

## Arjuna Mahendran: Central Bank of Sri Lanka's 65th anniversary

Speech by Mr Arjuna Mahendran, Governor of the Central Bank of Sri Lanka, at the commemorating ceremony of the Central Bank of Sri Lanka's 65th anniversary, Central Bank of Sri Lanka, Colombo, 28 August 2015.

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Today is a very important day for all of us. 65 years is not a small period in the life of an institution and first and foremost I must thank all of you who have kept the torch of central banking alive and well in Sri Lanka over the last 65 years. I know most of you haven't been here for that length of time but certainly those traditions have been passed on to you and you are I think preserving them very well and making sure that they are moving on into the next generations' hands in good condition. At this point, we should take a step back and look at what we have achieved in those 65 years.

First of all, when we were established in 1950, the statute that enabled the establishment of this institution was very clear, in-terms of its objectives and that statute has more or less remained unchanged in that whole period, which I think in Sri Lankan terms is quite a record. There haven't been significant amendments to the Monetary Law Act in that period and our objectives still remain the same; the control of inflation, the promotion of financial stability and banking sector and financial system stability and the thrust for a broader economic development of the whole country, that in a nutshell is what our objectives are, which is very clear, its unambiguous and it has kept us on the straight and narrow path through some fairly challenging periods.

I think there are very few central banks in the world that have gone through the sort of events that we have been through, most notably the bomb blast which you know affected us, the physical lives of several of our colleagues and their families and such like over the years. And that was related obviously to the civil strifes that this country went through for almost thirty years. Nevertheless I think the central bank has maintained financial stability, we have kept inflation reasonably under control, and the economic development of the country has done reasonably well despite those challenges, which is in no small measure due to the efforts of successive generations of central bankers who have stuck to their principles by and large and kept the momentum of the country moving forward. So it is appropriate for us to take a moment and just accept a little bit of self-congratulation at this point of time. And certainly, my endeavor is to see that we promote these noble ideals and take the country and this institution to even higher heights, now that we have peace in this country and a lot of those hurdles that the central bank faced in the last three decades are behind us and we have to gear ourselves to promote those objectives of this institution in relatively normal circumstances in the future.

To do this, we now have to assess what those three objectives of ours mean in the broader sense and I have been reaching out to some of you over the last six months in this regard. First of all, when we look at the control of inflation, I think that has been fortuitously resolved by external events. You can see that in the global markets we have falling commodity prices worldwide. The large country that has appeared in the last decade, China, has indulged in a lot of spending in the last ten years to revive the global economy and in the process, commodity prices shot up which caused no small measure of problems for us. But now, that spending boom is over and as you can see, China's growth is slowing down. And as a consequence, we also benefit from falling commodity prices and therefore our inflation is easier to control.

On the financial stability front, I would say that the banking system looks in reasonably good shape. That is partly because banks have been extremely conservative in the last twenty to thirty years because of the war situation and they did not lend aggressively. More recently we saw some of them becoming a little aggressive and they got a bit burned when agriculture

was affected by the drought last year. Then you saw the big exposure to gold and pawning activities which also affected bank balance sheets slightly. Most of those problems I am glad to say, seem to be behind us. So the banking system looks in fairly good shape. Finance companies pose some concerns and. I think we have far too many of them. We were a bit too liberal in-terms of encouraging finance company growth in the last ten to fifteen years. As a consequence, today we are coping with some unusual situations in that sector. But there again, with some resolve and some out of the box thinking, we will be able to bring that sector also under control. So all in all, I think the financial system is responding favourably. We have several infrastructural challenges ahead of us so we have to make our stock markets, our bond markets and our foreign currency market work as a market and really respond to the challenges of bringing in more participants, broadening its appeal and becoming real instruments of channeling the savings not only of Sri Lankans but also of people living overseas so that institutions and our real businesses can benefit from those flows of financial activity and grow at a stronger pace than they have grown in the past. That is our broad challenge going forward and at the same time ensuring that we do not allow the sort of excesses that creep in, in such situations which cause financial disturbances and panics.

So this is going to be the challenge going forward for all of us, to establish that stability and to have a very clear set of rules. Remember that the way financial markets have evolved historically for centuries is on the basis of having “rule-based” systems, where every player in the market, whether it is the regulator or the regulated, abides by a set of rules. And that is the most effective way for any system to function. It cannot be based on the whims and fancies of the regulator, or the government or any single player in the market. There has to be an even playing field, the goalposts have to be stuck very firmly in the same place and the same rules have to apply, just like game football or cricket. You cannot change the rules as you go along. That to me, is very essential. So at the moment we are trying to make those rules very clear to all the market players in various forms. We have already done so in most of the markets, in the foreign exchange market, in the fixed income markets, and I think the SEC is now trying to establish the rules in the equity market. Once all that comes together I think you will see a significant improvement in the way our entire financial sector operates and hopefully that will be the main conduit for financing of development in the years to come. So this deals more or less with the challenges we have in the financial space and our efforts to ensure financial stability.

But really, it is the third objective, which is the economic development of the country that I wish to spend a few minutes on today. This is the area, which, for various reasons central bank has engaged and disengaged over the years and decades. Basically, the bank took a backward step about fifteen to twenty years ago and very understandably so, because that was the time when the war was raging and we had our own problems to contend with, particularly in-terms of ensuring stability. Therefore the central bank did not pursue aggressively a strategy of engaging with the rural sector and with the broad development of the entire country. We more or less stuck to our basic activities in-terms of financial stability optimization and inflation control and economic development objective took a slightly backseat. I think now it is incumbent on us to really re-engage with the government, with all the social sector players, with all sorts of industry groups, agriculture groups, service sector groups and really map the way forward on how this country can grow. When you look at the situation it is not bad, but on the other hand there is a lot of work to be done. Take for instance the fact that the entire Northern Province contributes only 4% of the total national GDP. That is simply unacceptable. We have nine provinces in this country and you cannot have one of them only contributing 4%. That is simply unbalanced, and the opportunity is that we have in Northern Province three branches, in Trincomalee, in Jaffna and now in Kilinochchi, and there is no reason at all why we cannot spur all the banking institutions in Northern Province to come under our umbrella and really see that the economic potential of that region is achieved. It is very simple. We just have to see that the banking institutions and ourselves work on a coordinated basis to look at what resources that area of the country has,

whether it is manpower or land that is unutilized, and the agricultural potential. I am not saying that we should only focus on the Northern Province, even the Southern Province. We have a branch in Matara, but I think there is a lot of work to be done. I recently visited areas around Hambanthota, and I find that the potential there really, is still not exploited. There are a few factories here and there, few agricultural projects that we are funding, but we are nowhere near the sort of potential we can achieve particularly since so much infrastructure has been installed in that area and built in recent years. I think that infrastructure is not being used. We have the rather comic situation today where an airport is being used to store paddy because of a mismatch of the needs of that airport to be economical with the needs of the broader economy which has other pressing problems to be achieved. So this is a classic example how we have to put on our thinking caps and come up with solutions for the government.

One big advantage that we have is that central bankers have through the decades, manned very important government institutions. Even when I look today, institutions as varied as the Ministry of Defense, the Ministry of Finance and such like have very senior central bankers working there in some form or another. And even in the legal sector, the Attorney General's Department is working very closely with us. I think we have a significant role to play in-terms of capacity building not just in the banking sector, but in several other sectors that are vital to the economy. That is the challenge that all of you have to remember and try and participate. I myself, when I worked in these institutions few decades ago, the Ministry of Industries, in the Treasury, it was a very enriching experience personally. But at the same time, I carried over the expertise I had picked up in the Central Bank and enriched those institutions as well. So that tradition should continue and I think it is incumbent on the central bank to really use our manpower.

All of you are a concentrated pool of brainpower in this country. I do not think any other institution has so many qualified individuals. We have engineers, we have people from all sorts of fields, not just economics, in this institution, and we have to really build on those skill sets. One of the plans I have, which I am discussing with the DGs, AGs, is to try and deepen our skill sets. We have to identify specific skill sets which are necessary for the central bank in the first instance, and also for the broader nation and to try and deepen those skill sets in a conscious basis so that our manpower development, what you call the improvement of our human capital becomes much more entrenched and becomes much more integrated in-terms of the national economic developmental effort. Just to give you an example, we do not have enough accountants in the government service. When I talk to the police, the CID, the Attorney General's Department, all these departments they do not have accountants. They cannot analyze when they see a balance sheet in any corporate case, they do not know how to handle it. There is a desperate shortage of manpower, partly because the accountants in this country can get much better salaries when they work for the private sector. Now how do we bridge this gap? I think given that the Central Bank is a very secure service – maybe we do not pay as much as the private sector but we do give security of tenure, you all get EPF and pensions – these sort of long-term prospects will attract good people to this institution on continued basis. I have tried in my own way to fight with the government to get increases in wages for all of us and also reinstating the pension and I hope that will make it much more attractive for people to work for this institution and keep you from moving away into the private sector. But in the process we also have to develop our skill sets and really organize and prepare ourselves for the challenges of the future.

The future I think is going to look very different from the past in this country. We are now reaching a level of normalcy which most of us have never experienced in our lifetimes. The year I joined this institution, 1983, was when the problem of the ethnic issue started, unfortunately. And it raged on for almost thirty years. So I do not think any of us have really experienced that normalcy and as a result, people are not really prepared to take on the challenges of what a normal market economy looks like. Hence, it is really incumbent to us, to define for the country, for the government, for the people. And to propagate that message

we have to be much more forceful in-terms of using the media, whether it is the newspapers, the television or social media, to bring forward views on what we think the future of Sri Lanka will look like. Obviously in consultation with the government, we have people, as I said, in various institutions of government who can coordinate with us to come up with a comprehensive message, and using our annual report and other publications, we can continue to project that report, that view, that map of the future and engage with the government on how that will be achieved, all the while stressing the need for financial stability, the control of inflation and for seeing that economic development takes place in an optimal manner. That I think is really the challenge for us. We have to imagine what the future is going to look like. And at the moment I think this is the best institution to do so.

So the challenges are ahead of us. It is not easy to change mindsets. Remember, that a lot of people in this country, particularly those who work for the government have been used to a war situation. For most of their working lives, they have been living in a war economy. A war economy is very different from an economy at peace. That, in my view, is why you had a change of government this year and you have a new government, who is trying to win the peace. We won the war, but it was very difficult to win the peace. Why? Because our mindsets were stuck in the past. There was that concept of control. You had to control everything in the economy including prices. When I say prices, I mean the exchange rates, the interest rates, other prices which affect the functioning of the economy. That is all justifiable in a war situation. But when you come into a peace situation, where it is a normal functioning market economy, then you have to re-think, you have to get back to first principles, and reassess how the economy should work in a new dispensation. That is a challenge before us, and I'm asking all of you to join in this effort to try and redefine the scope of everything we do in the Central Bank, to see that we reorient ourselves towards winning peace in the broader sense, to making the financial sector, the economy and other types of institutions in this country work in an effective manner that can raise the growth, the potential of this economy, raise the skill levels, and most importantly, bring about that ethnic harmony which I think has been amply demonstrated here today in-terms of all religions and faiths coming together and propagating the message of peace and goodwill, at the same time hoping for a better Sri Lanka for us, our children and grandchildren.

So with that simple message, I thank you very much for all your efforts. I think the last six months for me have been a very steep learning curve, coming back and reorienting myself with this institution, which is very dear to my heart. I have observed tremendous improvement, in-terms of several processes that were never there when I left this institution in 1993. I find that there is still more to do but I think Sri Lanka as a country has a great potential. We are geographically situated in a location which is at the center of the fastest growing population cohort, globally. As you know, the last twenty to thirty years were the era of China. China grew massively because it had a very fast-growing population. Also the East Asian countries around it, like South Korea, Taiwan, Singapore and Hong Kong had mounted their economic miracle by opening up their market and making their exchange rates competitive and basically getting huge amounts of foreign investment. That model worked effectively and it is the only model that really is open for emerging markets to prosper. But now they are facing a problem. Their populations have stopped growing so they do not have young, creative workers coming into the workforce in-order to make their economies continue to grow at the fantastic rates of growth they achieved for several decades; 10–12% of rates for economic growth. So now the challenge is for the countries around the Indian Ocean. Particularly the Southern Indian Ocean. The whole SAARC Region including India, Sri Lanka, Pakistan, Bangladesh, even the Maldives in its own way, and then look at the Middle East, parts of the Middle East which are prospering, particularly the UAE, Oman, Qatar and similar countries and then the whole of the African Continent, which you may or may not know, has about a billion people. This is almost the size of China about ten years ago.

If Africa can get going with its vast stores of minerals and other types of natural resources, then you really see a transformation in this part of the world. This part of the Indian Ocean

will, I think, really be the fastest growing region in the world in ten years' time. But we have to be part of that, we have the head start in-terms of human capital. I have travelled this region intensively and nowhere have I found the quality of manpower that you have in Sri Lanka. When I used to go Pakistan ten years ago, all my clients used to tell me that their teachers used to be from Ceylon. We are very famous for our teachers, even in Singapore and all these regional countries, Ceylonese teachers used to go and teach in the 1960s and teach their children how to speak, read and write in English and they have very fond memories of this. This shows how ahead of the curve, Ceylon, as it was then known was in-terms of grooming and teaching people basic skills. For instance, most of the senior doctors in Singapore were Ceylonese who went across, including people in the judicial sector. The current Finance Minister of Singapore is Tharman Shanmugaratnam and his father was a Sri Lankan from Jaffna who went across and is still a member of the Medical Faculty in the Singapore University. So we have a head start in-terms of human capital. All our people as you know, have a hunger for education, whether you go to the village or the richest families in the cities, all of them have that great hunger for education. To me that is our strength. We have better human capital resources I would wager, on a per capita basis even than India and other countries in the region. So we can provide that real leading edge. Our people are all over the world. Wherever you go, if you look at expatriates, Sri Lankans in any country, anywhere in the world – I have been to the Caribbean, places like Barbados, even there you find Sri Lankans. And they are doing very well in their professional endeavours. So we have to reach out to this diaspora, as I call it, and ensure that they also come and help us but already within the country, we have a sufficient pool of people who really can lead the charge, not just in-terms of raising Sri Lanka's profile but also attracting foreign investment and other resources which will help this country provide leadership in this region in the decades ahead.

So remember that it is a great challenge for all of us, this institution is going to be at the epicenter of this country's efforts to develop itself. President Maithripala Sirisena who visited us, a few weeks ago, made it very clear that his main objective is to see that people's incomes increase. That is his objective. He has spelt out his objective. How do we achieve that? That is where we have to sit now and brainstorm. To me the key challenge is how to raise productivity. Productivity is very important, output per capita. This is the key element that we have to utilize. We have to see how we can harness the use of Information Technology to leapfrog a lot of time that we have wasted in this useless war that ended five years ago and see that we really enable ourselves to make this economy grow, leapfrog into the 21st century, start using IT and other types of skills which will then make us a very modern economy and raise our productivity levels which have lagged in the last thirty to forty years. That I think is a key challenge we should focus on, and how to achieve that is really up to you. It is your ideas that will make this happen. So thank you very much once again, I wish you all the very best for the next 65 years, I don't know how many of us will be there but I am sure some of those young people who have just joined the bank will certainly be there for a large measure of that time. And I think we have everything at our disposal now to achieve what I have set out. It is really up to you now to make that happen. So thank you very much and God bless you.