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'Waste is everywhere as govt. panders to politicians'



Dr. Harsha de Silva

Economist Dr. Harsha de Silva says a 30% inflation rate has never been heard of in this country and does not exist anywhere but in banana republics today. Dr. de Silva in an interview with The Sunday Leader said the people would have to suffer the consequences of 'terrible economic management' of the recent past and particularly hurt, he says, would be the urban poor who would be unable to meet their minimum dietary requirements to avoid hunger due to the unaffordable cost of living.

According to him, the only relief will be when inflation comes down. Also, he says that when the total revenue of the government was insufficient to meet the debt obligations and defence expenditure, the money would have to be pumped in by the Central Bank.

"If a country can be developed by printing money, we would be the richest country in the world! Unfortunately it does not work that way. Economics is based on certain theories and a fundamental premise is that 'there is no free lunch'," Dr. de Silva said. Exc

By Mandana Ismail Abeywickrema

Q: The country's inflation level has hit an all time high of almost 30%. The Central Bank earlier in the year predicted that the first half of 2008 would record a two digit inflation level. Given the sustained increase in the level of inflation what prospects do you see for the country's economy in the next few months?

A: Launching the Monetary Policy Roadmap amidst much fanfare in January 2007, the Governor of the Central Bank said inflation, as measured by the Colombo Consumer Price Index or CCPI, would peak around 20 % in April 2007 and by January 2008 come down to between 7 and 11 %. Nothing of the sort happened. Then in January 2008, launching the Roadmap for this year, he said that inflation, this time measured by the CCPI (New) would be down to 10 % by year end.

Unless the Governor changes the inflation index for the third time in a year; from CCPI to CCPI (New) to his current flavour Core Inflation, he will not be able to show 10% inflation. Core Inflation is purely an internal measure of the CBSL and to use it to suggest inflation is low in Sri Lanka is an insult to the intelligence of the people in this country. In my view inflation - the real measure that people feel when they visit the grocery store, will continue to dog us for the rest of the year.

Q: Given this situation, does the country face the threat of hyperinflation and if so at what point will it come?

A: Thirty percent inflation has never been heard of in this country and does not exist anywhere but in banana republics today. Even though there are many definitions of hyperinflation what we are facing is not hyperinflation; that will happen if the 30% is for a period of one month, instead of one year as it is the case now.

I am certain that the professional economists at the Central Bank will never let their politician boss to print money in such a way to create hyperinflation. A good example is when they admitted last week that the reserve money targets that the Governor used to parrot around, as being accurate was actually wrong and substantially lowered the money printing targets for the rest of 2008.

This goes to show that there is intellectual agreement among economists both in and outside the Central Bank and that it will be impossible for the politicians led by the Governor to dislodge the same; particularly after inflation records have been established.

Q: The people are heavily burdened by the rising cost of living. Do you see any relief for the consumers given the overall economic climate both locally as well as internationally?

A: Unfortunately not. We will have to suffer the consequences of terrible economic management of the recent past. Particularly hurt will be the urban poor who would be unable to meet their minimum dietary requirements to avoid hunger due to the unaffordable cost of living. The only relief will be when inflation comes down. But one must keep in mind that once high inflation has been registered, which is an episode of rapidly rising prices, all what low inflation does is to slow the rising costs, not reduce prices.

Q: The government has attributed the rising prices to the global market prices. However, other countries in the region that are also involved in importing the same goods have not faced a crisis like in Sri Lanka and maintain much lower inflation. How do you respond to this scenario?

A: Simple. The Central Bank, or rather the Governor, seems to have misled the President and the rest of the country by saying that inflation in Sri Lanka was totally a supply-side problem. When it was pointed out that massive money printing to accommodate the profligate Treasury was more an issue than imported inflation he and his henchmen found it apt to brand such critics with the 'T' word.

Now what has happened? Facing the same imported costs as us, every country in the region, bar a few, has been able to contain inflation under 10% when we are at 30%. There is a

saying that you can fool all the people some of the time, or some of the people all of the time, but never all the people all of the time!

Q: A senior government minister was quoted in an interview saying that the government had to print money to fund its expenses, especially defence and the wages of the new employees to the public sector and that printing money would be the only alternative to fund the government's expenses. This would propel the level of inflation to increase further. How serious is this situation to the overall well being of the economy in general and the people in particular?

A: If a country can be developed by printing money, we would be the richest country in the world. Unfortunately it does not work that way. Economics is based on certain theories and a fundamental premise is that 'there is no free lunch.'

If the Central Bank prints money to say, pay for losses at Mihin Air, then some poor family in Katunayake will have to pay for it with higher prices for potatoes. So that is what is happening. The state is enormous and still growing. Every month a new state venture is started or a dead one reincarnated; every month billions of rupees of losses at state owned enterprises are covered, every month thousands of new people are recruited to the numerous state agencies and provincial administrations, every month dozens if not more ministers go on extravagant foreign jaunts living it up at the most expensive hotels around the world.

Now when the total revenue of the government is insufficient to meet even the debt obligations and defence expenditure, where is the money for all the others? So it is obvious that a politically motivated Central Bank will come to the rescue. We are living that nightmare and enjoying the forbidden fruits.

Q: The Central Bank this month further tightened its monetary policy and revised its reserve money targets. However, given the heavy expenditure bill of the government, how much money do you think the government will have to print to meet its expenses?

A: Tightening monetary policy was like I said earlier an acceptance that the reserve money targets were wrong. To do so even at this late stage is better than not doing so at all. But these are only plaster solutions. What we so desperately need is an independent Central Bank.

The amendment to the Monetary Law in 2002 was made to ensure this independence by appointing the majority of members of the Monetary Board with the concurrence of the Constitutional Council. In the absence of the CC, this unfortunately has not happened.

But for the Central Bank to mislead the country by saying the appointments must be made from the 'private sector' instead of the concurrence of the Constitutional Council in its Annual Report released just weeks ago in my view goes beyond ethical boundaries.

Q: The country among other crises, is faced with a rice shortage as well as skyrocketing rice prices. The crisis faced by the country has further deepened with other countries in the region deciding not to export rice and Myanmar being hit by a cyclone. How do you think the government could overcome this situation?

A: During the CFA the rice produced in the country increased significantly with the contribution from the Northern Province. That is no longer true. But now with the global rice prices increasing the incentives for local farmers to grow rice has improved significantly. But our ability to compete is well below that of some of the other rice exporting nations due to numerous archaic laws and low economies of scale.

Therefore, what needs to be done now is to get the necessary agricultural reforms completed so that the private investors can invest in agriculture to seize this global opportunity. If that can be done we can turn this current predicament in to a profitable prospect.

Q: The government has used certain statistics, especially the per capita income level of US\$ 1620 to respond to criticism levelled against it on the economic front. However, many economists have pointed out that the statistic was misleading and inaccurate. Do you agree, and if so, why?

A: The annual per capita income of US\$ 1,617 is simply the division of the total nominal GDP by the number of people. While it is a widely used statistic to measure economic well-being of a country, it does not give an accurate picture as to how well or poorly a household is doing.

The Household Income and Expenditure Survey, or the HIES, undertaken by the Department of Census and Statistics is a much more useful indicator to assess the reality at the household level. Now according to the figures just released, the annual mean per capita annual income is only US\$ 670, nowhere near the US\$ 1,617. The annual median per capita income is a mere US\$ 440. This means that 50% of the population live in a household that receives less than US\$ 1,830 per year.

Q: Statistics have revealed disparities in the wages system in the country. While the majority of the country's workforce, nearly 63%, that is employed in the private sector has recorded a negative growth in real wages since 2005, the public sector employees have recorded a somewhat positive growth in wages. Given the negative growth in wages and the rising cost of living, what impact do you think it has had on the people's purchasing power and the overall development of the economy?

A: This is the sad irony of this country. People who sweat and work hard are punished by those who hardly do any work. It is unbelievable but true that the real wage indices of the workers in wages board trades had dropped by 30% since 1978. In fact the real wages of those in service trades have dropped by 50% according to the Central Bank Annual Report for 2008. All this is in the background of the real wages of the state workers increasing by 70% during the same time; most of it in the last few years.

Q: The Central Bank's handling of the country's main private sector retirement fund, the Employees Provident Fund (EPF), has been criticised due to the billions lost by the fund. It has been alleged that the fund recorded the loss since the government utilised the system to inflate away debt. It has been reported that the EPF has lost Rs. 23 billion in real terms in 2007 due to the increase in inflation. What is your perspective on this issue?

A: EPF is the 'peace of mind' for the employees of the private sector, state-sponsored corporations, statutory boards and private businesses. According to the EPF, its aim is to 'assure financial stability to the employee in the winter of life and to reward the employee for his or her role in the economic growth of the country.'

In order to do so, EPF mentions that the 'main investment objective of the fund is to earn a 4% real rate of return over the annual average inflation measured in terms of GDP deflator.' What happened in 2007? Its effective return was 11.4%. What was the GDP deflator? Fourteen percent. So did it make 4% real return? No way; it made a huge loss of negative 2.6%. It was negative 0.2% last year and negative 0.9% the year before. The only period the EPF made a 4% real return since 2000 was in 2002 and 2003; ironic indeed. Why are the protectors of the working class so quiet?

Q: The government has pumped millions of dollars of public money into Mihin Air, which is now facing bankruptcy. Is it feasible for the government to continue funding Mihin and what strain will it have on the economy?

A: Mihin Air should never have been started in the first place. It was a disaster from the word go. Everyone is blaming Sajin Vaas Gunawardena for the mess. But the reality is there was nothing he could have done differently to turn it around. He should never have started it. My advice to my old friend is to shut it down. It is true it has cost us all a huge amount of money, but it is better to cut our losses now than sink even deeper.

Q: One area the government has come in for criticism is wastage and extravagance with the jumbo cabinet also a subject of criticism. Where do you see the government has failed and in what areas can it cut down on wastage?

A: Waste is everywhere. Hundreds of ministers, thousands of staff around them, thousands of vehicles to transport and protect them and their families - billions of rupees are needed to meet these costs. I understand that in coalition politics one needs to pander to the demands of the dozens of crossers-over, but this is unbelievable. I wonder if any other country has such a large number of ministers. Clearly, the President must realise this is not good governance. But, nothing will change. This show will run until the last day of this government; if and when that would be. And thereafter, there is no guarantee the next government will not do the same.

Q: The war is not going according to plan with the military suffering a debacle in Muhamalai and the government revisiting the April deadline and now talking of at least till end 2009. What are the economic consequences of a prolonged war effort, both immediate and long term?

A: The impact of the war is being felt across all sectors of this country. The indirect cost in terms of lost investments, lost tourism, lost opportunities and migration of skilled workers itself is much bigger than the Rs.170 billion the government will spend this year on the war. Add to that the costs of looking after the displaced and rebuilding.

I call the war the 'broken window fallacy.' Break the window and repair it; you will add to GDP but end up with the same window. War is also like that. We destroy, then we repair, we add to the GDP, but people have nothing to show for it. The rating agencies are downgrading us, human rights agencies are blacklisting us, EU is threatening not to renew GSP+; all these are consequences of the war. I sincerely hope we as Sri Lankans can find a peaceful solution to this conflict that has gone long enough.