ISAS Brief

No. 527 – 20 November 2017

Institute of South Asian Studies
National University of Singapore
29 Heng Mui Keng Terrace
#08-06 (Block B)
Singapore 119620
Tel: (65) 6516 4239 Fax: (65) 6776 7505
www.isas.nus.edu.sg
http://southasiandiaspora.org

Sri Lanka's Budget 2018:
Environment, Enterprise and Economics

Sri Lanka's government recently introduced its budget for 2018 in November 2017, which follows the 'Vision 2025' masterplan introduced in September 2017. This paper looks at the central themes which emerged out of the budget speech, namely, a 'blue-green' economy and 'Enterprise Sri Lanka', as well as the potential of the budget to address Sri Lanka's current economic challenges which include an intractable deficit, low revenue collection and a trade imbalance.

Ankush Ajay Wagle[1]

Introduction

Sri Lanka, which once enjoyed healthy economic growth, has witnessed an economic slowdown over the last three years. A potent mix of factors such as bad debt, trade imbalances and poor revenue, accentuated by the advent of natural disasters such as floods and drought, has hobbled growth, and requires urgent policy attention. Earlier, in September 2017, the government had introduced 'Vision 2025', an economic reform plan aiming to boost competitiveness and correct unequal geographic growth, among other objectives. Against this backdrop, Sri Lanka's 2018 budget was introduced by the Minister of Finance,

[1] Mr Ankush Ajay Wagle is Research Assistant at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore (NUS). He can be contacted at ankush@nus.edu.sg. The author bears full responsibility for the facts cited and opinions expressed in this paper.

Mangala Samaraweera, on 9 November 2017. The budget was presented under the theme of 'Blue-Green Budget: Enterprise Sri Lanka' wherein the 'blue' and 'green' refer to the objectives of integrating the 'full economic potential of ocean-related activities' and an 'environmentally sustainable development strategy' respectively, whereas the 'enterprise' is the attempt to 'reawaken the entrepreneurial spirit'[2] of the nation.

The Blue-Green Economy

Sri Lanka's chosen theme for the 2018 budget corresponds with the same 'blue-green' strategy (formally known as 'Sri Lanka Next') announced by the government last year and which also comes under the aegis of its commitments made during the COP21 climate change conference in Paris.[3] Under the umbrella of a 'blue' economy, Samaraweera put forth proposals, including the protection of the coastal belts, lagoons and estuaries and establishing a Blue-Green Institute as the coordinating secretariat for further 'blue-green' theme undertakings. The budget also apportioned Sri Lankan rupees (LKR) 3,325 million (S$29.3 million) for projects in the fisheries industry such as upgrading anchorages and landing sites, and technology such as refrigerated storage.

On the 'green' side, the minister proposed introducing tax incentives to promote the shift towards electric vehicles, with the aim of phasing out all fossil fuel-powered vehicles by 2040 and converting all government vehicles to electric or hybrid vehicles by 2025. Incentives to the value of LKR5,300 million (S$47.01 million) will also be earmarked for off-grid solar power. Furthermore, he also proposed introducing a carbon tax for different types of motor vehicles. Perhaps in view of both the disastrous garbage dump incident in Colombo and the devastating floods across the country, where many people lost their lives earlier this year, Samaraweera highlighted the allocation of LKR3,000 million (S$26.4 million) to develop the Arruwakkalu waste disposal and management site as well as LKR4,900 million (S$43.4 million) towards flood mitigation measures, including the construction of reservoirs. Other significant measures include pollution controls such as those for groundwater monitoring, eco-friendly parks, the 'Pavithra Ganga' river project and 'Nilwala Eliya' model

[2] Budget 2018 – Budget Speech. The Parliament of Sri Lanka. http://www.parliament.lk/files/pdf/budget/2018/budget-speech-2018.pdf. Accessed on 12 November 2017.

[3] Sri Lanka Next. http://www.srilankanext.lk/news.php?id=9. Accessed on 13 November 2017.

park. The collective expenditure earmarked for these initiatives is LKR5,250 million (S$46.5 million).

Enterprise Sri Lanka

The second major theme of the budget was that of developing ‘Enterprise Sri Lanka’. Under this overarching theme, the budget outlined monetary disbursement and relevant policy steps for stakeholders such as small and medium enterprises (SMEs) and entrepreneurs, as well as areas such as trade and investment. The largest allocation within the budget was LKR10,000 million (S$89 million) towards the setting up of a development bank with an export-import window. This bank will finance private sector initiatives in the long term. The finance minister also declared that eight existing credit schemes for SMEs and micro-entrepreneurs will receive LKR15,000 million (S$132 million). Other disbursements were also declared for sectors such as start-ups and information technology. From a trade perspective, the budget announced the removal of 1,200 para-tariffs on imports (in addition to 100 removed last year) and the introduction of an Export Market Support Programme for domestic exporters. In logistics, it laid out plans to amend maritime acts relating to ports and shipping to aid competitiveness. Additionally, several industry-specific reforms for goods such as tea, cinnamon, maize, coconut, poultry, boats, timber, gems and jewels were proposed. In the area of foreign direct investment (FDI), the budget included reforms for removing restrictions on land ownership rights of foreign-owned listed companies, introducing systems for e-local governance and facilitating public-private partnerships. Lastly, in developing an entrepreneurial environment for the youth, the budget allocated a collective LKR5,500 million (S$48.5 million) for initiatives such as an Employment Preparation Fund, skill development programmes and technical colleges.

The Potential of Budget 2018: A Mixed Picture

In September 2017, Sri Lanka’s government launched ‘Vision 2025’, a blueprint for the holistic development of the country. The 2018 budget largely followed this roadmap and even reproduced verbatim some of the medium-term objectives, including doubling exports to

US$20 billion (S$27.10 billion), raising per capita income to US$5,000 (S$6,775) and increasing FDI to US$5 billion (S$6.7 billion) a year.[4] The Vision 2025 plan identified four constraints to growth as follows – structural failings, weak export performance, public finance burden and regulatory barriers.[5]

The 2018 budget has certainly tried to address some of these issues. For example, in public finance, the government has had low revenue generation for some years due to several reasons, including tax exemptions, the low tax base and inefficient tax governance.[6] After the low point of 11.5 per cent of revenue as a percentage of the gross domestic product (GDP) in 2014, there has been a marginal growth in the revenue for the last three years. The 2018 budget seeks to bolster this trend by building on the fiscal policy of 2016 in aiming to broaden the tax base, rationalise tax concessions and streamline the tax collection. It also sets aside provisions for the implementation of the Revenue Administration Management System under the Inland Revenue Act, which was revised and certified this year. If implemented efficiently, these policies hold the potential of boosting the revenue next year, as projected by the government. Similarly, as previously noted, the budget has made the provisions to reduce regulatory cholesterol through the removal of land ownership restrictions and liberalising access to finance for SMEs through the establishment of the development bank. This again holds potential for economic growth.

However, the projected increase in revenue still falls short of addressing Sri Lanka's persistent budget deficit. On the expenditure side, the budget projects a fractional 0.5 per cent increase in the expenditure as a percentage of GDP (from 19.9 per cent in 2017 to 20.4 per cent next year). As a lower-middle income country, the government's budget deficit is high (5.2 per cent of GDP in 2017) although the government has projected this to reduce to 4.8 per cent in 2018. The debt servicing requirement of the government is projected to jump to 89 per cent of the revenue next year which will only fuel the country's debt.

4 "Eight Year Economic Development Plan: Vision 2025 A Country Enriched", *Sunday Observer*, 10 September 2017. http://www.sundayobserver.lk/2017/09/10/features/eight-year-economic-development-plan-%E2%80%98 vision-2025%E2%80%99-country-enriched. Accessed on 13 November 2017.

5 Vision 2025, pp 12. Prime Minister's Office, Government of Sri Lanka. http://www.pmoffice.gov.lk/download/press/D00000000061_EN.pdf?p=7. Accessed on 13 November 2017.

6 Sri Lanka Ending Poverty and Promoting Shared Prosperity, *World Bank*, 2015. Accessed on 20 November 2017.

In the external sector, the budget outlines some policies to mitigate the weak export performance (which is attributed to a strong ‘anti-export’ bias), including the Export Market Access Support programme, a trade portal for the dissemination of information, and industry specific policies. While these appear to be positive steps, they are unlikely to change the country’s trade imbalance situation which suffers from deeper issues such as the reliance of government revenue and exports on imports.[7] Furthermore, FDI inflows into the country have been dismal due to a variety factors such as the poor regulatory environment and the difficulty in doing business (Sri Lanka ranks 111th in the World Bank’s doing business ranking in 2017).[8] A report by the global rating agency Moody’s, released last month, projected that FDI inflows to Sri Lanka will remain around the current level (1.2 per cent of the GDP in 2016) over the next two years.[9]

Lastly, the projections of the budget itself have been debated. For example, the report by Moody’s also forecasts that the current account deficit will persist in 2018 and 2019 (with the low FDI unable to cover this deficit),[10] which goes against the budget projections which expect a surplus from 2018 onwards. Professor S S Colombage, an economist and former civil servant, has also projected that the budget deficit next year will surpass the 4.8 per cent predicted by the government and would likely be above five per cent.[11]

Conclusion

Sri Lanka’s 2018 budget theme, based on the blueprint of the ‘Vision 2025’ policy, is markedly different from that of the previous year (the broad theme of the 2017 budget was ‘Accelerating Growth with Social Inclusion’[12]). However the monumental macroeconomic

7 For a better understanding of Sri Lanka’s trade issues, see Gunasingham, Amresh. ISAS Insights No. 475, “Sri Lanka’s Trade Imperative”, https://www.isas.nus.edu.sg/ISAS%20Reports/ISAS_Insights_No._475-_Sri_Lanka’s_Trade_Imperative[1].pdf. Accessed on 14 November 2017.

8 The World Bank, *Doing Business*, Available at: http://www.doingbusiness.org/data/exploreeconomies/sri-lanka. Accessed on 17 November 2017.

9 “Moody’s paints grim picture for SL’s FDI prospects”, *The Daily Mirror*, 18 October 2017. http://www.dailymirror.lk/article/Moody-s-paints-grim-picture-for-SL-s-FDI-prospects-138648.html. Accessed on 13 November 2017.

10 Ibid.

11 “Sri Lanka likely to overshoot budget deficit continuously till 2020”. *The Daily Mirror*, 16 November 2017. http://www.dailymirror.lk/140518/Sri-Lanka-likely-to-overshoot-budget-deficit-continuously-till-. Accessed on 17 November 2017.

12 Budget 2017 – Budget Speech. The Parliament of Sri Lanka, op. cit.

challenges that the two budgets confront are the same. It will certainly require a Herculean effort in fiscal discipline, deft policymaking and effective implementation to overcome the proverbial mountain of economic problems while also achieving the lofty social and environmental goals set out in the budget.

. . . . .