Keynote Speech by Mr. K. M. Mahinda Siriwardana, Secretary to the Treasury, and Ministry of Finance, Economic Stabilisation and National Policies at the "ICC Sri Lanka *Workshop on Trade Finance*", organised by the International Chamber of Commerce of Sri Lanka on 17th February 2024 at Ramada Hotel in Colombo

Theme: *"Road to Excellence – The Continuous Pursuit of Trade Business in Sri Lanka"*

1. Introduction

When excellence in the corporate world is considered, it generally refers to achieving business excellence (BE). In fact, "*the business excellence is about developing and strengthening the management systems and processes of an organization to improve performance and create value for stakeholders. BE is much more than having a quality system in place. BE is about achieving excellence in everything that an organization does (including leadership, strategy, customer focus, information management, people and processes) and most importantly achieving superior business results"*[1]. Achieving business excellence is a journey which requires unwavering determination, and a burning passion to make a lasting impact.

When we talk about excellence in trade business, it is important to understand that continuity of the business itself is critically important, yet alone achieving excellence in trade business. The point I want to highlight here is that 2 years ago, we had a situation where even continuation of a trade business was a difficult task. Opening of a Letter of Credit (LC) was very challenging as Sri Lanka had lost its credibility internationally due to many factors related to the macroeconomic performance of the country that eventually led to the deep economic crisis. The situation was so dire that some commercial banks had defaulted their LCs towards March 2022. Their credit lines had been affected adversely, creating serious negative implications on their trade financing and foreign exchange operations. The key message is that if the economic situation is not conducive, it is not easy to undertake a trade business. Therefore, prudent management of the economy and maintaining excellence in economic management is critically important to establish an operating environment in which trade business can thrive.

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[1] "*Understanding Business Excellence*, An awareness Guidebook for SMEs", Asian Productivity Organization, https://www.apo-tokyo.org/wp-content/uploads/2021/05/Understanding-Business-Excellence.pdf

Hence, I wish to take the first part of your theme today i.e. "*Road to Excellence*" and share my thoughts on some of the issues that I have encountered in the context of economic management, particularly fiscal management, which has a linkage to the second part of the theme, "*The Continuous Pursuit of Trade Business in Sri Lanka*".

Achieving excellence in economic management is critical in Sri Lanka in the context of the deep, unprecedented and most complex economic crisis that Sri Lanka faced in its post-independence history. This is particularly relevant when it comes to coming out of the crisis and creating a growth friendly environment. In order for the different sectors of the economy to excel, a fundamental prerequisite is excellence in economic policy making and governance. In 2022, we all experienced the devasting implications of economic instability and macroeconomic volatility. This was a direct outcome of economic policy failure. This was substantiated in the Supreme Court verdict on FR No. 195/2022. Similarly, excellence in governance and the rule of law are non-negotiable requirements for investments by corporates and SMEs to thrive.

In fact, multiple cross-country analyses[2] have indicated that the key determinants of the investment decision include factors such as macroeconomic stability, enforceability of contracts, ease of setting up business, access to talent, reliable access to utilities, affordable raw materials and so on. The role of government in driving economic advancement and public well-being is ensuring excellence in the above factors and in delivery of public services. The government must also address market failure through unobtrusive regulation, and ensure social justice through effective social protection.

In today's address, I wish to delve into the first of those factors, macroeconomic stability, and particularly fiscal policy, drawing on my experience as Secretary to the Treasury during the last 22 months. I will then touch on how this is linked to trade, and the role of trade in supporting a sustainable recovery of the Sri Lankan economy.

2. Triggers of the Economic Crisis

Sri Lanka's worst economic crisis since independence was due to long standing structural macroeconomic vulnerabilities, that were exposed by domestic policy errors (tax cuts, artificially fixed exchange rate, and artificially suppressed interest rates), and exogenous shocks, including the COVID-19 pandemic and the Russia-Ukraine conflict. Tax cuts by end 2019 resulted in Sri Lanka's sovereign credit ratings being downgraded, leading to

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[2] Refer OECD - https://www.oecd.org/tax/options-for-low-income-countries-effective-and-efficient-use-of-tax-incentives-for-investment.htm

loss of access to international capital markets. As a result, Sri Lanka couldn't refinance maturing external debt of USD 5-6 bn per year. External debt service continued by running down scarce officials forex reserves without any replenishment. Reserves were also used to pay for essential items, including for containers that were stuck in the Customs due to lack of foreign exchange in the market. Eventually, reserves ran out, leading to major shortages of essential items, inflation spiraled peaking at 70% in September 2022, the currency crashed with an 80% depreciation. There were 13 hour power cuts and fuel queues up to 4 to 5 days. Supply chains were completely disrupted. These are hard facts and circumstances directly related to the dire foreign exchange situation of the country at that time. Even in hindsight, nobody can deny that the shortages and queues were due to any other factor. In fact, we would not even be having this workshop on trade finance since even the most basic trade finance instruments, such as LCs, could not be utilized. Due to these disruptions and related reasons, the economy contracted by 7.8% in 2022 and a further 3% in 2023.

When I assumed duties as Treasury Secretary in early April 2022, the country was in chaos. There were neither rupees nor dollars at the Treasury. Every day was a struggle to meet the mandatory payments of the government, be it pensions, Samurdhi, public sector salaries or interest. At the time, just the salary bill and interest cost exceeded government revenue. Government borrowing was a major challenge as monetary financing had reached an excessive level, there was no foreign financing due to the weak credit rating, and the state bank overdraft window was all but closed. Cash-flow management was near impossible as the country ran a primary budget deficit of 5.7% of GDP in 2021. Looking back, now it is hard to believe that we got through that time without missing any of those mandatory payments of the government.

Unfortunately, less than 2 years later, many in society have forgotten or chosen to forget the incredibly difficult time that we went through. The road to recovery has of course not been easy, taxes are higher, utility costs are higher, and salaries are yet to catch up with the escalation in cost of living due to the crisis. However, few consider the counter-factual. What might have been the outcome if the reforms implemented over the last 2 years were not put in place? There are live examples of this – particularly what is going on in Lebanon, Argentina and Venezuela. To avoid that kind of outcome has been an incredibly difficult task. I have witnessed first-hand the dedicated efforts of public officials at the Ministry of Finance, the Central Bank, other line ministries, and the political leadership that supported this process. Most importantly, it was the sacrifices made by the people of our country that has enabled Sri Lanka to gradually get back on her feet.

As public officials, these efforts are our duty and responsibility as professionals. However, it is indeed disheartening when the bona fides of public officials are unfairly called into question, including by members of the country's legislature, behind the cover of Parliamentary privileges. The actions of Treasury officials and all public officials are open to public scrutiny and officials must be accountable for the same. However, such scrutiny and critique should be based on accurate information, legitimate data, and should be in the public interest. It is disappointing to note that recent criticism of Treasury officers has not met any of these basic requirements and I believe is therefore contrary to the public interest.

3. Lessons in the Pursuit of Excellence

I would like to take this opportunity to address some recent critiques of fiscal policy that have received prominence in the public domain, and link my responses to the pursuit of excellence.

(i) Fiscal transparency, accuracy of data, and evidence-based policy making;

One of the most important lessons from the economic crisis that began in mid 2021 is the importance of transparent economic data and policy making based on objective evidence, devoid of ideological bias. Taking that on board, the Treasury under my leadership from April 2022 took every effort to ensure that the Finance Minister was kept fully informed of the real picture in terms of the economic situation. At no point did we sugar coat the reality and paint a rosy outlook. The two Finance Ministers that I have worked with have shared this spirit and kept the public fully informed of the economic reality since April 2022. Difficult decisions had to be made, and the government had run out of space to provide patchwork solutions without addressing the fundamental structural issues of the economy.

Unfortunately, prior to April 2022, economic realities had largely been hidden or ignored in the lead up to the crisis. The impending economic calamity was visible for several months prior to the crisis hitting us with disastrous consequences. At the time, I was serving as Deputy Governor at the Central Bank and I provided detailed analysis on numerous occasions to the leadership of the CBSL indicating the high risk associated with the home-grown solution being pursued at the time and on the impending serious economic crisis. Unfortunately, such warnings based on professional expertise and experience were ignored. The economic decision making leadership at the time misdiagnosed the country's fundamental solvency crisis as a straightforward liquidity crunch and 22 million of people suffered the consequences.

This failure to apprise the highest levels of leadership of the country of the holistic economic situation was one of the key reasons why Sri Lanka was not able to avoid the crisis. It is exactly for this reason that under my leadership, the Treasury has at all times kept the political authorities, including the Finance Minister (Hon. President) and the Cabinet of Ministers fully equipped with all the information, analysis, and recommendations, to enable optimal decision making.

It is also important to note that there isn't a monopoly on data and information. The government is now far more open with data. For example, the regular publication of debt related statistics, more regular fiscal updates, enable third parties to also analyze the progress of the economy more effectively. Sri Lanka is in the midst of an IMF programme, and their bi-annual reviews provide a clear independent view of the economic situation. I remember in the past, when international credit rating agencies provided their assessments of the economy and indeed shared warnings of the impending debt crisis, these were outright rejected by the economic leadership at the time.

In my view, contrary to the claims made by some people with vested interests, the economy under the former President collapsed because of the wrong advice given to him on managing the economy. This was not simply an issue of wrong data, but he was misguided on the overall course of economic policy, that eventually led to a complete collapse.

It is observed that the political leadership then was shielded from views that were counter to the home-grown solution that was mooted then. According to the submissions made before the Supreme Court, it has been alleged that the former officials of the then administration had created what was described as a 'Chinese wall' around the former President and had concealed from him the true condition of the economy"[3].

This is not the case today. In fact, the Public Financial Management Bill, which will be submitted to Parliament in the coming weeks, will create stronger legal requirements for fiscal transparency. This would be an important step towards preventing a future economic crisis, where Business Chambers like yours also have an important role in encouraging and supporting evidence-based policy decisions. As we all know, the best decisions, whether in the corporate domain or government, are the outcome of robust analysis and evidence – that is a key element of driving excellence in policy making.

As elections draw closer, there will no doubt be many claims that taxes can be reduced and utility prices can be reduced. It is essential that the public questions the realism of

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[3] "*Shocking revelations at Supreme Court: Did Cabraal alter GR's letter to IMF?"*, The Morning, 23 September 2023: https://www.themorning.lk/articles/MbV0GCtBvEAqwawzifxf

these claims and asks for evidence and analysis as to how such measures can be sustained without jeopardizing public finances and dragging the country back into the depths of the crisis like in 2022.

(ii) Importance of collective responsibility in decision making

In the corporate world, you all recognize the value and importance of collective decision making. Particularly when times are tough, requiring difficult decisions, the various choices would be debated by the management and then a collective decision is taken to the Board. Similarly, the Board of Directors would debate the pros and cons of a decision and would converge on the best option for the company and everyone would back that collective decision. The company would suffer when individuals go back on those collective decisions and criticize them among employees, shareholders, or the broader public. This would undermine the company in the public eye and would create a toxic culture that hurts performance as a whole.

Government policy making is no different. In Sri Lanka, a policy would be debated at ministry level and then be presented to Cabinet. The Cabinet would debate the options and arrive at a collective decision. In case of legislative changes, the policy would then be debated in Parliamentary sub-committees, and then eventually be debated by the entire Parliament and voted into law. When it comes to financial decisions, according to Article 148 of the Constitution, it is Parliament that has full control over public finance. There are numerous parliamentary Oversight Committees that engage in detailed scrutiny over public finance related policies (COPF, COPE, and COPA to name some).

In recent times, there have been statements in the public domain that I as the Treasury Secretary and Treasury officials are responsible for tax policy and that any adverse outcomes are the sole responsibility of the Treasury. This is an example of abdication of collective responsibility, and one that undermines the credibility of the government and the country as a whole.

Tax policy in today's context is technically designed by the Treasury in consultation with the IMF due to the ongoing EFF programme. The technical proposals and alternative options would then be discussed with the Finance Minister for his approval/concurrence. The Finance Minister will present the various options and recommendations to the Cabinet who will arrive at a collective decision. The necessary legal amendments would then be scrutinized by the Attorney General, and in the case of Sri Lanka's recent income tax law and VAT law amendments, the Supreme Court also provided judgment on the fairness and reasonableness of the measures.

In this context, it is indeed unfortunate when persons who supported the policy changes at various stages in its evolution then criticize those same decisions in public. This undermines the credibility of the government and of the country as a whole. Such actions are in no way supportive of enabling excellence in decision making and policy outcomes. It is particularly unfortunate when those who level criticisms at the measures being taken to remedy the fallout of the economic crisis, were senior decision makers when the policies that led to the crisis were being implemented. Had the same degree of concern and scrutiny been applied at that time, Sri Lanka could have avoided the economic crisis that affected 22 million of people.

This is the essence of the landmark Supreme Court decision on FR No. 195/2022 which says *"In deciding this issue, we are of the view that the respondents ought to have known the factual situation that prevailed when they assumed public office and they should have fashioned their acts and efforts to ensure that the situation is not further aggravated but resolved. On assumption of public office, it was their duty to ensure that the existing issues were addressed and resolved in the best interest of the country and take every possible measure to avoid an aggravation to the detriment of the people"*[4].

Having said that, we do not deny that contemporary tax policy decisions have been difficult and painful. They add to challenges faced by the public. The government understands this, acknowledges it, and accepts it. However, there are also no alternatives in the short term for Sri Lanka to come out of the crisis we suffered since mid-2021. The policy path in place provides the required increase in revenue, but also in parallel, the tax base is being widened which will enable tax rates to be eased once revenue targets can be met in a sustainable manner. The early results of this are encouraging with the tax base increasing by 130% in 2023 compared to 2022. But we have to be patient for the policy measures to yield the required results – if we jump the gun and reverse course too soon, we will be back in a situation like 2022 in no time.

(iii) The importance of building robust institutions

Whether it is in the corporate world or in government, there is always danger in relying on the virtues of individuals to deliver the best outcome in the long term. Strong institutions are required to ensure that good practices survive the passage of time, and that in the event individuals fail to act in the best interest of the collective good, there are institutional checks and balances to mitigate risk. Therefore, strong institutions help deliver excellence in policy outcomes over the long term.

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[4] *The Judgment on the FR No. 195/2022",* Page 116, Decided on 14.11.2023, Supreme Court of Sri Lanka.

In Sri Lanka's government structure, it is unfortunate that not enough attention has been paid to institutional development. In the country's political culture also, there is a tendency to place immense faith in individuals resolving the country's problems. If Sri Lanka's public institutions were stronger, it may have been possible to prevent the ill-thought out policy measures that contributed to the economic crisis. In contrast, consider what happened in the UK in 2022 when the newly elected Prime Minister Liz Truss attempted to implement very similar policy measures to Sri Lanka in end 2019. The robust institutional structure in that country prevented those decisions being implemented and undermining the broader public interest.

Since April 2022, the government has made a concerted effort to drive institutional reform in key government agencies. This applies to the Ministry of Finance as well, where we have commenced a process of revamping the Treasury structure to make it fit for purpose for the 21st century. Similar measures are being undertaken in the revenue collection institutions, including the steps towards establishment of a separate Revenue Authority.

The performance of the Inland Revenue Department, Sri Lanka Customs, and Excise Department have also been subject to public criticism in recent times. There are no doubt long standing weaknesses in these institutions which have been neglected for years if not decades. This is in my opinion symptomatic of an overall neglect of public finance and attention to revenue collection in general. Over the last three decades, government revenue collection steadily declined from over 20% of GDP to a record low of 8.3% of GDP in 2021. However, this did not receive much attention of successive governments and Parliamentarians since shortfalls in revenue were simply borrowed. When fiscal rules, such as the Fiscal Management (Responsibility) Act were at risk of being breached, the law was simply amended by Parliamentarians to avoid addressing the fundamental issues.

It is only when such accumulated borrowings led to a sovereign debt crisis and economic crisis that people have realized there was a problem in the first place. Over the last 22 months, there have been concerted efforts to address these deep legacy issues in our fiscal institutions. To give one example, the RAMIS system has been subject to public discussion in the recent past – but the IRD has been struggling with this system since 2013. It was only in 2022 that the required funds were paid to update the system.

Therefore, it is disheartening when those who should have been vigilant of the state of public finances, including the performance of revenue institutions, and were silent all this time, now raise their voice to criticize those who are trying their utmost to remedy the situation. Several Parliamentary Oversight Committees have been in existence throughout the period of fiscal decline leading up to 2022, but whether the expected checks and balances in the public interest have simply materialized before the unprecedented, deep and complex economic crisis is questionable. To reiterate what was mentioned previously, public officials are not above and beyond criticism and accountability, but such critique should be in a just and reasonable manner, taking into account appropriate allocation of responsibility.

The take away here is that strong institutions are an essential component of excellence in government and in corporate structures. Weak institutions undermine the efficacy of checks and balances, which can lead to abuse of power, and also allow wrong decisions to be implemented which can cause a corporate or a government structure to collapse.

4. No Shortcuts on the Road to Excellence

In my experience, the above factors are all critical components on the road to excellence. It is evident that this road is a difficult one, filled with obstacles and challenges. There are also no short cuts on this road – and this applies to both the government and corporate worlds. If we examine some of the reasons for the collapse of the Sri Lankan economy, it was due to seeking short cuts, instead of a disciplined approach to economic management and development.

(i) In end 2019, taxes were reduced in order to stimulate economic growth and provide relief to consumers. This creates good results in the short term and is widely popular. This could be compared to a shop that provides a large discount in order to boost sales and achieve their top line growth target quickly. However, this can easily lose sight of the long term impact. The shop may not be able to cover its costs at that discounted price and will run into large losses. The more sustainable but difficult option would have been for the shop to streamline production, sourcing, and training, to reduce costs through productivity gains and thereby provide a sustainable reduction in pricing. In the case of the economy, long term growth is also driven by productivity gains, and not by short term fiscal or monetary stimulus. Productivity in turn is driven by enhanced competitiveness, exposure to competition, and access to skills and technology. The latter is a far more difficult path than short term stimulus measures, but as we have seen, it is a far more sustainable and responsible option.

(ii) In the lead up to 2022, the currency was maintained at Rs. 203/USD since it was believed that this is the best way to prevent the debt to GDP ratio from expanding, and the best way to keep imported inflation under control. Fixing the currency was a short cut to achieving attractive macroeconomic indicators. But this policy contributed to the creation of an ever-expanding informal currency market which eventually starved the official banking sector of forex liquidity that contributed to the extensive shortages of essential imports. The fixed currency also hurts the balance of payments as exports became uncompetitive and imports became relatively cheap. Eventually, the fixed rate was no longer tenable and the resulting free float of the Rupee without any safeguards resulted in an over 80% currency depreciation that contributed to spiraling costs and erased the real wealth of 22 million of citizens.

(iii) Since 2019, the government was running double digit budget deficits, but at the same time wanted to maintain interest rates at single digit levels in order to support investment and economic expansion. However, in the absence of foreign financing, low interest rates can only be maintained by monetary financing (money printing). The outcome of over 2 years of extensive monetary financing was the escalation of inflation up to 70%, which severely undermined economic expansion, investment, and eroded the wealth of 22 million of citizens. The more sustainable option would have been to focus on building government revenues by reversing the 2019 tax cuts, thereby reducing the budget deficit and government financing requirements, keeping inflation expectations in check, and enabling interest rates to reduce in a real manner as opposed to artificial means.

The Supreme Court judgment characterized some of these decisions as follows; *"Prolonged inaction due to arbitrary, irrational and/or manifestly unreasonable decisions and inadequate measures over the period under consideration had heavily contributed to disastrous consequences"*[5].

Today, we are going through the pain of correcting those mistakes of the past. This pain is felt across all segments of the community. The poor and vulnerable suffer the most, but everyone has seen an erosion in their quality of life. This leads to another important lesson in achieving excellence – that is the importance of humility, accepting when you have been wrong and willingness to change course. I firmly believe that if the government had realized the unsustainable nature of its home-grown solution and reverted to an economic reform programme supported by the IMF even in the latter part of 2021, we could have avoided the worst of the economic crisis. As I urged the Monetary Board of the CBSL and which had been quoted in the Supreme Court judgment as well, "*The pain*

[5] *The Judgment on the FR No. 195/2022",* Page 117, Decided on 14.11.2023, Supreme Court of Sri Lanka.

to the economy and the people of Sri Lanka would have been less if this decision was taken at least one year ago."[6]

Sri Lanka's economic tragedy could be compared to a pilot navigating a plane, seeing warning signs on the dashboard indicating danger up ahead. The pilot could rely on his scientific training and technology, and change course, or stubbornly believe that he can fly through the danger, putting the lives of his passengers at risk. In Sri Lanka's case the latter option was chosen, causing the economy and its 22 million of citizens to suffer a disastrous crash. I call this "*flight path analogy*".

5. Sri Lanka is Now Ready for Business

Fast forward from April 2022 to February 2024, there has been a dramatic shift. Shortages have been eliminated as foreign exchange liquidity is readily available in the banking system. LCs can be opened freely, import restrictions have been eliminated, except on personal motor vehicles, and supply chains fully restored. This was enabled due to a restoration of confidence following the progress of the IMF supported reform programme. The government reached a primary budget surplus in 2023 for only the 6th time since independence. Inflation declined from 70% to 6.4% by January 2024. Key State Owned Enterprises (SOEs) converted a loss of Rs. 745 billion in 2022 to a profit of Rs. 313 bn in the first 9 months of 2023. Economic growth (1.6%) returned in Q3 2023 following 6 successive quarters of contraction.

The country ran a current account surplus in the balance of payments for the first time since 1977. This enabled the Rupee to appreciate from around Rs. 363/USD to around 313/USD at present. Many believe that this is artificially boosted due to the moratorium on selected foreign loan repayments. However, once repayments resume, these repayments will be at a reduced level due to debt restructuring. One of the IMF targets for debt restructuring is the reduction of foreign debt service from 9.4% of GDP (2022) to less than 4.5% of GDP. By that time, it is expected that Sri Lanka's current account inflows through exports of goods and services would have continued to grow to absorb the restructured debt service requirements.

This is where the second component of your theme becomes extremely relevant. For a sustained recovery from the economic crisis, Sri Lanka must pursue a qualitatively different type of economic growth which is led by non-debt creating inflows as opposed to the non-tradable sector. Non-debt creating inflows refers to export of goods, export of

[6] *The Judgment on the FR No. 195/2022",* Page 99, Decided on 14.11.2023, Supreme Court of Sri Lanka.

services, and FDI. To achieve this, the government has a role in creating macroeconomic stability, and an operating environment in which trade and investment can thrive. Towards this end, the government is pursuing FTAs with strategic partners to build market access for Sri Lankan exporters, and to make the country attractive for FDI.

Market access alone is not sufficient – supply capacity also needs to be addressed. Since there is limited fiscal space to provide cash support to target sectors, the government is focusing on eliminating the barriers to investment and expansion of business. Examples of this include the identification of large areas of government held land for productive export-oriented agriculture. Labour market bottlenecks are being addressed through a comprehensive modern labour law. The investment framework is being streamlined with the amalgamation of the BOI and Export Development Board creating a new Economic Commission with a unified focus on supporting trade and investment. These are just some of the measures being taken by the government to create the enabling environment for traders and investors to operate optimally. The rest is up to you, the leaders of private enterprise, to deploy your ingenuity in furthering excellence in trade.

6. Concluding Remarks

When we talk of system change, I believe we have to address some of the issues we discussed today. Over the decades, the leadership of this country has abandoned long term policy processes and chosen short cuts towards quick but unsustainable results, and we as voters have collectively rewarded such myopic, unsustainable promises. We have chosen populist options and fallen for political slogans and false rhetoric. However, I believe this tide may be shifting, and the younger generations I believe are more discerning and will demand a qualitative shift in policy making. We should encourage the youth in this regard, to question populist measures, to demand how realistic election promises are, and to expect and receive policy measures which serve the long-term interest, which is their future, not ours.

The road to excellence is a difficult one. It is fraught with challenges and complex choices. Sri Lanka’s recent economic policy dilemmas provide invaluable lessons in understanding these challenges. However, if you are equipped with integrity, humility, objectivity, and you can discard stubbornness, ego, and greed, there is no doubt that you can succeed on this path. That’s where you can achieve excellence in a much broader sense. As a country, I am confident that we have the capacity and the capability to pursue this path to excellence, and it is the collective will that is required. We owe it to the next generation to finally embark on the road to excellence; it is better late than never.
