

# **Policy Challenges of a New Government.**

**by**

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# Policy Challenges of a New Government.

## Background

- **Long term and Short-term Policy Missteps Leading to Economic Crisis**

# Policy Challenges of a New Government

## Economic Crisis

- ▶ **Long Term Factors:** Crisis has been in the making for some time due to entrenched and long-standing structural macroeconomic imbalances over several decades
- ▶ **Recent Policy Missteps:** Several missteps reinforcing long-standing ills leading to hasten the crisis

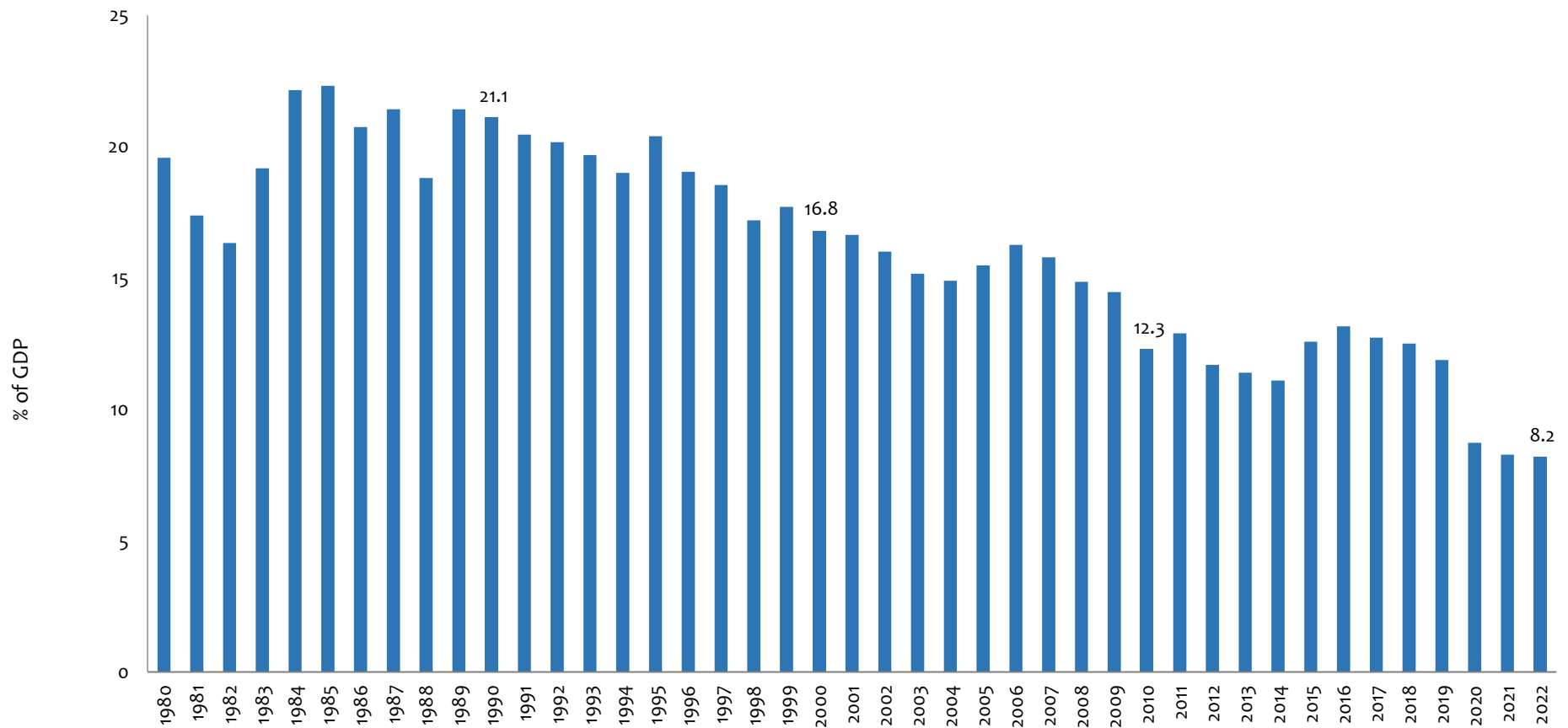
# Policy Challenges of a New Government

## Economic Crisis-Long Term Factors

- ▶ **Postponement of economic reforms: longstanding structural imbalances**
  - Continuation of unmanageable Twin Deficits (budget deficit and current account deficit) for a long time: Sri Lanka had a primary account surplus only in six years- 1954, 1955, 1992, 2017, 2018, 2023 and current account surplus -four years -1950, 1951, 1977 and 2023
  - Unrestrained monetary accommodation of fiscal deficits
  - Politically motivated welfare programs: cash transfers
  - Overvalued exchange rate leading to anti-export bias
  - Persistently loss making SOEs: underpriced state supplied utilities
  - Rigid labour and land markets
  - Weaknesses in governance framework

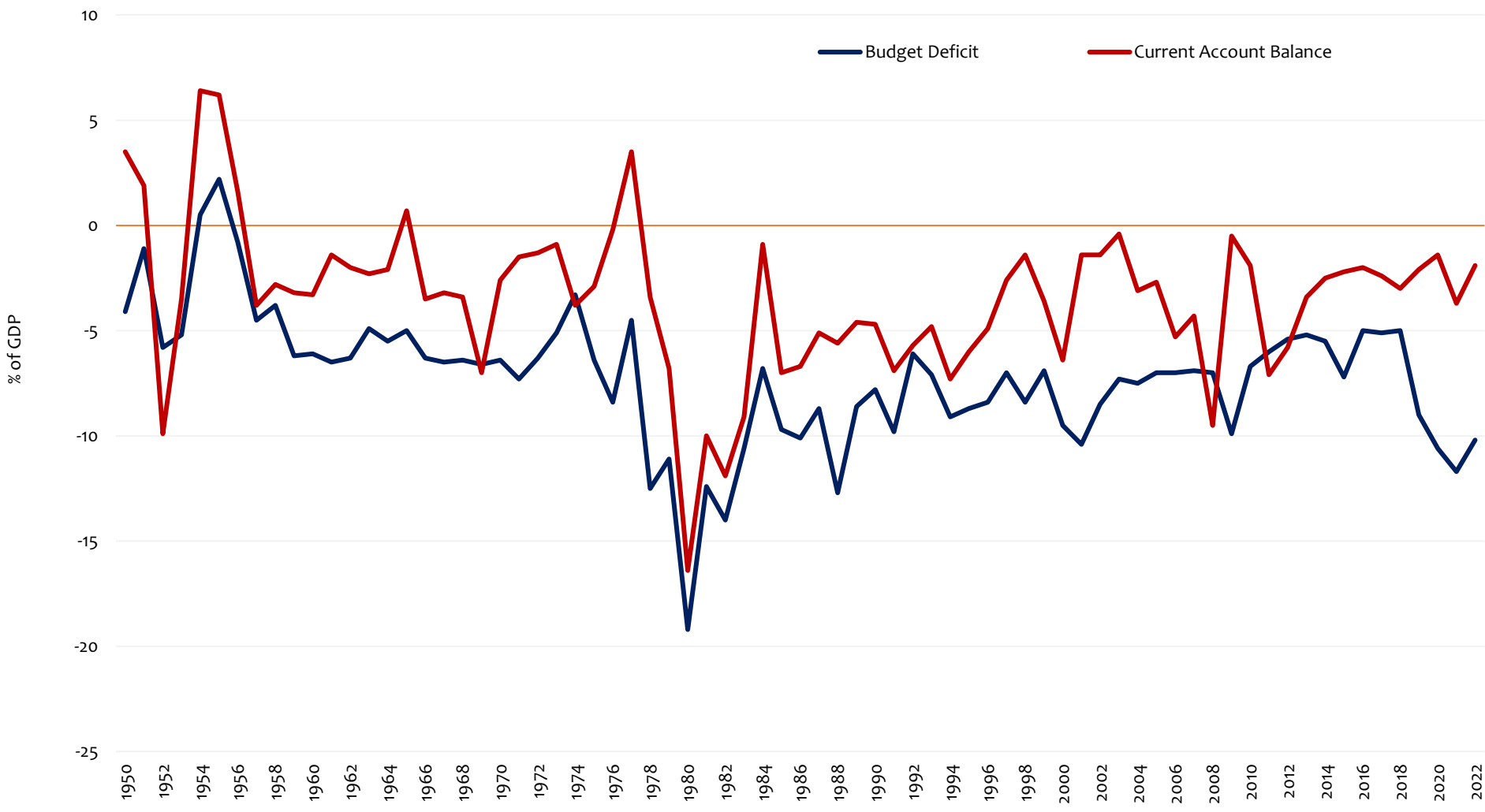
# Policy Challenges of a New Government

Chart 1: Government Revenue (as % of GDP)



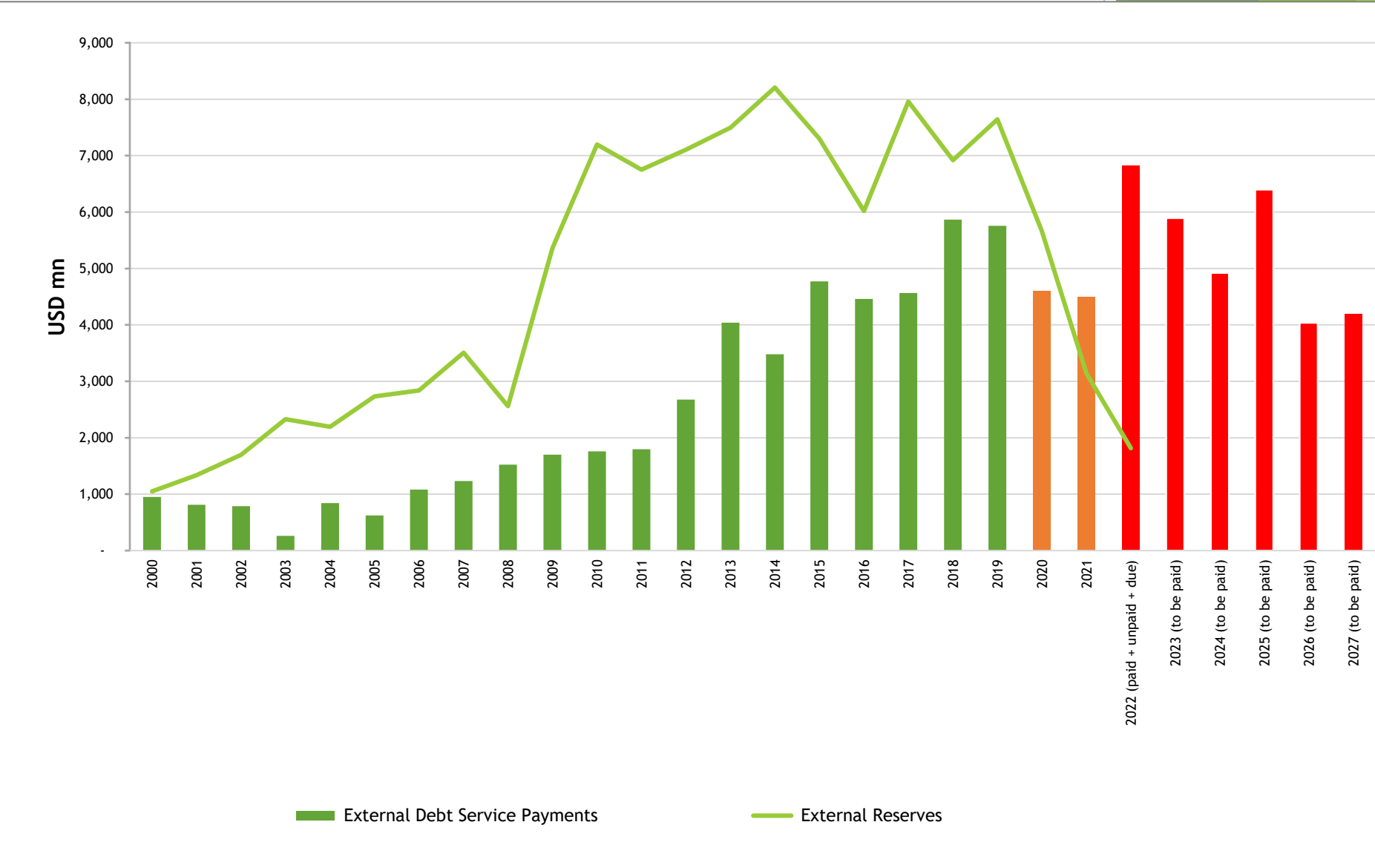
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## Chart 2: Twin Deficit of the Sri Lankan Economy



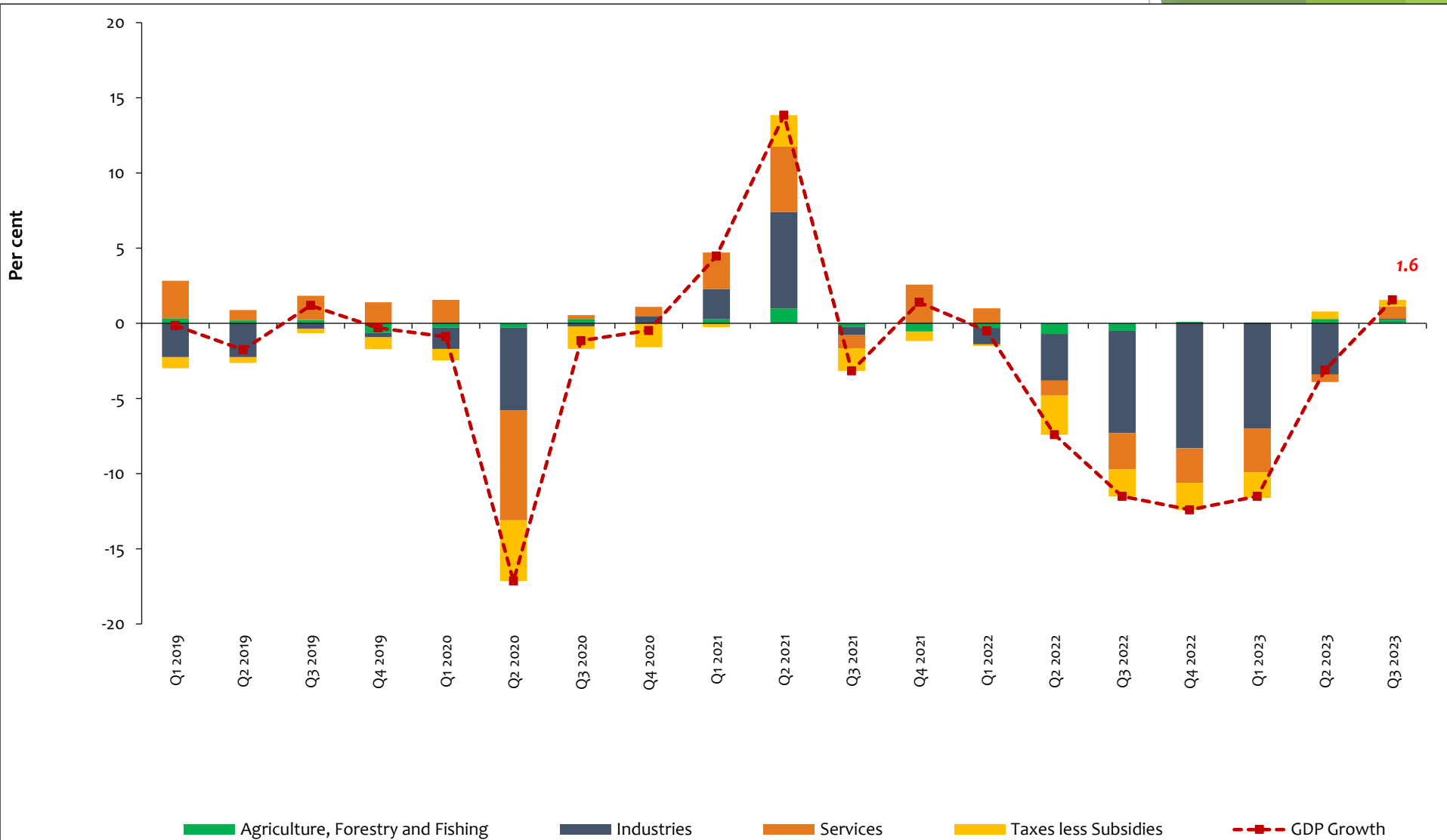
# Policy Challenges of a New Government

## Chart 3: Decline in Gross Official Reserves amidst mounting Debt Servicing



# Policy Challenges of a New Government

## Chart 4: Recovery of Real GDP following Consecutive Contraction (year on year)





# Policy Challenges of a New Government

## Economic Crisis- Recent Contributory Factors

The crisis has begun due to multiple compounding factors like

- ▶ tax cuts,
- ▶ sovereign rating down grades,
- ▶ money printing,
- ▶ depletion of forex reserves,
- ▶ pegged exchange rate,
- ▶ low interest rate regime,
- ▶ shift to organic farming,
- ▶ 2019 Easter Sunday bombings, and
- ▶ impact of the COVID-19 pandemic.

# Policy Challenges of a New Government

## ECONOMIC CRISIS

- ▶ has led to unprecedented levels of inflation, near-depletion of foreign exchange reserves, contraction of the economy, loss of livelihood, shortages of fuel, food and medical supplies and power cuts and socio-political tension
- ▶ has led to sovereign default first time after the independence (declared on the 12<sup>th</sup> of April 2022)

# Policy Challenges of a New Government

## Economic Crisis-IMF-EFF

- ▶ Sought the assistance of IMF in early 2022
- ▶ Agreed on a four-year stabilization program - EFF with US \$ 3.0 Bn in March 2023. It includes
  - ▶ Revenue based fiscal consolidation/fiscal institutional reform
  - ▶ Strong social safety net
  - ▶ Debt restructuring aiming to restoring debt sustainability
  - ▶ Building forex reserves
  - ▶ Safeguarding financial stability
  - ▶ Governance reforms

# Policy Challenges of a New Government

## IMMEDIATE RESULTS

- Inflation** : **down**
- Forex reserves** : **rising**
- Interest rates** : **coming down**
- Govt revenue** : **rising**
- Budget deficit** : **narrowing**
- Treasury Cash Flow**: **management without CBSL inflows**
- Primary balance**: **positive primary balance in 2023;**  
**projected positive for 2024**
- Current Account**: **positive balance in 2023**
- GDP growth** : **2023 H2 positive**  
**and 2024 projected positive**

# Policy Challenges of a New Government

## UNWRITTEN SOCIAL CONTRACT

- ▶ reduces the government footprint to fit into low tax regime
- ▶ raise taxation to sustain govt service that Sri Lanka is used to

*Cannot enjoy the best of both worlds any more*

# Policy Challenges of a New Government

## OVERALL POLICY DIRECTION

- ▶ **Export oriented competitive social market economy addressing environmental concerns**
- ▶ **High income country by 2048**

## TARGETS

- ▶ **Higher rate of annual economic growth: 7-8%**
- ▶ **Trade to GDP: above 100%**
- ▶ **Annual new exports (2023-32): US\$ 3 Billion**
- ▶ **Annual FDI (2023-32): US \$ 3 Billion**

# Policy Challenges of a New Government

## GROWTH PROMOTING REFORM PROGRAM

- ▶ **Modernization**
- ▶ **Factor Market Reform**
- ▶ **Greater International Economic Integration**
- ▶ **SOEs Reforms/PPP Program**
- ▶ **Institutional/Legal reforms**
- ▶ **Digitalization**

# Policy Challenges of a New Government

## MODERNIZATION PROGRAM

- ▶ **Agriculture**
- ▶ **Education**
- ▶ **Health Services**
- ▶ **Public Services**
- ▶ **International Relations**
- ▶ **Defence**



# Policy Challenges of a New Government

## FACTOR MARKET REFORM

- ▶ **Labor - Unified/modern law**
- ▶ **Land- Utilization of unused/under-used lands - new law and centralized institution**
- ▶ **Investment-new law and unified institution**

# Policy Challenges of a New Government

## GREATER INTERNATIONAL ECONOMIC INTEGRATION

Promotions of

- ▶ External trade
- ▶ Tourism
- ▶ Investment

(a new law and unified  
institution for trade and  
investment promotion)

# Policy Challenges of a New Government

## SOE'S REFORMS AND PPP PROGRAM

- ▶ Establishment of a Holding Company and New Laws for SOEs restructuring program
- ▶ New PPP law and development of PPP pipeline

# Policy Challenges of a New Government

## INSTITUTIONAL/LEGAL REFORMS

- ▶ New laws/amendments in line with the economic reform program
- ▶ Institutional reviews and consolidation

# Ongoing Economic Crisis of Sri Lanka: Origin, Remedial Actions and the Way Forward

## DIGITALIZATION

- ▶ Development of public sector driven all embracing digital transformation including new electronic laws and programs

**THANK YOU!**

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