems in the public sector.

- The current dependence of the administrative organisations on lifetime employees would need to be abolished.
- Concurrently, the remuneration and compensation practices applied in the public sector should, unlike today, be geared to levels and conditions that would make public sector jobs more competitive in the job market.

Such a radical reform agenda, obviously, needs extensive and continuing public support. The creation of a support constituency for the reform agenda has to include organisations of the civil society as well as elements in the bureaucracy and in the polity who are ready to accept reforms. The creation of such a support constituency has to be based on the fullest awareness of the need for and content of the proposed reforms. If, therefore, a reform agenda is to be launched, a mandatory obligation is cast on the political leadership to be in the vanguard of a process of public education and of awareness creation.

The readiness of a support constituency to rally behind an agenda for the restructuring of governance would only be forthcoming if there is a perception that the leadership in the polity, both within and outside the government of the day, is serious about and is committed to implementing the agenda of restructuring.

**NOTE**

In the article published under the title "Consumer Rights & Comparison with other Countries – UK, Australia and India" in our Jan/Feb. 2002 issue on Consumer Protection & Fair Trade, the author's designation has been inadvertently stated as [illegible] Federation of Consumer Associations of Sri Lanka (FOCASL) by an oversight. While we regret the error, we give below the correct designation of the writer. We [illegible] the inconvenience caused in this connection to [illegible] the present President of FOCASL.

[illegible]
Former Senior Economist, Central Bank of Sri Lanka
Present Member, Fair Trading Commission

# WTO Members Report on Anti-Dumping Activity

The WTO Secretariat reported that in the period 1 July – 31 December 2001, 19 Members initiated 186 anti-dumping investigations against exports from a total of 55 different countries or customs territories. During the corresponding period of 2000, 18 WTO Members had initiated 187 anti-dumping investigations.

India initiated 51 investigations during the second semester of 2001, as compared with 21 investigations initiated during the second semester of 2000. The United States had the second highest number of initiations (35) during the second semester of 2001, compared with 38 during the corresponding period in 2000. Argentina had the third highest number of initiations, 18, a decrease from 34 initiations in the comparable period during 2000.

China, with 25 investigations on its exports, is at the top of the list of countries subject to anti dumping investigations, although this number is a decrease from the 32 investigations initiated on Chinese exports during the second semester of 2000. Brazil, Chinese Taipei, Thailand and the United States were next, each with 9 investigations initiated on their exports in the second semester of 2001. Indonesia, Korea and Japan each had 8 investigations initiated on their exports in the second semester of 2001.

A majority of the investigations during the second semester of 2001, 121, were initiated by developing countries, with developed countries initiating 65 investigations. This parallels the situation during the second semester of 2000, when developing countries had initiated 101 investigations as compared with 86 initiations by developed countries, but differs significantly from the situation in the first half of 2001, when developed countries had initiated almost twice as many investigations (88) as developing countries (46). Exports from developing countries were the subject of 31 investigations initiated during the second semester of 2001, while exports from developed countries were the subject of 51 initiations, and exports from transition economies (including China) were the subject of 44 initiations. This represents a change from the previous semester and from the second semester of 2000, during which periods transition economies were the second most affected group of countries, while developed countries were the least affected.

The largest group (80) of investigations initiated during the second semester of 2001 involved products classified in the base metals sector of the Harmonized System of Tariff Classification, which includes iron, steel and aluminium products. The other two sectors most affected were chemicals and plastics, with, respectively, 41 and 34 investigations initiated. The United States initiated 33 out of its 35 investigations on base metals products, while India initiated the majority (28) of its investigations on chemical products. Turkey initiated 12 out of its 13 investigations on products in the plastics sector.

Eight WTO Members imposed a total of 79 final anti-dumping measures against exports from 33 countries or customs territories during the second semester of 2001. This total represents a sharp decline from the 107 measures imposed during the corresponding period of 2000. Notable also is the decline in the number of countries imposing measures, from 16 countries during the second semester of 2000. The United States imposed the most final measures (21) during the second semester of 2001, a significant increase from the 8 final measures imposed by the United States during the corresponding period of 2000. India was a close second to the United States in the number of final measures imposed during the period, with 20 measures. The European Communities and Argentina each adopted 11 measures during the period, which for the Communities was significant decrease from the 32 measures, imposed in the second half of 2000. Argentina had imposed 10 measures during the second half of 2000.

Exports from China were the subject of the largest number, 21, of final measures imposed during the second semester of 2001. Chinese Taipei was a distant second, with 6 measures. For China, this represents a slight increase from the 17 measures imposed against its exports during the second semester of 2000.

During the second semester of 2001, developing country Members imposed a total of 33 final measures, while developed country Members imposed a total of 46 final measures. Developing countries and transition economies (including China) each had 34 measures imposed against their exports, while developed countries had 11 measures imposed against their exports. As was the case for initiations, the sector most affected by final measures was base metals, with 34 final measures imposed on products in that sector. This was followed by the chemicals sector, with 13 measures imposed, and the machinery and electronics sector with 8 measures.

The anti-dumping semi-annual reports by Members for the period 1 July – 31 December 2001 can be found under document series G/ADP/N/85.

The WTO Anti-Dumping Agreement allows governments to act against dumped imports where there is material injury to the competing domestic industry. In order to do that the importing government has to determine, after investigating, that dumping is taking place, calculate the extent of dumping (how much lower the export price is compared to the exporter's home market price or "normal value"), and determine that the dumping is causing injury.

GATT Article VI allows countries to take action against dumping. The Anti-Dumping Agreement clarifies and expands Article VI, adding detailed procedural and substantive requirements, and the two operate together. They allow countries to act in a way that would normally break the GATT principles of binding a tariff and not discriminating between trading partners – typically an affirmative finding in an anti-dumping case results in an additional import duty on the particular dumped product from the particular exporting country in order to bring its price closer to the "normal value" or to remove the injury to domestic industry in the importing country.

Courtesy: WTO

# Diary of Events

**March**

1st **Deep-sea bunkering at Hambantota** - The Government will shortly establish a deep-sea bunkering facility out at sea, around 15 nautical miles from the proposed Hambantota port which will provide a deep sea bunkering facility for vessels sailing past Sri Lanka. This is the most state-of-the art proposal that Sri Lanka could proceed with where ships can be re-fuelled and serviced mid sea without arriving at the port which will provide the impetus to industrial and shipping growth for not only Southern Sri Lanka but also the entire region.

**Incubator for Matara** - UNIDO provided $ 100,000 for Ruhunu Business Incubator UNIDO arranged and funded international and local consultants to carry out a feasibility study and to identify a location for an incubator in the Matara District. The main sponsors of the Ruhunu Business Incubator (RBI) are the Agriculture Faculty of the Ruhuna University, the Matara District Chamber of Commerce and Industry (MDCCI), Japan Lanka Industrial Centre (JLIC) and the SDA.

4th **Central Bank enhance limit of NOP** - The Central Bank has enhanced the limit on the daily positive Net Open Position (NOP) of Commercial Banks from 10 per cent of capital and reserve to 15 per cent and extended the limit on the duration of forward contracts in foreign exchange to one year with effect from 1st March 2002. This enhanced limit would enable commercial banks to manage their foreign exchange positions while financing even large import bills, without causing excessive volatility in the foreign market.

7th **Cheaper cargo rates** - Ceylon Carriers Ltd. and the Transport Corporation of India signed an agreement to launch a cost-effective system of cargo transportation in Sri Lanka. Its immediate benefit would be cheaper cargo rates. This network in the sub continental links 900 major cities, and it covers a network of 160 towns in Sri Lanka. The service is available to manufacturers, wholesalers, distributors, hoteliers, marketing and plantation companies.

13th **Australian grant for rural women development** - The Australian High Commission announced financial grants, totaling 1,750,000 rupees, on 8th March. The funds will assist seven community organizations undertaking projects to support Sri Lanka women, especially in rural areas. The Australian forces for International Women's Day this year were Women in Agriculture.

15th **ECHO help to Jaffna through ICRC** - The European Commission, through its Humanitarian Aid Office (ECHO), has allocated Euro 1 million to assist the population of the Jaffna peninsula, ECHO's partners for this operation will be the International Committee of the Red Cross and Action Centre for Faith (ACF) 700,000 Euro will be channelled to the ICRC to provide transport of humanitarian assistance by sea to the Jaffna peninsula. A further 300,000 that will be allocated to ACF for the improvement of water and sanitary conditions for those sections of the population regarded as particularly vulnerable.

**Tourissm boost** - Sri Lanka tourism will receive a boost with the arrival of the 2nd batch of Iranian tourists to Sri Lanka on 21st March 2002, on Mahan Air. There will be 180 passengers in this tourist group and they are scheduled to visit historical places in Sri Lanka. Iranian market is one of the potential tourist markets and it helps to increase the confidence of Iranian tourists to Sri Lanka.

**Total exports are soaring** - Total exports inclusive of imports/re-exports in January 2002 shows an increase of 1.19 million kgs or 5.41% when compared with the same period last year. Bulk exports show a growth of 1.4million kgs or 10.9% instant tea exports show a growth of 22.7%. Approximate FOB unit value for total exports in January recorded at Rs 220.22 shows an increase of Rs 2.72 or 1.25% when compared with the Rs 217.50 recorded for the same period last year.

18th **Rubber & coconut record negative growth** - Major plantation crops recorded a negative growth rate. Two of the country's major plantation crops coconut and rubber recorded negative growth rates last year. While coconut production was down by 9.7% to register a figure of 2.8million nuts. Rubber was down by 1.4% to record a production figure of 86 million kilos.

19th **Capacity building of Regional Chamber of Commerce** - An agreement to promote capacity building of regional chambers of commerce and enterprises in Sri Lanka was signed recently between the Federation of Chambers of Commerce and Industries of Sri Lanka (FCCISL) and the Swedish International Development Agency (SIDA) at the FCCISL Auditorium.

**SIDA assistance** - SIDA will provide US$ 1 million (Rs 93 million) for the five year project due to be completed in two phases with initial support for three years and a further extension of two more years depending on its initial success.

20th **Debt relief grants from Japan** - An exchange of notes, providing Yen 3,577 million (approximately Rs 2.5 million) in grant aid, was signed by Mr Shuhei Takahashi, charge d' Affaires of the Embassy of Japan and Secretary Ministry of Finance. The Debt Relief grant will make adjustments to the past bilateral aid from Japan to Sri Lanka to relieve the debt repayments difficulties in Sri Lanka. This grant has been extended annually since 1978 by Japan in keeping with Resolution 165 of the ninth special session of the Trade and Development Board of the UNCTAD – dated March 11, 1978.

21st **Central Bank reduces Re-purchase rates** - The Central Bank has reduced Oversight Re-purchase (REPO) and Reverse Repurchase (reverse repo) rates by 50 basis points from 12 per cent to 11.50 per cent and from 14.00 per cent to 13.50 percent respectively with effect from 20 March, 2002 with a view to moving towards a more active open market operations system. The repurchase rate is the rate at which commercial banks and primary dealers are invest their surplus funds in Treasury Bonds and Treasury Bills and Commercial Banks and primary dealers can obtain funds from the Central Bank against the collateral of Treasury Bills and Bonds.

**New food processing technology** - The partnership with the Nashville Electric Service and the Electric Power Research Institute announced a new food processing technology that uses ozone to improve the freshness and extend the shell life of freshly cut fruits and vegetables. The process will be used at Strickland Produce Inc. in Nashville, following a four year development period, ozone a natural sarilizer that can be generated by special processing equipment will be used during the washing of produce before it is pre-packed and shipped to grocery stores and restaurants. The ozone technology destroys bacteria that can cause premature spoilage of fruits and vegetables while also ensuring a safer product for the consumer without any residue of chemical by products.

22nd **Rebate for self-generation of Electricity** - The Ceylon Electricity Board (CEB) will extend the present Self-generation Rebate Scheme for international and commercial customers till the end of June, 2002. A unit generated and consumed by the customer will be paid at Rs 10.50 per unit and resold back at the present tariff rate, CEB told Daily News.

24th **International aid for Development** - The International Community has shown a interest to assist the country to achieve its economic goals backed by Norway, the OPEC Fund, Japan, the World Food Programme and the Asian Development Bank the Netherlands and Germany.

**WFP provides grant** - The World Food Programme has agreed to grant Rs 1,600 million to rehabilitate people displaced in the war-torn area.

**ADB to assist in poverty reduction** - The Asian Development Bank President, Todao Chino, who signed the US Dollar 210 million Poverty Deduction Partnership Agreement with Sri Lanka for the year 2002, at the Finance Ministry.

**Australian government to assist in Mine Action Programme** - The Government of Australia has committed Rs 7 million support a Mine Action Programme in the Northern and Eastern parts of Sri Lanka. The main objective of this programme is to facilitate the safe return of internally displaced persons to sites in Jaffna, Vavuniya, Mannar and Trincomalee. Australia provides funding for resettlement and mine action programmes through the Australian Agency for International Development (AUSAID)

26th **VAT to push economic growth** - The government expect additional economic growth and employment generation following the sweeping reforms in the taxation regimes with the abolition of the 12.5 per cent Goods and Services Tax (GST) and the National Security Levy (NSL) and replacement with the two band Value Added Tax (VAT) at 10%-20%.

27th **Electricity charges to rise** - The Ceylon Electricity Board has raised electricity tariffs by 31 to 38 per cent operative from April 1. Domestic users will have to pay Rs 3 for the first 30 units, Rs 4 for 31 to 60 units, Rs 4.40 for 61-90 units and Rs 10.60 for 91 to 180 units, Rs 15.80 will be charged above 180 units, according to tariffs announcement.

28th **Japanese grant for Kotmale Power Project** - Japan granted a soft loan of US$ 297 million dollars (33,265 million yen/Rs 24,280 million) for the upper Kotmale Hydropower Project. The project will add 150 MW to the country's power generation capacity. The total project cost of this project is US$ 380 million, with a local component of US$ 83 million. The Japanese component of the funds will be released by the Japan Bank for International Co-operation (JBIC). The loan is repayable in 40 years inclusive of a grace period of 10 years.

29th **UNICEF help to promote children's rights** - A grant of Rs 78.2 million was provided to UNICEF by the Swedish International Development Agency (SIDA) recently to promote children's rights to protection from abuse and exploitation. The grant was made for the period of three years from year 2002 to 2004, the funds will also be utilized to expand the infrastructure and address judicial, law enforcement, probation and child-care therapy, counseling and rehabilitation issues.


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the year.
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worth Rs. 4 Million is all
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நீங்கள் செய்ய வேண்டியதெல்லாம் மாதம் முழுவதும் உங்கள் மக்கள் வங்கி சேமிப்புக் கணக்கில் ஆகக் குறைந்தது ரூ. 10,000 அல்லது நடைமுறைக் கணக்கில் ரூ. 5,000 நிலுவையாக வைத்திருப்பதுதான். உங்கள் சேமிப்புக் கணக்கில் அல்லது நடைமுறைக் கணக்கில் நீங்கள் மேலதிகமாக வைப்புச் செய்யும் ஒவ்வொரு ரூ. 5,000 உம் உங்களுக்கு மேலதிக வெற்றி வாய்ப்புக்களை எடுத்து வருகின்றது என்பதனை மறந்து ... கணக்குகள் ஜயசிறி சீட்டிழுப்பில் சேர்த்துக் கொள்ளப்படுவதில்லை.)
Simply maintain a minimum balance of Rs. 5,000 in a Current Account or Rs. 10... ccount with the People's Bank (remember, every additional Rs. 5,000/- in your Current