

Ajith Nivard Cabraal: Sri Lanka's peace dividend and recipe for growth and stability

Presentation by Mr Ajith Nivard Cabraal, Governor of the Central Bank of Sri Lanka, at the 25th Anniversary Convention of the Association of Professional Bankers "Beyond growth – a formula for success", Colombo, 8 October 2013.

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President of the Association of Professional Bankers, Mr. Aravinda Perera. Guest of Honour and Immediate Past Governor, Reserve Bank of India, Dr. D. Subbarao, Deputy Governors of the Central Bank, Distinguished delegates at the 25th Anniversary Conference of the Association of Professional Bankers, My dear friends.

At the outset, I wish to thank the Association of Professional Bankers for inviting me this evening to share a few thoughts on the occasion of their 25th Anniversary Conference. I am also delighted that a highly accomplished and eminent scholar who has held the esteemed offices of Secretary to the Ministry of Finance of India and the Governor of the Reserve Bank of India, Dr. Subbarao is here to deliver the Keynote Address, at this august Conference. I am sure his scholarly inputs, spiced with his rich experiences would add immense value to the deliberations of your Conference, and that such foundation would provide the most appropriate platform for the timely Conference Theme: ***"Beyond Growth – A Formula for Success"***. Knowing the high technical prowess, vast experience and wonderful oratorical skills of Dr. Subbarao, I do not think I need to offer any comment on the theme of the Conference, since he would do ample justice to that topic. Therefore, I shall merely concentrate on the subject area that the President of the APB invited me to dwell upon, namely ***"Sri Lanka's Peace Dividend and Recipe for Growth and Stability"***.

My dear friends, when any person looks around our country they will witness the massive and rapid infrastructure development taking place. They will also experience the phenomenal changes that have taken place, and are taking place in our economy. The past major drawback in our country and economy, namely, the terrorism conflict, is now over, and we have so far enjoyed about four and a half years of peace and tranquility. ***Much has happened during that period, which really is the peace dividend, although sometimes we do not think of it on those terms.*** Therefore, in order to set the background for my address, let me quickly reflect on some of these achievements.

In the post-conflict economy, Sri Lanka recorded many important milestones. Per capita income doubled to reach over US dollars 2,900 in a relatively short period, thereby elevating the country to an "emerging market economy" status; the economy grew to a robust US dollar 59 billion, from about US dollars 24 billion in 2004; Inflation was controlled at single digits for more than four and a half years; Poverty levels reduced to around 6 percent from about 15%; Unemployment reduced to less than 4 percent; The quality of infrastructure was enhanced to a level comparable with many emerging market economies; Foreign reserves were maintained at over 6 billion US dollars; The public debt was managed prudently so as to reduce the debt-to-GDP ratio from a high of 105 percent in 2003 to about 78 percent; An over 8 percent economic growth was achieved in successive years 2010 and 2011; Private foreign investment inflows into the government has exceeded US\$ 7 billion; The Fiscal deficit was limited to 6.4% in 2012, from a high of 9.9% in 2009; The country's Doing Business global rank has reached the 81st level, up from 102nd in 2010, while being poised to jump about 10 places this year; Regional development has made tangible progress and the Western Province share of GDP reduced to around 43% from 51% in 2005; Regular foreign investment has flowed into banks and the stock market; The banking system was maintained in a stable condition even in the midst of very difficult global circumstances.

Needless to say, the collective efforts that we have all put together to improve and sustain the positive outlook for our nation, have ensured a conducive investment

atmosphere. In that regard, the stable inflation and the comparatively lower interest rate regime prevailing today, serves as an important support to businesses, by reducing the risk factors. Moreover, the country's peaceful environment, complemented by political stability, has been able to ensure the continued safety of investments, while providing a reasonable yield. In this context, the robust investment framework along the lines of the "5+1" hub concept, has now opened out new ventures in promoting maritime, aviation, energy, knowledge and commercial sectors, while tourism is emerging as a further thrust industry with great promise.

My dear friends, those in the banking sector know very well that there were many special initiatives that were taken over the past several years at various times, in order to fashion and support this transformation. For purposes of completeness, let us quickly recollect a few such major initiatives that helped us in this regard.

We established consultative and advisory committees from the private sector for monetary policy and financial system stability; We opened out Sri Lanka Treasury Bills and Bonds to foreign investors; We issued international Sovereign Bonds; We introduced mandatory corporate governance practices for banks and NBFIs; We developed resolution schemes to stabilize systemically important banks and NBFIs, and when needed, we applied such schemes practically; We established a Deposit Insurance and Liquidity Support Scheme; We fashioned the current "virtuous cycle" – low inflation to low interest rates to higher investment to higher growth, etc.; We accessed an IMF SBA on our terms, and completed the programme; We intervened in the application of certain fiscal policies, which were sympathetic to inflation behavior and other macro-economic factors; We implemented tough monitoring of inflation control measures; We introduced some far-reaching stabilization measures whenever needed; We relaxed Foreign Exchange Regulations on a planned basis.

That list of "Have dones" is therefore an impressive one. But, we would be the first to admit that, that is the past. The challenge now would be as to what more we should do in our journey into the future. How do we reach a US\$ 100 billion economy? How do we proceed beyond the US\$ 4,000 per capita income level? How do we ensure that we do not fall prey to the deadly "middle-income trap" that has snared many countries in the past? How do we ensure that our transformation is sustainable and long lasting? How do we maintain momentum? In short, what is the "recipe" that Sri Lanka must have for growth and stability, in the next decade and beyond?

I believe all those questions are important ones, for the economic policy planners to reflect upon, and to share with other key stakeholders of the economy. While doing so, there would also be many matters and issues that all stakeholders of the economy would need to give their continuous attention, and share with policy makers. It's a two way process! In that context, I believe your 25th Anniversary Conference would provide a useful opportunity for a broader discussion on this all important "recipe", so that we, as policy makers would also benefit by your rich and professional contributions.

My dear friends, in my view, Sri Lanka's long term growth and stability recipe would need to contain several key ingredients.

First, the maintenance of sound macro fundamentals and the continuous movement of those macro fundamentals in a positive and benign direction. What that would mean, in a practical sense, is that we will have to maintain inflation at low and stable levels for the next decade. That would, in turn, mean that the demand side management would have to be carefully anticipated and managed, while the required interventions in the supply side will also need to be promoted and encouraged. At the same time, the fiscal consolidation would need to be sustained, so that the positive effects of such effort would enable the debt dynamics to improve constantly. Those efforts would also have to be supported by on-going improvements in productivity, with the resulting benefits influencing the exchange rate as well. Businesses will have to become more productive, competitive and efficient, and the overall expansion of the economy through new fronts, particularly the 5 Hubs and Tourism,

would need to continue in a focused fashion. By constantly improving our enabling environment and economic structures, as well as by ensuring that the private sector stays vibrant, motivated and well financed, the economy should be able to consistently grow at over 7% per annum, and in certain years, even exceed 8%. By maintaining such a momentum, our economy would become more resilient and diversified, thereby enabling us to face whatever new risks that could emerge from an unpredictable global environment.

Second, Sri Lanka would need to attract regular capital from outside our shores in order to bridge our current savings/investment gap so as to sustain the over 7% growth momentum. In the past, some persons have been pre-occupied with the notion that foreign direct investments and investments into the Government, are the only channels through which foreign savings could enter our country. However, we have taken a broader view, and we believe that our savings/investment gap could be bridged through several sources in addition to the traditional sources. As a result, we have encouraged foreign inflows into the banking sector, foreign inflows into the stock and corporate bond markets, and foreign inflows as loan capital into eligible businesses. All these channels have now been made transparent and convenient, thereby making it easy for overseas investors to make their investments. These convenient inflows, with appropriate safeguards for the providers of capital would enable the country to enjoy a sustained inflow of savings, which would, in turn, support the high growth momentum envisaged by the economy.

Third, we need to continuously ensure the stability of the financial system. In this regard, the banking and the NBFIs sectors, as well as the insurance sector would play very important roles, and over the next few years, we are keen that a consolidation takes place in these sectors, in order to have strong institutions within these sectors. In today's hostile and volatile environment, it is necessary for the banks and NBFIs to at least have a minimum critical mass, in order to be competitive, resilient and strong. That would necessarily mean that some of the smaller and less stronger institutions would need to merge with each other, or become the targets of strategic acquisitions in order to create large and strong institutions in this sector. Such a consolidation would also enable the governance structures to improve, as well as reduce today's rather high "cost per transaction", as a result of the enhanced scale of operations. Therefore, over the next few years, it would be necessary to fashion and encourage such a consolidation outcome, and the policies that would lead to such an outcome would need to be encouraged.

Fourth, the country will have to sustain its poverty reduction strategies as well continue with strategies that are designed to foster balanced regional growth. Over the past four and a half years, an enormous investment has been made in the North, which has resulted in the Northern Province reaching a reasonable parity *viz-a-viz* the other provinces. This has been an amazing achievement, and I believe we have now been able to set the stage for a more gradual improvement of all provinces, so that we could bring all the provinces closer to the standard of the Western Province, which has already comfortably surpassed a US\$ 4,000 per capita income. The recent infrastructure development drive at rural level, particularly the construction and upgrade of the rural roads and the supply of electricity to every household in the country, together with the massive strides we have made in making finance accessible to all people in all parts of the country, have greatly helped to fulfill these objectives. Therefore, the stage is now well set for the constant upgrade of a variety of services at Provincial level, and the effective integration of all areas of the country, with better roads, technology, communication, business services and banking services. Such improvements would serve to reduce provincial disparities, and thereby allow the country to achieve its ambitious goal of less than 3% poverty by 2016. At the same time, as a result of the fast tracked development of the provinces, we could probably reach a situation where the GDP contribution from the advanced Western Province would only constitute around 33%, by the year 2025. Such an outcome would indicate a sustained revival of the 8 lagging Provinces, which collectively accounted for less than 50% of the GDP contribution in the year 2005. Accordingly, if within 20 years, 2005 to 2025, the Western Province share of the

country's GDP could be reduced from one-half to one-third, I believe we would be well on track to balanced regional growth, whilst also not depriving the Western Province of the fruits of rapid development. Such a transformation would mean that the cry which led to two bloody revolutions, namely, "kolombata kiri, gamata kekiri" would be a slogan which could then be comfortably relegated to the dust-bin of history.

Fifth, we would need to enhance the productivity levels of the country, whilst also managing the migration of a large work force from the current traditional sectors to some of the new sectors that are opening out in our economy. Over the next few years, large numbers of youth and other skilled persons would need to form the new back-bone of the labour force that is needed for the 5 Hubs and Tourism, as well as in some of the other growth sectors such as health and education. Where would this new work force come from? Obviously, some will need to migrate from the agricultural sector, while others would need to shift from their present activities to the new areas of activities. Such a shift would necessarily demand that the existing economic activities would have to robustly improve its' productivity levels, through the use of better techniques and methods, including the application of IT. That transformation would also suggest that a massive education and training effort would be needed, whilst also requiring the enhancement of the levels of productivity and work ethic, particularly in the agriculture sector. Those changes would be vital, as well as, good for our economy. Vital, because when such a shift takes place towards the new thrust areas, the transformation of the economy will take place as planned. Good, because some of the economic sectors, particularly agriculture, where we had been used to very low levels of productivity, would have to get its act together and quickly transform itself to new and better methods of resource use so as to do more with less! In that scenario, exciting opportunities will emerge towards the realization of overall higher levels of productivity, and I believe the bedrock for our future sustainable development would be this productivity improvement across all sectors of our economy.

Sixth, Sri Lanka must continuously improve its global rankings. As is well known, our country had been lagging behind in the world scene on many fronts, mainly as a result of our focus for nearly 30 years, being on just keeping body and soul together in the face of the deadly terrorist threats. As a result, up until a few years ago, our global rankings were quite dismal and low. Of course, our rankings were somewhat high on health and education and very high on cricket! But unfortunately on many business related indices, we were lagging far behind many countries, and our scores in Doing Business, economic freedom, global competitiveness, etc. were certainly not flattering. However, about 2 years ago, we started an initiative to carefully examine the criteria that is used to rank countries in relation to various indices, and taking the necessary steps to improve in each of these areas, and prove to the world that we really mean business! I believe if our efforts continue to prove successful over the next few years, and Sri Lanka materially improves its global rankings on many business indices, we would stand out as an economy with great promise and potential. That would also help us to be well positioned to truly gain recognition as a global Hub.

In this connection, let me relate a little story that may indicate Sri Lanka's growing promise and potential. A few days ago, a high ranking official of one of a major multinationals met with me, and he told me that they are becoming increasingly frustrated by the very high costs that they have to bear in the top Asian capitals of Tokyo, Beijing, Singapore, Hong Kong, Jakarta, Manila and Kuala Lumpur, which is making it increasingly expensive for them to do business in those cities. According to this official, their Head Office is therefore actively searching for alternate cities in Asia with good quality infrastructure, high standards of law and order, efficient communication, convenient sea and air connectivity and excellent living conditions, in order to consider re-location of some of their regional offices. In that regard, he said to me that within the next few years, if Sri Lanka is able to display a high degree of improvement in each of these areas of interest to multinationals like them, Sri Lanka could very well be a strong candidate for consideration by such global giants, to locate their regional offices. In this conversation, what struck me first was that such a conversation would

never have been even remotely possible, just five years ago. What struck me second, was the fact that Sri Lanka is today moving into the radar screen of global giants, which shows that we are being taken seriously. That, my dear friends, to my mind, is one of the best indications that Sri Lanka is gradually reaping the peace dividend after its 30 year conflict!

Seventh, Sri Lanka would need to show progress of its political stability on a sustained basis, over the next several years. As we all know, high norms of democracy have been maintained and peaceful conditions exist, in our country, compared to many other countries. However, a strong negative publicity has been drummed up by a certain segments of the overseas Sri Lankan diaspora, through which such groups have been able to portray Sri Lanka as a country with political and human rights deficiencies. Unfortunately, the massive progress Sri Lanka has made in recent years with regular elections, terrorism and violence free conditions, rapid economic development, large scale investments, large numbers of newspapers, TV and radio stations publishing and beaming news almost every second without any censorship whatsoever, have not been given sufficient credit, internationally, as a result of the outside world being bombarded with the false claims by these anti-Sri Lanka forces. Although the efforts of these inimical groups are gradually losing steam in the face of the Sri Lankan political structures being continuously strengthened, there is however a vital need for Sri Lanka as a country, and for all Sri Lankans as individuals, to work towards developing our external image on a continuous basis. In that context, we must constantly remind our overseas friends that Sri Lanka is a country that has a 2,500 year history with strong political institutions and an educated, politically savvy population, and that the people of different castes, creeds, and ethnicity, interact lot better than in many other countries. By doing so, we could effectively challenge and deal with the build up of various false myths that may have the potential to threaten the political stability in our country over the next few years. If we are able to respond successfully, and convey this reality to the outside world in a comprehensive manner, we could put to rest, many of the unfair and false allegations that have been leveled against the country.

My dear friends, what I have endeavoured to explain so far are the key ingredients that would need to be used in the recipe for growth and stability. However, as we all know, ingredients alone won't provide us with a tasty, wholesome dish. To turn out a tasty dish, we need to use the ingredients, in the right quantity and quality, prepare and temper those ingredients properly, mix them appropriately, and cook them at the right temperature according to the required method. It is only then that the dish will be tasty, attractive and wholesome.

What then is our next challenge? In my view, the special ingredients that I have so far spoken of, as well as the other elements that are needed to develop a good economy, namely, basic common sense, good timing, sound policy mix, sensible political considerations, continuous well-being of the people, would all need to be generously used as flavours in the preparation of the final dish of growth and stability. We would also need to maintain the balance of all the ingredients at the right "temperature" if the outcome is to be right. After all, a dish, if it is overdone or half done, is not going to be edible. In the same way, if economic planners do not judiciously give consideration to developing and matching the right mix of policies which work, and being sensitive to the timing and sequence of the flow of the policy implementation, the growth and stability of the economy would not be attainable.

Mr. Chairman, my dear friends, over the past 7 years, I believe we have been able to deal with many challenges from within and outside, and that is why we have been able to deliver stability and growth to our economy. Nevertheless, we must all remember that yesterday's tasty meal will not necessarily mean that tomorrow's meal will also be tasty. Tomorrow is another fresh challenge with different considerations, and circumstances. If we are able to assess these conditions cleverly, and develop our plans properly, (and I believe we are well positioned to do so), Sri Lanka would truly be on course to deliver growth and stability on a sustained basis to our people and our economy.

Mr. Chairman, permit me to conclude by making the simple remark that there is no path to success or prosperity, other than via careful planning and hard work. Sri Lanka has so far progressed with promise, because we have “walked the talk”. Many of the goals that we set in the past and the major projects that we set our sights upon, have been realized, or are taking shape before our very own eyes, because of dedicated and committed actions. Let’s be encouraged and inspired by those successes. Let’s also step up for the future, and get ready to deliver growth and stability on a consistent basis.

Thank you.