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Sri Lanka in 2018:

Towards a Bold New Vision¹

As Sri Lanka enters 2018, it carries with it a number of key issues from the previous year. Its economy faces serious challenges due to the lack of adequate revenue generation to meet its demands. Health and food security pose challenges to social security. The Indian Ocean geopolitics will also continue to influence the island nation. In this backdrop, the task for the government would be to achieve the goals and objectives set out in “Vision 2025: A Country Enriched” – the policy document of the government.

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The year 2017 drew to a conclusion, marking several achievements for the United National Party-Sri Lanka Freedom Party coalition government. The government issued a comprehensive document, explaining Sri Lanka’s vision for the foreseeable future. Launched

¹ The Institute of South Asian Studies (ISAS) at the National University of Singapore (NUS) has undertaken a prognosis of the eight South Asian countries in 2018. This is both opportune and relevant, given significant developments in the region. Although it requires some crystal ball-gazing, such prognosis is important in providing an understanding of the outlook for each country. This paper is part of a series of nine papers on key development in the eight South Asian countries, namely, Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka, this year.

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in September 2017, Vision 2025³ outlines a shared sense of purpose and an understanding of the need for coordinated collective effort. Thereafter, Budget 2018 reflected the action plan for achieving the goals and targets set in the Vision 2025 document. The government managed to introduce new reforms to tax system through the new Inland Revenue Act, marking progress in financial reforms. It is expected that the Act will achieve a wider taxation base, and reduce tax avoidance and tax evasion that will help the country raise revenues in the long term.

Following the Local Authorities Elections (Amendment) Act, No. 16 of 2017, in December 2017, the Election Commission called for polls in 341 local authorities. The local government election will be held under the mixed electoral system whereby 60 per cent of members will be selected through the first-past-the-post voting system and the remaining 40 per cent through closed list proportional representation.

Despite floods and other natural disasters which adversely affected the macroeconomic performance of the country, the gross domestic product (GDP) grew at an approximate rate of four per cent. However, rice production fell by 53 per cent in the first quarter of 2017 due to drought and a further 2.9 per cent in the second quarter due to flood, affecting food security in the country. The product of the major export crops – tea, rubber and coconut – also declined significantly.

The government is taking initiatives to transition the economy from being rural based to an urbanised one which will be manufacturing- and service-oriented. It is also carrying out fiscal and political reforms to improve public and financial management, and to strengthen democracy and reconciliation. However, Sri Lanka will still continue face some crucial economic and social challenges. Against this backdrop, this paper looks into some specific issues and challenges the country will continue to face in 2018.

³ Vision 2025: A Country Enriched. http://www.pmooffice.gov.lk/download/press/D0000000061_EN.pdf. Accessed on 15 January 2018.

Economic Challenges

Sri Lanka's GDP is expected to grow just below five per cent in 2018 and inflation is predicted to fall to four per cent.⁴ As the health of the economy improves, the current account balance is also expected to further improve. The tourism and construction sectors will further bolster the economic growth. However, if Sri Lanka does not expand its scope in generating revenues and attracting investments, it will be challenge to achieve the GDP target and stabilise the economy.

Presently, the government primarily relies on tax-based revenues and borrowing to ensure financial security. The new Act on the Inland Revenue Tax, introduced in 2017, was targeted at improving the tax-to-GDP ratio and improving the revenues of the government. Given the government's eagerness to move away from a tax-based to a non-tax based economy, it has to focus on improving the performance and revenues from state-owned enterprises.

Sri Lanka's economic structure is as such that the services sector contributes 60 percent to the GDP. Even more interesting is the engagement of state-owned enterprises in the services sector. According to the 2016 Performance Report of the Department of Public Enterprises (PED) of the Sri Lanka Ministry of Finance, there are about 400 state-owned enterprises (SOEs) in operation in Sri Lanka. Of these, 55 have been identified as strategically important based on their importance to the national economy, volume of operations and the number of employees. However, out of these 55, 16 SOEs made losses in 2016. The total losses of these SOEs were around US\$4.1billion (SG\$5.41 billion) between 2006 and 2015.⁵ During the first quarter of 2017, four key SOEs⁶ recorded US\$199.9 million (SG\$263.82 million) in operational loss.

The losses by the SOEs are one significant factor that will hinder or decelerate the economic growth of the country. Given the size and the breadth of the SOEs, their activities determine the overall productivity of the Sri Lankan economy. Their efficiency and effective

⁴ Sri Lanka: Economy, *Asia Development Bank*, <https://www.adb.org/countries/sri-lanka/economy>. Accessed on 15 January 2018.

⁵ Five key institutes, namely, Ceylon Petroleum Corporation, Ceylon Electricity Board, Sri Lankan Air Lines, Mihin Lanka and Sri Lanka Transportation Board are responsible for 95 per cent of the losses.

⁶ Ceylon Electricity Board, Ceylon Petroleum Corporation, SriLankan Airlines and Sri Lanka Port Authority.

performance is vital if the government wants to develop a non-tax based economy. However, as the Performance Report 2016 of the PED admitted, the low investments in productivity-enhancing technologies and practices, capacity building of staff, lack of the necessary skills due to the inability to attract human resources in competitive basis with the private sector, and overstaffing hinder the ability of the SOEs to effectively contribute to the national economy. Given the government's keenness in enhancing non-tax based revenue and its commitment to accountability, autonomy and productivity of the SOEs, it is important for Sri Lanka to make multiple policy interventions in order to ensure efficiency and productivity of the SOES.

Further, investments should be attracted from both the domestic and foreign investors. Periodical political changes, which affect immediate changes in policy, affect the government's ability to attract investments from both the foreign and local private sectors. The constant change in policies, following the change in the local political environment, has damaged the confidence of the investors. As a result, it negatively affects foreign direct investment into Sri Lanka. Ensuring a favourable business environment and strengthening confidence are important in order for investors to see Sri Lanka as a viable investment destination.

The country should give serious thought to encouraging the private sector to participate in infrastructure development through public-private-partnership – this will expand the economic portfolio of infrastructure. While infrastructure development is important for a healthy economy, the dependency on borrowing to improve the infrastructure will only lead to rising indebtedness.

Social Issues

The majority of challenges in social security will come from the health, food and water sectors. The Sri Lankans are particularly vulnerable to dengue epidemic which surfaces every time after a rainy season. According to the Epidemiology Unit of the Ministry of Health, 185,688 suspected dengue cases were reported in 2017. In the first two weeks of January 2018, the unit reports of 2,982 cases of suspected dengue patients. This data shows that the

current mechanisms under the anti-dengue campaign are not enough to eradicate the crisis. Currently, under the anti-dengue campaign, the government promotes the regular removal of possible mosquito breeding sites and proper waste management. The focus is to combat stagnant water collected during floods and rainy seasons. However, the severity of the crisis suggests that innovative measures such as bioinsecticides, biological and new genetic approaches should be given serious consideration as alternatives to controlling the mosquito population.

Sri Lanka has fallen further in the Global Food Security Index in 2017. According to the 2017 index, Sri Lanka ranked 66th in terms of food insecurity, falling one place down from its ranking in 2016. As per the State of Food Insecurity in the World Report of 2015, 23 per cent of Sri Lanka's population is undernourished. The Cost of Diet Analysis of the World Food Programme records that 33 per cent of the population cannot afford the minimum cost of a nutritious diet. The rising cost of staple food, due to the frequent occurrence of extreme weather conditions, and declining arable land and food production, are issues that require immediate attention in order to improve food security in the country.

Despite the slow economic growth, Sri Lanka has always ranked highly in its human development. In fact, its level of human development is equal to that of the developed countries. One of the things that the Sri Lankan citizenry expects from its government is ensuring social security. Sri Lankan governments which have attempted to restructure the universal social welfare of the country or have failed to ensure social security for the citizenry have faced defeat at the national elections as a result.⁷

Vulnerability to Regional Competition

Sri Lanka will continue to be affected by challenges arising from regional competition. As the competition among the major powers for presence and influence in the Indian Ocean continues to increase, Sri Lanka's vulnerability to regional trajectories will increase

⁷ Harthal of 23 August 1953 was a result of the government's failure to ensure economic and social security, food security in particular, is one of the best examples. Later, in 1956, people used their voting rights to overthrow the United National Party government which was in power during the Harthal. For more information on the Harthal, refer to *Harthal!* by Colvin R. De Silva.

accordingly. The year 2017 ended with rising competition between China and India, following the Doklam incident, and there were hints of growing competition between the two Asian giants for influence in the smaller South Asian countries. Despite India's opposition and concerns, Sri Lanka leased the operation rights of the Hambantota port to China Merchant Port Holding Company for 99 years and commenced the Sri Lanka-China Logistics and Industrial Zone Office in the Ruhunu Economic Development Area.⁸ While this marked another achievement Sino-Sri Lankan relation, it continued to fuel Indian paranoia over Chinese presence in Hambantota. This is clearly reflected in New Delhi's tug of war with China over the control and operational rights of Mattala Airport.⁹

The beginning of 2018 witnessed the announcement of Singapore and Sri Lanka signing a free trade agreement (FTA), which signaled another landmark in Sri Lanka's foreign policy. At the moment, Sri Lanka has only two bilateral FTAs, namely, with India and Pakistan. The one with Singapore, once signed will be its third. Singapore is currently Sri Lanka's fourth largest export partner behind China, India and United Arab Emirates. The proposed FTA is expected to comprise commitments in trade in goods, services, investment and government procurement¹⁰ which will give a significant push towards the enhancement of trade relations between the two countries. It will also reinforce Singapore's position as one of Sri Lanka's top trading partners – it has declined from being Sri Lanka's second largest import destination (2005-09)¹¹ to fourth at the moment.¹²

The commencement of the Economic Zone with Chinese funding and the signing of the FTA with Singapore, against the backdrop of the failed Economic and Technological Cooperation Agreement (ECTA) with India, are likely to lead to discussions on whether New Delhi is losing its foothold in its underbelly. This new development will only cause India to increase its efforts in Sri Lanka. New Delhi is already negotiating for the operational rights of Mattala

⁸ "Sri Lanka-China Industrial Zone Office in Hambantota Port kicks off industrialization of Ruhuna, *Daily FT*, 6 November 2017. <http://www.ft.lk/business/Sri-Lanka-China-Industrial-Zone-Office-in-Hambantota-Port-kicks-off-industrialisation-of-Ruhuna/34-642838>. Accessed on 15 January 2018.

⁹ "Asia Pacific News: India and China compete for control of an almost empty Sri Lanka airport", Nyshka Chandran, *Consumer News and Business Channel (CNBC)*, 13 December 2017, <https://www.cnbc.com/2017/12/13/india-and-china-rivals-compete-for-control-of-empty-sri-lanka-airport.html>. Accessed on 15 January 2018.

¹⁰ "Singapore, Sri Lanka keen to pursue bilateral free trade pact", *Daily News*, 1 June 2016. <http://www.dailynews.lk/2016/06/01/local/83417>. Accessed on 15 January 2018,

¹¹ Foreign Aid Review Reports (multiple years), Department of External Resources, Sri Lanka.

¹² Sri Lanka Trade at a Glance: Most Recent Values, World Integrated Trade Solutions, World Bank Group. <https://wits.worldbank.org/CountrySnapshot/en/LKA>.

Airport, and development of Trincomalee port, the Trincomalee Oil Tank Farm and the adjoining area. India's push for the ECTA will also lead to a resurfacing of the discussions fairly soon.

Conclusion

The aforementioned issues provide an overview of Sri Lanka's economic, social and regional landscape in 2018. However, these issues represent only some of the key challenges. Considering the events of 2017, it is also fair to assume that energy insecurity and environmental issues will also pose challenges for Sri Lanka in general. As such, the government has to carefully craft its policies to ensure that it will meet the goals and objectives outlined in its Vision 2025. In order to ensure the healthy and sustainable growth of the economy, the government needs to initiate policy changes to ensure the efficiency and effectiveness of the country's massive public enterprise sector, strengthen the SMEs, and ensure a better business-friendly environment for investors. It also needs to encourage public-private partnership in every sector. At the same time, innovative measures to address social issues, including health security, food and water security, and energy security are vital because they will have a direct or indirect impact on the economic performance of the country. Investing on research and development to address social issues is one of the major steps the government could take in this regard. Finally, given the rising competition in the Indian Ocean Region, Sri Lanka should make its foreign policy choices carefully. Sri Lanka should capitalise on the opportunities arising from the strategic competition between the other countries, while ensuring a balanced foreign policy. This will be a tough challenge though!

Most importantly, Sri Lanka should capitalise on its strategic location and be more involved in the Indian Ocean affairs. The country's positioning in the middle of the Indian Ocean brings advantages in the forms of opportunities, yet also makes it vulnerable to regional trajectories. Since Sri Lanka is directly influenced by developments in the Indian Ocean, it should be more actively engaged in these developments.

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