Reform: Why and how

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Problems . . .

- Not enough exports . . . .
- Young people wanting jobs that the economy is not producing . . .
- Getting old before getting rich . . . .
- Profligate government without resources to address our problems . . .

A solution: Global Value Chains

What does it take to participate in Global Value Chains?

- Greater certainty (➔ trade agreements)
- Low-cost labor, which we do not have; If not based on low-cost labor, skilled and productive workers (➔ education reforms)
- A big enough pool of workers (➔ education reforms; agricultural reforms; increasing labor participation by women; SOE reforms . . .)
- Right kind of infrastructure (➔ SOE reforms)

Greater certainty through trade agreements

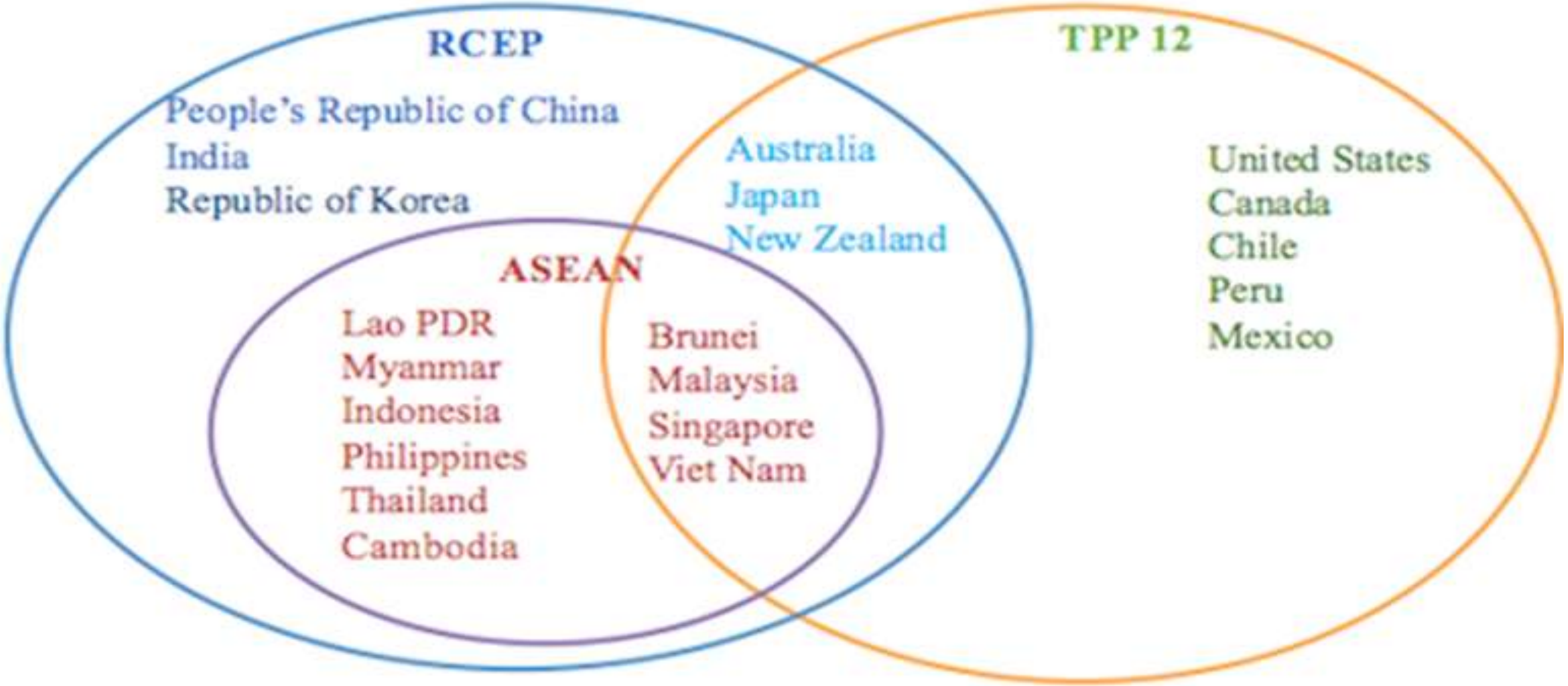
- A world incapable of multilateral trade liberalization under the WTO is moving toward plurilateral and bilateral trade regimes that cover goods, services, investment and trade-related matters
  - ASEAN is looking at RCEP and TPP
  - India has entered into a large number of bilateral agreements; in RCEP; considering TPP

- All Sri Lanka has are opportunities for bilaterals, despite having been member of GATT since 1947 and GATS since 1995
  - Many disadvantages to negotiating multiple bilateral agreements, but better than being excluded from benefits of agreements

Vietnam has many firms that compete with Sri Lanka firms

- “Overall apparel import growth used to come from China and Bangladesh, but today Vietnam is the main driver. I don’t think you will see that trend abate in the short term.”
  - Nate Herman, Vice President of International Trade, American Apparel & Footwear Association
- In 2016 AT Kearney Global Services Index (higher is more attractive for BPO sourcing)
  - Vietnam is 11th (score of 5.66)
  - Sri Lanka is 14th (score of 5.54)

Vietnam in RCEP & TPP; India & China in RCEP



Vietnam joined WTO in 2006. Additional Trade agreements since then

- TPP (signed, not yet in effect)
- Russia, Kazakhstan, Belarus (signed, not yet in effect)
- ASEAN Free Trade Area
- ASEAN-Australia+NZ FTA
- ASEAN-India CECA
- ASEAN-Japan CEP
- ASEAN-China CECA
- ASEAN-Rep of Korea CECA
- Chile-Vietnam FTA
- Japan-Vietnam ECA
- Rep of Korea-Vietnam FTA

Results: Exports increased x 9.5 (v x 2.1 for Sri Lanka) in 2000-2014

	Vietnam (2000)	Vietnam (2014)	Multiple	Sri Lanka (2000)	Sri Lanka (2014)	Multiple
FDI (USD millions)	1,298	9,200	7.1	173	1,616	9.3
Exports (USD billions)	17	161	9.5	5.5	11.3	2.1

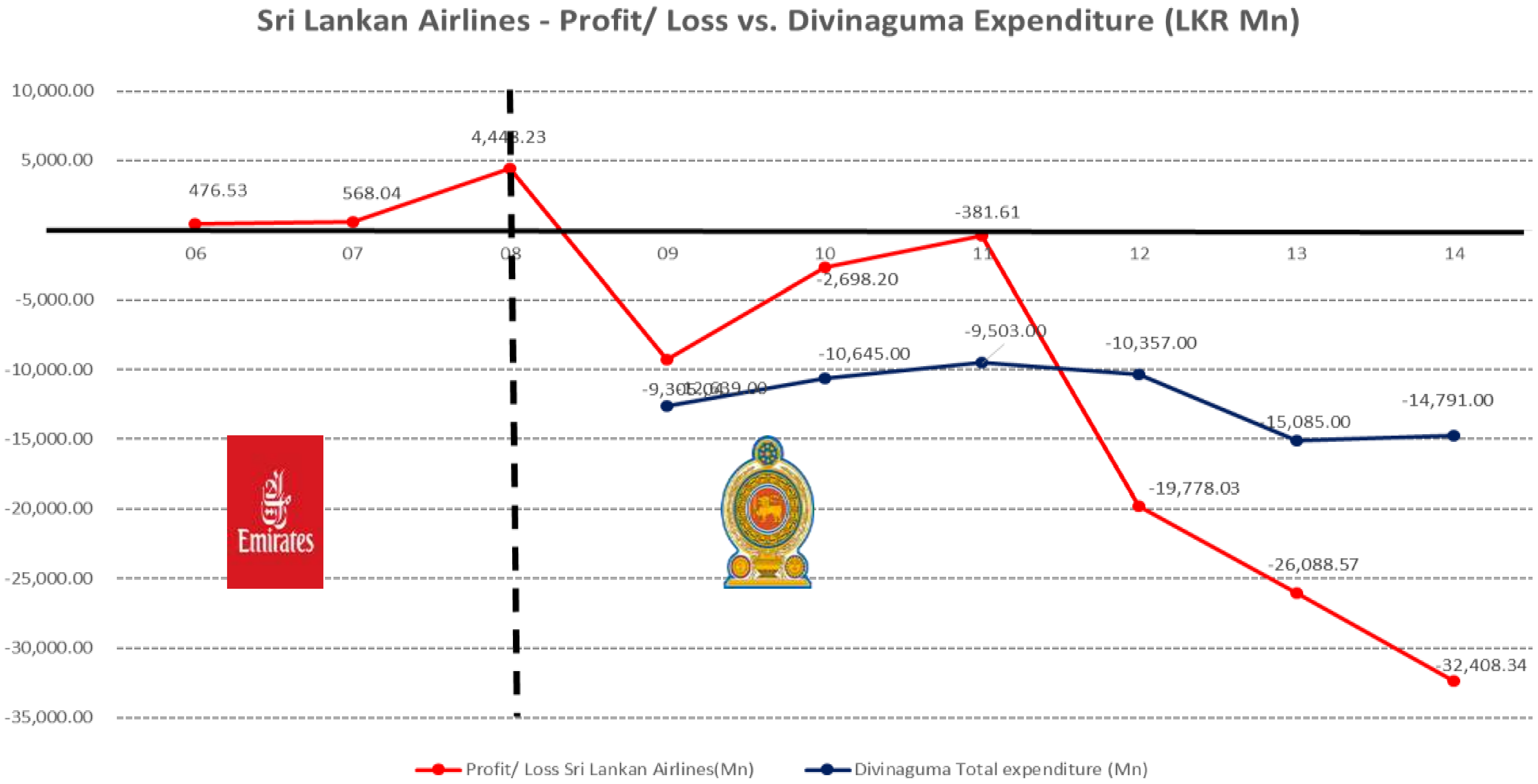
Source: Sri Lanka BOI

Efficient infrastructure/Reduced government spending

Name of the state own enterprise	Ceylon Petroleum Corporation	Ceylon Electricity Board	Sri Lankan Airlines	Sri Lanka Transport Board	Mihin Air Ltd	∑ 5 out of 55 SOE's
Cumulative losses 2006-2015	LKR 244 Billion	LKR 172 Billion	LKR 112 Billion	LKR 61 Billion	LKR 16 Billion	605 Billion
As a Percentage of cumulative losses*	38%	27%	18%	09%	03%	95%

605 Billion = 18% of 2015 GDP in Sri Lanka = 81% of the current budget deficit in Sri Lanka

[*Cumulative losses of 55 strategically important SOE's as per treasury]


Sri Lankan Airlines - Profit/ Loss vs. Divinaguma Expenditure (LKR Mn)
10,000.00
5,000.00
-5,000.00
-10,000.00
-15,000.00
-20,000.00
-25,000.00
-30,000.00
-35,000.00
06
07
08
09
10
11
12
13
14
476.53
568.04
4,448.23
-9,305.00
-2,698.20
-381.61
-19,778.03
-26,088.57
-32,408.34
-12,039.00
-10,645.00
-9,503.00
-10,357.00
-15,085.00
-14,791.00
Emirates
Profit/ Loss Sri Lankan Airlines(Mn)
Divinaguma Total expenditure (Mn)

Policy windows open when Iron Triangles get destabilized, but don't remain open for too long*

- *You never let a serious crisis go to waste. And what I mean by that it's an opportunity to do things you think you could not do before.*

  Rahm Emanuel, 2009

- Asian Financial Crisis → IMF intervention → Indonesia's reforms
- Third nationwide blackout has put those safeguarding CEB status quo on backfoot . . .
- Present economic crisis may cause government to change how it manages SOEs; it has the mandate from 2015 elections

- With apologies for mixed metaphors, but these are serious policy-studies terms: Kingdon, J.W. (1984), *Agendas, alternatives and public policy*; Heclo, Hugh (1978). "Issue networks and the executive establishment," in *The New American Political System*, ed. Anthony King.

First Best: Competition wherever possible, regulation where necessary . . .

- For effective competition, state cannot own some of the competitors because it has power to tilt the playing field, even if in unregulated industries (e.g., preferential access to credit; taxation)
- Regulation only necessary for infrastructure industries or those with serious information problems
  - Regulation is only partially effective with state ownership
    - What is the point in fining a state-owned company?
    - How practical is the cancellation of a license?

- ➔ First-best solution includes privatization

What is the second-best solution?

Originally proposed by Ven. Athuraliye Ratana, M.P.; included in 2015 January Common Candidate's Manifesto; also in UNP's 2015 August Manifesto

- The Government is the largest owner of business institutions. The ownership is held in trust for the people. Unfortunately these businesses have not been properly managed for the last 50 years. Therefore those institutions have incurred severe losses. As a remedial measure, all public enterprises will be placed under a Public Business Enterprises Holding Corporation Ltd. Trustees of the corporation will by law be appointed through a scheme based on consensus reached by the political parties and civil society. Further, laws will be introduced to regulate this institution on the same principles as a limited liabilities company.

Temasek model, as explicated before a simplistic understanding got entrenched (*FT, 29 January 2015*)

- Temasek owns SOEs that can be treated as normal business enterprises (not those that have other objectives such as the provision of housing or welfare) and can be subject to normal regulatory oversight. **The companies make commercial decisions and do not supply services below cost**.
- The SOEs are **managed by professionals whose only mandate is to run the companies efficiently and produce adequate profits for the owner**, Temasek Holdings. Depending on how they do on the defined performance indicators, they hold their positions. The assistance they provided to the ruling party or who they are related to by blood or which school they attended are not criteria for selection.
- How are the performance indicators set? No one can be asked to produce ever increasing amounts of profit, especially under competitive conditions. Without doubt, the ups and downs of the economy as whole will also impact return on investment.
- **The solution is to list the companies on the stock market**. So the performance of the Board members of companies such as Singapore Airlines that face competition are judged by metrics that include share price. **If the holding company determines that the investment is yielding inadequate returns, it can sell down its stake, in addition to getting rid of the directors.**

Good solution, but with some problems . . .

- **How is performance of the directors of Temasek Holdings assessed?** They are the final decision makers regarding how much equity is held in the various government-owned companies (they also hold equity in other companies such as Standard and Chartered (18%) and Bharti Airtel (3%). What is their accountability with regard to the investments and appointment and oversight of directors?
- Temasek **performance is judged in relation to benchmarks connected to the performance of its companies**.
- Yet, one cannot have purely objective criteria. However well the company is managed, there will be years when it will perform badly. That is just the way it is when one invests money. **In any democracy, sovereign wealth funds will come under pressure when times are tough.**
- For that, you have the final safeguard. Since 2002, **Temasek's CEO has been Ho Ching, who just happens to be the spouse of Lee Hsien Loong, the current Prime Minister and a member of the first family**. It also has a strong and empowered Board that includes several truly independent directors, including the former head of the World Bank.