

**BUDGET SPEECH
2005**

Part -I

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THE 2005 BUDGET

Presented by:

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Part A

1. Mr. Speaker, It is a great honor for me to present to you and this Honuarable House the first Budget of the Freedom Alliance Government, under the leadership of Her Excellency the President, Chandrika Bandaranaike Kumaratunga.
2. At the very outset, it is my duty to thank the people of this country who only eight months ago gave a resounding mandate to the Freedom Alliance and its partners to take the country forward on the basis of the "Rata Perata" program that was placed before them. Let us remind ourselves that the people of this country have on **eight** Occasions since 1992 endorsed the leadership of President Chandrika Bandaranaike Kumaratunga and her policies.
3. It is not only in Sri Lanka, Mr. Speaker, that the masses have rejected neo-liberal economic policies. Our entire region in the recent past has witnessed an electoral rejection of policies which create little enclaves of growth amidst countrywide poverty. Voters have called for an economic strategy that is both 'pro-growth and pro-poor'. At the last General Elections, Sri Lankan voters rejected the economic policies of the United National Front in no uncertain terms. They also rejected the rampant corruption, the abuse of state machinery, subservience to foreign interests and the arrogance of power, which characterized that regime.
4. Mr. Speaker, I am proud to say that the budget I am presenting today is the product of a wide consultative process, which attracted inputs from almost all stakeholders. It is based on a homegrown economic development strategy. Unlike in the past, our policy has been developed through a consultative process, which included the Trade Chambers, industry associations, SME organizations and Research Institutions. An opportunity was also given to our citizens to participate in the preparation phase of this budget. We received over 1,000 specific proposals from the public, in response to our call. Many of my Parliamentary colleagues, of varying political persuasions, also participated in this consultative process, with a good number of them providing direct inputs

based upon discussions with their constituents. I personally sat through several dozen meetings and heard first hand of the issues that remain and opportunities that have to be seized to strengthen the national economy. Her Excellency the President met the NCED Cluster Committees to find out first hand about the inputs the Government should provide to ensure a meaningful economic development.

5. I wish to acknowledge also the contribution of non-Governmental stakeholders like international agencies, private sector representatives, the media, Trade Unions and lastly, and most importantly, the patriotic citizens of our nation. They have displayed a great deal of maturity and understanding, especially when faced with the twin consequences of a prolonged drought, and the high escalation of global oil prices, which put unprecedented pressure on our economy, leading to a heavy burden on the cost of living. In spite of various political and parochial differences that have kept our nation divided on many issues, the willingness of our people to put nation before self has been an encouraging feature.
6. May I also convey my gratitude to my hardworking and efficient team of officers at the Ministry of Finance & Planning, and their Public Sector colleagues associated with the preparation of this Budget?

OUR APPROACH TO DEVELOPMENT

7. Mr. Speaker, I hope this budget which I am presenting exactly 143 days since I took office as the Minister of Finance, will not only meet with your expectations, but possibly exceed it, and more importantly, put this nation on an accelerated path of sustainable economic and social development, based on local values and national priorities as well as a shared vision of the future which would be acceptable to all our citizens.
8. Although, I am proud to say that we are a resourceful nation, in the same breath, I must admit with some dismay, that even after 56 years of independence, our valuable human and natural assets still remains largely untapped and underutilized. Our geographical proximity to the world's largest emerging markets of South Asia and the busiest shipping lanes which go past the southern city of Hambantota should form the backdrop of our economic growth. Our bio diversity provides good opportunities to produce more food than we need. Yet, we import sugar, milk powder, potatoes, onion and many other commodities. Our vast ocean and inland water resources should make us a net exporter; but shamefully we import fish for our consumption. We sit on

economic opportunities of substantial value in every part of the country; doing nothing with them. It is a colossal waste. We cannot any longer afford not to accept the challenge of radically transforming our economy.

9. It is time that we in Sri Lanka understand the value of our resources, the real cost of processing them, and the net margins involved. We have lacked the courage to unlock the value of our assets. We have a defeatist mindset that we don't have access to funds, technology or the markets to produce end-consumer finished products. We do not sell our own brand names with overseas marketing channels. The value difference in our export income loss is high because of our lethargic and unimaginative approach to value-added production, supply-chain, and export market development. Overall, I am sorry to say that we add little or no value to most of our domestic raw materials.
10. For instance, our gemstones get exported in raw and polished form, with hardly any value addition. Our jewelry craft skills and stone buying know-how gives us a competitive advantage, along with our unique local gemstones. A vibrant economy can be easily created around the jewelry trade, and this we must do in earnest. Our mineral sands are sold in raw form for a fraction of its value. Sri Lankan Silica is ideal for manufacturing chips and solar panels. Our Phosphate deposits remain untouched except by some puny exporters who scratch at the surface. Sri Lanka is losing billion dollar value addition opportunities while her manufacturing sector is basically confined to garment trade.
11. All of us have failed this nation by not focusing on developing our industrial capability, technological and marketing prowess and skills to realize the full value of our human and natural resources. We have neglected research and development, intellectual property rights, adoption of best practices, and many other critical areas that are too numerous to list, which have to be adopted if we are to really enter a period of sustainable economic growth. Therefore, Mr. Speaker it is time that Sri Lanka moved in the direction of high-technology product manufacturing using our raw materials and agricultural products.
12. Another clear message I want to send today is that our nation cannot any longer afford to tolerate corruption and mismanagement. Those engaged in corrupt practices seek an unfair commercial advantage, a short cut in the procurement process, and the subversion of a "level-playing" field for all competitors. It is a bad influence on our economy, and a cost to the consumer. It adds to the cost in doing business in this country. It has eroded economic value and inflated transaction costs. Mr. Speaker, it is time that we rise above our political differences to stamp out this cancer in our body politic.

13. Let me now turn to another basic issue. The Report of the UN World Commission on the Social Dimension of Globalization has a positive but critical message regarding the current path of globalization. It says that the potentials of globalization, in terms of growing connectivity and productive capacity, are immense. However, current systems of governance of globalization at national and international levels have not realized such potentials for most of the world's people-and in many instances have made matters worse.
14. The report states: "Seen through the eyes of the vast majority of men and women around the world, globalization has not met their simple aspiration for decent jobs, livelihoods and a better future for their children." As the report puts it quite succinctly: "There is no point to a globalization that reduces the price of a child's shoes, but costs the father his job".
15. The vision put forward by the Commission is one of bringing into being a system of global governance that is genuinely supportive of and conducive to national development strategies it says "There can be no successful globalization without a successful localization", where efforts to achieve coherence between economic and social objectives would place the needs and aspirations of ordinary people at the centre of rules and practices.
16. The report argues for making decent work a global goal. Work is central to people's lives and is the main test by which they judge globalization. It is a source of dignity, stability, peace and the credibility of governments. Since job creation goes hand in hand with enterprise development, it underpins private initiative and investment. And it is the key to reducing tensions behind so many ethnic and other conflicts, as well as social challenges, such as migration, youth unrest, gender inequality and poverty.

STRATEGIC THRUST IN OUR DEVELOPMENT PLAN

17. The Freedom Alliance government was elected by the people of Sri Lanka who experienced a development strategy followed for a period of two years which yielded virtually no benefits to the majority of the people, particularly those living in rural areas. **Our people had two choices – before the election – The Regaining Sri Lanka Program of the UNF Government and the Rata Perata Program presented to the people by UPFA.** That being so the people placed their faith in the new Policy Framework enunciated in "Rata Perata" program thereby supplanting the "Regaining Sri Lanka" program.

18. Mr. Speaker, our country, has followed economic liberalization, deregulation, and privatization policies for nearly 30 years, in-keeping with global trends. During last 15 years, our country has witnessed a “lopsided” annual growth rate of around 5.5%. I deliberately use the word “lopsided”, as the benefit cascade of this growth has been one-sided. If one examines the result of these policies it is clear that income-generating opportunities were concentrated in a limited geographical area – namely the urban centres in the Western Province. People in the rest of the country were sinking in an ever widening and deepening quagmire. Whilst the wealthy in urban Colombo saw a doubling of their incomes, the average income of rural people, who forms 70% of the population, saw no trickle down of benefit. Unemployment and high cost of living was their fate.
19. Mr. Speaker, in this globalized economic environment we have to choose. The previous government chose a policy of relying on the private sector and initiated a process of opening the economy, hurried privatization of state enterprises, phasing out the role of the public sector and deregulation of economic activities. The last budget came-up with a target of reducing 100,000 public sector employees by 2004 and a further 200,000 by 2006 from lower and middle income grades. This was the thrust of the Regaining Sri Lanka strategy. We may have recovered from the setback in our economy in 2001 which was due to multi-faceted difficulties that have been well documented in the 2002 Annual Report of the Central Bank of Sri Lanka, but, that recovery was only a constituent element of the normal growth path experienced during the past 15 years. The new strategies of the previous regime had no relevance for the majority of the people.
20. In many countries high per capita income growth has always been pro-poor. Usually, it increases the income of the poor more than it increases the income of the non-poor. However, in Sri Lanka during the last 15 years or so the situation is remarkably different. The poor benefited much less than the non-poor from growth. In fact the share of the poorest 40 percent in the national income which was 21 percent in 1980 has steadily declined to 14 percent in 2002, a distressing 1/3 decline in the share of income of the poor. The share of the rich increased more dramatically. For the richest 20 percent the share increased to 54 percent. The conclusion is clear: a growth rate alone is not sufficient to ensure a reduction in poverty and to achieve the goals of Sri Lankan society.
21. The country's economy has always remained vulnerable to external shocks with devastating impact on the poor. Their income levels are not adequate to cushion these sudden spikes, with no supplementary income opportunities to

tide over increasing household expenses. Ill sequenced liberalization has displaced many of the local industries and placed the employment of many people at risk. Income generating small cottage industries, and local industries have closed down, leaving the poor more vulnerable. Strategies designed to down grade the village, and draw the villager to an urban setting, is perhaps the most unreasonable and ill-informed economic plan that could have been unleashed on our country. In the village the poor at least have a home, an inter-dependent support base, and the ability to grow some food. The village tank is their security. Under the "Regaining Sri Lanka" Strategy the villager gets reduced to becoming a shanty dweller in an urban environment, with all of his income being spent on food, lodging and transport costs, with little or no savings. This lopsided strategy of an urban economy propelling the nation forward has to be reversed. Instead a rural economy that is anchored on local area resources and natural raw materials should be pulling the national economy forward. There has to be a gradual, but a definite shift towards high value added domestic resource based production activities. The pro-growth strategy Sri Lanka needs in the present global context is one which would actively favor manufacturing and agricultural production. No doubt the services sector must be encouraged. But the long neglected rural production capacity must be utilized to the full. This in essence is the difference in our respective strategies.

22. Prosperity must benefit all the people. Our Government has launched multi-pronged initiatives to awaken the rural economy and ensure the prosperity of the hinterland. The "Sanwardhana Sangramaya" that her Excellency the President inaugurated recently, along with the "Maga Nagma" or rural road rehabilitation program, "Dahasak Maha Vav" tank rehabilitation program, "Thousand Industrial Entrepreneur Village" program and the "Navodaya School Development program", are few of the several community centred, economic capacity building program. These are home-grown programs that our Government is committed to. We hope to create an enabling environment for rural entrepreneurs to self generate opportunities for themselves and be proactive participants in bridging the urban-rural divide. This is the way forward to reduce poverty and create growth. Our friends in the donor community should take note of this, and help us in this gigantic effort of giving support to pro-poor growth strategies. We share a common interest in ameliorating the conditions of the poor.
23. I am convinced that it is the unequal distribution of opportunities and lack of access to modern know-how and technology that has widened the incidence of poverty. It is this gap that the UPFA Government hopes to bridge. Once a

rural entrepreneur is put on a level playing field with his urban counterpart, I have no doubt that he will succeed.

24. Mr. Speaker, our economy is predominantly a small and medium enterprise economy. Over 50% of our Gross Domestic Product is produced by this sector. 65% of our tea production is by smallholders in the plantation sector. 50% of our nation's apparel and garments industry is handled by individual entrepreneurs. Around 70% of public transportation is dominated by private bus and lorry operators. 80% of domestic trade activities are done by sole proprietorships and partnerships. 45% of tourism and recreation services are handled by family entrepreneurs. 50% of the construction industry is supported by small and medium enterprises. In a nutshell, the economic backbone and much of the economic muscle are provided by the SME's and the entrepreneurs behind them. The development of such an economy needs to recognize the partnership between private and public sector. A policy based on the competitive advantage of domestic resources, including human resources, must be formulated. In this background, the principal thrust of our economic policy will be to re-engineer small and medium enterprises – the real private sector in Sri Lanka,- in order to achieve a balanced rate of economic growth, regionally distributed benefits and a high level of employment and productivity. Therefore there is an urgent need to establish a multi-prong, integrated support mechanism to promote SME entrepreneur competitiveness including comprehensive assistance to exporters who engage in high value addition to domestic resources.
25. Mr. Speaker, markets are powerful forces, but they are not perfect. Institutions needed to make them work efficiently are often weak or absent. Government institutions are needed to improve market outcomes. The legitimate role of the government need not only be to concentrate on macro economic policies, leaving every thing else to the private sector. Government must ensure that public interest is best served. Therefore repositioning of the public sector in the national economy will be a priority. We will conduct a comprehensive skills gap analysis of the public service. The UPFA Government believes in investing in people, as we want an efficient administration. The public service needs to be equipped with skills and knowledge to deal with the emerging economy. Those detractors who failed to see the wisdom of our policies, will one day thank the UPFA Government for having the foresight to invest in training for the recently recruited 42,000 young graduates. We intend to prepare them to become effective public servants and change agents who are knowledgeable and service oriented.

26. When it comes to food security, agriculture plays a vital role in our economy. Domestic food self-sufficiency in high nutrition value foods is a must. Agriculture is basically a private activity in Sri Lanka and, hence, public investment has a crucial role to play in creating infrastructure in terms of irrigation, roads, markets, storage facilities, rural electrification and technology development. This is besides investments in public in education and health. The pace and pattern of agricultural development are largely conditioned by the growth of infrastructural facilities identified above. Infrastructure helps ensure timely and adequate delivery of supplies and services to farmers, and helps integrate local markets with national and international markets. Further, we must realize that there is a strong relationship between rural infrastructural development and the value of output from agriculture. Therefore, an adequate and efficient infrastructure system is essential for realizing the potential of this sector. It will be given high priority by the Government.
27. Mr. Speaker, another view gaining ground in recent times is that the decline of capital formation in the public sector has been compensated through investment by the private sector. Logically, this argument looks attractive but it becomes clear that this is unrealistic when one examines the composition of private capital formation. Private sector capital formation is essentially for commercial ventures. However, public sector capital formation is mainly in the form of construction of dams, roads, marketing centres, rural electrification, etc, where private sector capital formation is hard to come by. Therefore, public sector capital formation needs to be managed and focused on areas like irrigation and watershed development, rural electrification, extension services infrastructure development where private sector investment is not available. We articulated that strategy in our Economic Policy Statement "Creating our Future – Building our Nation". Most agree that this vision is appropriate for our country. That is the path we have chosen.

ECONOMY IN 2004 AND OUR CHALLENGES

28. Mr. Speaker, let me now turn to economic performance in 2004. The Sri Lankan economy in 2004 was confronted with the twin negative impact of the continued global oil price escalation and a devastating drought, which wiped out agricultural production in the second quarter of this year. Despite, these difficulties our economy remained resilient and grew from 5 to 5.5%. The plantation, agriculture, fruits, vegetable, manufacturing and services sectors, particularly the hospitality industry, provided the major impetus to this growth.

29. It is with a sense of satisfaction that I announced that our savings have increased by Rs. 45 billion, recording a 14% growth over the last 7 months. Imports of investment goods increased by 39 % and private credit demand has increased by 20 % largely in production activities thereby reflecting wide spread economic progress. This augurs well for economic growth.
30. Exports have increased by about 8% in US\$ terms. This is a welcome relief to us, especially in the wake of rising energy costs. The wider the access to diversified global markets, the greater the insulation from economic down turn cycles. The apparel industry is now able to hedge the potential risks of the US market with the growth of European markets. Apparel exports increased by 5% and value-added manufactured exports increased by 8% in US\$ terms. Tourist arrivals have increased by 11 percent this year, providing stability to the hospitality industry, and the much needed income to all of the support services in the tourism trade. Remittances from abroad grew by 5 % making a solid US\$ 1,140 million in 8 months. Tea, rubber and coconut which provide livelihood for small-holder agriculture have bounced back both in terms of good international prices as well as robust growth in production. Unfortunately, paddy production suffered a setback due to the severe drought in the second and third quarters of this year. Approval granted for housing Greater Colombo rose by 19%, telecommunication services increased by over 10% and Colombo port achieved a growth of 10% in container handling as well as in cargo handling. Stock market capitalization increased to Rs. 361 Billion almost Rs. 100 billion increase over 10 months depicting the best performance in the regional equity market. .
31. Mr. Speaker, the cost of living, remains a major concern. The government has incurred about Rs. 8 billion as fuel subsidies in order to provide relief to the people although it has increased the fuel prices by about 30%, Prices of rice, lentil, sugar, milk powder, gas, and many other essential commodities have increased. Some of these prices have increased due to the cost escalation in oil prices. Other items like rice increased due to the supply shortages resulting from the drought. At the current prices the annual cost of oil imports could reach US\$ 1,600 million in comparison to US\$ 837 million in 2003. If not for the high oil cost and the drought, trade deficit would not have been more than US\$ 1,100 million and the budget deficit would have been less than 7% GDP.

MANAGING OUR RESOURCES

Food

32. To bring down high prices, food production needs to be increased on a priority basis. Although as a temporary measure we have reduced duties and taxes on some imports, we must reintroduce these duties and taxes to protect our farmers. We must provide remunerative producer prices in order to increase local food production. We need to give high priority to food security by increasing production of rice, sugar, vegetables, milk, fish and livestock. We spend too much foreign exchange on the importation of these items. Our consumption habits must also change. As a nation we have to change our dietary habits and focus on consuming nutrition rich food, which are essentially indigenous vegetables and pulses, which are today commanding premium prices abroad. The local supermarkets and food distribution companies would be encouraged to introduce more local varieties, and voluntarily reduce high cost imported foods that have little or no nutritional value. Our farmers should also benefit from new marketing. Our Trade and Tariff Policy needs to develop a defensive mechanism to prevent the dumping of condemned food. Recently we were alerted to the activities of unscrupulous importers of food that is not even fit for animal consumption. Laws needs to be strengthened and customs be made more vigilant in this direction.

Energy and Water Conservation

33. We also need to produce alternative energy sources to reduce our imports and enhance efficiency and productivity. We need to develop a National Energy Plan. It should develop an alternative energy infrastructure, including the move towards using more fuel-efficient vehicles and even considering public transport that can be run on cheaper sources of fuel. I am glad that Railway management is working on cheaper and more fuel efficient models which are due to come on stream within a few months.
34. Whilst all of the alternative energy sources will take time to be discovered and developed, the nation has to find solutions immediately to the energy crisis. It is here that consumers play a vital role. We need to modify our consumption habits, and be more energy efficient in everything we do. We need to adopt energy conservation practices and reduce wastage. Our vehicle owners particularly, those whose fuel bills are paid for companies and the Government and also the luxury vehicle owners who can afford to pay, must realize that we as a nation cannot afford to spend our hard earned foreign exchange, largely earned by poor women workers, as payments for petroleum products.

35. Therefore, the public has a very big role to play in energy conservation, both in the use of electricity, which is largely generated with diesel turbines, and also in the use of vehicles. Corporate citizens must also be more responsible and realize that it is self-defeating to engage in wasteful energy consumption practices, for ultimately it is Sri Lanka's competitiveness that will suffer. A dollar saved is a dollar earned.

36. The same is true when it comes to a necessity we take for granted, namely water. The treated drinking water that comes to an urban household costs the Government Rs.20 per liter. We provide domestic households a large quantum of water at subsidized rates. Most people waste this treated drinking water to wash their cars and water plants. A developing nation such as ours, cannot afford to let our drinking water be wasted in this manner. Supplies are limited and it costs the Government millions to purify. It is also an energy consuming process. We spend foreign exchange on electricity to purify and pump water. Thus our citizens must adopt more responsible practices such as rain water-harvesting at home. The public must understand that the country pays a heavy price for indiscriminate water use.

37. Our farmers too must adapt their agricultural practices to take advantage of the rains, and follow a calendar of activities to maximize the use of water collected in the reservoir. The Government has embarked on a useful project of restoring our irrigation systems and reservoirs. It is a worthy beginning. The water in the reservoir should be kept as a reserve and to improve ground water level on land and moisture levels in the air. Paddy agriculture should use the minimal amount of water. We must get away from the wasteful ways we employ today. Our ancestors understood the value of water. The Great King, Parakrama Bahu instructed us to use every drop of water carefully and not let it flow to the ocean without benefiting man. His key message was do not waste a precious resource. It is not our intention to impose water taxes on farmers. But through a process of information dissemination, we must voluntarily move to a regime of better water usage and conservation practices.

Conspicuous Consumption

38. We will need to consider high taxation for conspicuous consumption. This is why we introduced high taxes on motor vehicles. It is important that we reduce excessive and wasteful consumption, whilst making exceptions for genuine users of energy, particularly the SME's. Whilst it is the duty of the Government to ensure that electricity and fuel is made available for cooking, transportation and basic amenities, any additional usage over and beyond the

standard consumption units, needs to be charged at the full cost of energy paid for by the country. Mr. Speaker, it is time that our nation realizes that we must live according to our means. Living beyond our means is the reason why we face a huge debt and other economic problems.

39. So my plea to the nation is to be more mindful and responsible in your consumption habits. I rather prefer we modify our consumption habits voluntarily, than it be mandated by law. After all, we are in a market economy with a healthy respect for individual freedom. Please do not abuse that freedom. In more advanced economies, the citizens proactively initiate conservation campaigns, and social service organizations, professional organizations and other NGOs adopt good practices without looking to the Government to modify public behavior. It is time that our citizens also adopt more socially responsible practices.

Taxation

40. When it comes to paying taxes, only a fraction of our population complies. Many do not make proper declarations. While someone may ask: why pay taxes to a system that wastes money, the hard reality is that all of us citizens do enjoy many public services, and we need a tax system to pay for it. Who pays for the maintenance of the roads? The hospitals? And medicines? The schools? The teachers?. The indirect and direct tax payer is the answer. We have a working population of 6.8 million people, but less than 200,000 people pay taxes. 80 percent of tax revenue is raised from indirect taxes on consumption. Is this fair? The UPFA Government will therefore, widen the tax net and bring those who avoid paying taxes and revenue duty to book. At the same time, we will reward those law abiding citizens who pay taxes as well as those businessmen who make proper declarations. It is time that our people are encouraged to become responsible citizens, and understand that we must all pay our dues.

Financial Situation

41. Mr. Speaker, before I turn to the economic and financial policies of our Government, it is important that I make a comprehensive assessment of the current financial situation of the country for the benefit of the members of this House and the people.
42. When we formed the Freedom Alliance Government in April 2004 we inherited a poorly designed and unrealistic budget. In it, revenue has been grossly overestimated. It included a profit transfer of Rs.5,000 million from the Central Bank to the consolidated fund. Such funds were not provided for in the

Balance Sheet of the Central Bank. It included a further sum of Rs.4,500 million from so-called EPF dormant accounts which belong to the workers of this country. It has assumed land sale of Rs.3,000 million. In reality none of these revenue sources have been available.

43. On the other hand there were commitments, not provided for in the Budget estimates. Despite the instructions to suppliers by the then Government to refrain from annual price adjustments in terms of various commodities such as gas, petroleum, flour etc., the 2004 budget had not made any provisions to meet such payments or subsidies. On the premise that regional bus companies and Railways Department were to be privatized, no provision had been made to make the required expenditure for those enterprises. Such enterprises had not been allowed to adjust their prices to recover costs. Consequently, the additional burden imposed on the budget on account of Railways and the bus companies alone was around Rs. 5,000 million. No provision had also been made for the committed wage adjustments in the health sector and pharmaceutical requirement for hospitals. The additional burden on these were Rs.3,000 million. Several foreign aided projects had been incorporated in the national budget, without adequate counterpart provisions. In effect, for every five dollars that has been identified, as inflows to the budget for foreign aid programs, there should have been at least two dollars or more budgeted as the local input. The total under-provisioning on account of conflict area rehabilitation projects, the Southern Highway Development Project, land acquisition, water supply schemes, the wild life conservation program etc. is around Rs.16,800million. We had to top up these contributions through supplementary provisions to ensure that project assistance from our development partners were utilized. There were also deferred payments to contractors and suppliers by the previous regime due to inadequate provisioning in the Budget which has put the construction industry into serious financial difficulties.
44. The UNF Budget had also assumed nearly US\$ 200 million of foreign funding on the basis of certain commitments, which were not eventually realized. For instance, a pledge had been made regarding the creation of a Revenue Authority, the privatization of People's Bank, privatization of Regional bus companies, implementation of a compensation formula under the Termination of Employment Act (TEWA) together with a whole host of commitments and performance targets. Consequently, before even our Government came into office, due to difficulties in implementing program conditionalities, and inability to keep to performance benchmarks, the IMF itself had suspended the PRGF facility in September 2003. It is in this background that the original budget estimates that were set forth in the 2004 budget became totally divorced from

reality. In both income and expenditure estimates, the UNF Budget was an “Alice in Wonderland” exercise.

45. The report submitted by the outgoing Secretary to the Ministry of Finance had confirmed in terms of the provisions of the Fiscal Responsibilities Act of 2002 that the budget deficit was going to increase from the original target of 6.8% of GDP to 7.8% of GDP. So we inherited a much high budgetary deficit for 2004 than was articulated by the previous Government in its propaganda campaigns regarding the economy.
46. Mr Speaker, it is also relevant to ask whether it was desirable to continue with the budgetary strategy adopted by the previous Government in terms of the ‘Regaining Sri Lanka’ Programme, which was essentially a debt reduction strategy. But public debt/GDP which was 103 percent of GDP in 2001 increased to 106 percent by 2003. In per capita terms it increased to Rs. 96,813 from Rs.77,552. Furthermore, Capital Expenditure declined to 5.0 percent of GDP. The result was that infrastructure projects such as roads, bridges, and buildings came to a halt. The legacy of that short lived administration was half built bridges, roads and public buildings. Work on the Katunayake Expressway was started in 1999. If this was not mishandled, by now a new road would have been added to our network. It will now cost much more. Rural infrastructure was totally neglected. How can a debt reduction strategy be sustained without a genuine effort to increase Government revenue? Tax revenue declined from 14.8 percent of GDP to 13.2 percent. In real terms it was a 12 percent decline. The much talked about exchange rate improvement was a result of the weakening of US\$ at that time, as well as budgetary support from Donors.
47. On the other hand we had to confront two serious economic crises this year. First was the drought in the second and third quarters. In many rice producing districts it had a devastating impact on the Yala production, resulting in a drop of about 40% in output. It created a huge mismatch between supply and demand, pushing the rice prices in excess of Rs.50 /Kg as compared to an earlier price of below Rs.30/Kg. Simultaneously the world entered into a fuel crisis with prices rising from US\$30/bbl prior to April 2004 to a near US\$60/bbl. At the current prices, annual cost of oil imports could reach US\$1,600 million in comparison to US\$ 837 million in 2003. The result is an increase in cost of imports by almost over US\$ 450 million. This in turn led to large subsidies resulting in an additional burden on the government and state enterprises such as Ceylon Petroleum Corporation(CPC) and Ceylon Electricity Board CEB).
48. We took measures to consolidate the Government revenue effort significantly. All enabling legislations have been made operational in order to ensure that

revenue measures proposed in the 2004 budget are implemented. We corrected the leakages introduced to the system through the infamous tax amnesty legislation. We have set a target of Rs. 3,000 million to be collected from this source alone, this year. In place of creating a Revenue Authority against the wishes of the employees, we managed to persuade the staff of the Inland Revenue Department to provide collective leadership in launching a modernization program for the Department. The staff committed themselves admirably to a major revenue drive. The tax revenue growth up to October this year is 19% despite low tax collection during the first half of the year. The Inland Revenue Department will move onto a new administrative structure with a heavy investment in human resource development, sectoral automation and professional tax audit activities beginning from next year. We have sought assistance from the revenue agency of the government of Thailand and the ADB for this purpose. To the credit of the Steering Committee of the Inland Revenue Department's Modernization Project, a new tax code and a code of conduct are ready for launching soon after this Budget Session. With all these efforts we have attempted to maintain this years budget deficit in the range of 8 – 8.5% GDP.

49. Nevertheless, Mr. Speaker, the borrowing levels by the government and public enterprises remain excessive due to fuel subsidies and ballooning foreign exchange requirements for imports, particularly fuel, and motor vehicles and food. While preserving private sector credit demand for productive activities, the consumption demand needs to be curtailed through appropriate price corrections in fuel prices and reduction in expenditure on motor vehicle and food imports. The Government and public enterprises need to reduce their debt financing in order to reduce monetary expansion below 15 percent and stabilize inflation at a single digit level.

50. In this background, we have taken some painful and perhaps unpopular measures to consolidate the financial environment. Price of petrol and diesel have been raised to catch up with international price increases. We are still behind but we are making some headway. Consequent to these price adjustments, we allowed the bus operators also to correct their fare structure. Postal rates have also been revised. Electricity tariff revision is pending. Taking note of a large increase in luxury consumption expenditure, particularly from imports, we introduced a rigorous taxation and stringent conditions regime on the importation of motor vehicles. Excise tax on cigarettes was raised. Countervailing measures were introduced to discourage smuggling of tobacco products to protect Government revenue. The revenue gain from this was around Rs.1,000 million. The government believes that general subsidies on diesel and petrol are not desirable and we will phase them out completely

although we had to accommodate Rs. 8 billion in subsidies this year. However, special needy groups such as the three wheeler operators, public transport operators etc. will be protected from any further price increases.

51. Mr. Speaker, despite many difficulties caused by these unexpected crises, we also took the first steps in creating a new economy. We implemented the fertilizer subsidy scheme, 1000 tank rehabilitation program, provided employment for 42,000 unemployed graduates, launched a free nutrition program for primary school children in rural areas, re-scheduled loans of small paddy millers, provided drought relief and began the rehabilitation of rural roads.
52. We need to consolidate the positive results of these policy initiatives while addressing the cost of living problem and rising costs of oil. In order to reduce the cost of living, we have eased supply conditions by removing duties and value added taxes on rice, sugar, and lentils. We intend improving market supply conditions in order to stabilize the cost of living. We do not think however that the removal of taxes on petrol and diesel is a solution to the current energy crisis. We certainly need to adjust to realistic international price levels while protecting the vulnerable groups. Removal of taxes on these commodities will only provide unfair benefits to rich urban consumers and not to the poor.

NEW POLICY INITIATIVES

Mr. Speaker soon after our Government was formed, we created several important national institutions namely: the National Council for Economic Development (NCED) , the Strategic Enterprise Agency (SEMA), The National Procurement Agency (NPA) and the National Council for Administration (NCA) – They are mandated to promote governance and efficiency in their respective fields.

53. National Council for Economic Development - NCED

We need an independent institution like NCED to harness diverse policy inputs and place them before the Government. NCED is built on the concept of bringing together a group of private sector and state sector stakeholders to jointly develop national economic policies and plans. They will also address issues that affect different sectors. We have institutionalized the process of pairing public servants with proven private sector domain experts and other nongovernmental stakeholders to do the thinking and planning on behalf of the

country. In this short space of three months since the NCED was created, it has constituted 18 cluster committees and directly engaged over 200 key private sector and citizen volunteer committee members to participate in the policy formulation and execution process of the Government. These cluster committees also include high powered clusters for donor coordination and North-East Development, Millennium Development Goals, Employment Creation and Labour Relations, Trade and Tariff, Financial Sector Reform and Public Sector Reform among many others.

54. Strategic Enterprises Management Agency - SEMA

As stated in our Policy Framework this government will not privatize strategic state Enterprises. Alternatively, we have created the Strategic Enterprise Management Agency (SEMA) to strengthen the management of these enterprises and to improve their performance. SEMA is managed by a team of professionals with domain knowledge and expertise to assist business development of strategic enterprises. They are mandated to ensure that 14 key state sector institutions adopts best management practices and corporate strategies, to undertake management reforms to ensure optimum productivity and focus on initiatives to become efficient partners in the national economy. Our Government is steadfast in its belief that with the introduction of good management practices, retraining standards and a disciplined approach to corporate planning and implementation a state enterprise could match or even exceed the performance of its private sector counterparts. This is shown by the successful performance of the two state banks. With Performance linked incentive pay and other productivity enhancing strategies. These organizations could be turned around. Strategic business plans which have been prepared for these enterprises will be submitted for the approval of the Cabinet before the end of this year.

55. Administrative Reform Committee - ARC

The need for carrying out a program of administrative reforms in order to make the Government's administrative machinery an efficient, citizen friendly and modern entity has been long felt. An Administrative Reform Committee had been established under the preview of the Prime Minister to oversee institutional reforms in the public service. This committee has drawn up a 16-point work plan. The major area of reform will be the rationalization of the functions of Government agencies. This will ensure that they will concentrate on functions relevant to current needs. This will be followed by an exercise to improve the procedures through which the Government Functions. Special emphasis will be placed on the need for transparency and the use of modern

information technology. The other aspect of institutional reform will be the upgrading of quality of personnel in the public service. In an attempt to make the administration closer to the people the Divisional Secretariat will be our focal point in institutional reforms. The Government proposes to coordinate the execution of the budget at Divisional Secretaries level in order to ensure effective use of public funds and drive the people" economy.

56. National Procurement Agency – NPA

The National Procurement Agency has been established to strengthen and streamline the government procurement system. It is mandated to prevent delays and inefficiencies by formulating simplified and harmonized procurement policies, guidelines and standards. The NPA will also engage in capacity building, accreditation and monitoring in order to ensure value for money accountability and transparency in government procurement practices. Our expectation is to manage procurement functions as a specialized activity by professionals to maximize value for money.

57. The National Council for Administration - NCA

The NCA was set up to revive the recommendations of the salaries Commission 2000 which called for the establishment of a permanent commission on administration with statutory powers and a Secretariat. This was a considered decision to get away from the earlier practice of appointing salaries commissions for specific purposes without a mandate to follow up on their recommendations.

The Board of Management of the NCA has now been appointed and the commission has commenced work. The Council is composed of members who have wide experience in the public service as well as those from the private sector. Its initial responsibility is to revisit the salary structures recommended by the Salaries Commission of 2000 taking into consideration the ad hoc increases of salaries granted to specific sectors and continuing anomalies in the salary structure of the public service.

The responsibilities of the council are wide. Apart from continuously monitoring salaries, allowances, overtime, incentives etc. and making relevant recommendations to the government, it has been tasked with developing a national wage policy, cadre management in the public service, review of line ministries and other government agencies, identifying institutional shortcomings, managerial limitations and removing such constraints.

Mr. Speaker, through the setting up of these institutions together with the active participation of line Ministries we have commenced the re-engineering of Government to fulfill its role in the socio-economic development of our country. This process involves a massive skills upgrading and training program, including IT skills as well as teaching of best management practices. We hope to make human resources of the public service equal to the task like their private sector counterparts. In addition to training new recruits to the service, Government will soon launch an agency wide re-training program for all public servants, linking the private sector education institutes and public institutions, to jointly work out an accelerated program of Knowledge and Skills Empowerment. We will also be doing a baseline survey of current productivity levels, and adopting proven productivity measurement tools to enable the Government to consider rewarding performance. We hope the international donor community will support this initiative. It is absolutely essential that our workforce is trained and equipped with up-to-date knowledge and skills. The world is today operating in a knowledge based economy, and if Sri Lanka is to remain competitive as a place for investment, we must ensure that our Government service performs at an acceptable level. I have no doubt that they will. We are already witnessing a change in the Government work culture, particularly in the state banks and in the revenue agencies.

58. Budget Monitoring and Aid Utilization –

Although there is some improvement in the utilization of foreign aid the overall result is still inadequate. Unutilized aid commitments are in excess of US\$ 3,000 million. Sri Lanka's budgets now aim at obtaining US\$ 1,000 million each year from loans and grants. This is in addition to a large volume of domestic provisions earmarked for various development activities. In this context several bottlenecks that affect the smooth implementation of projects such as procurement procedures, provision of adequate local resources, implementation capacities, accounting and administrative procedures, release of funds by the Treasury etc. has been examined and a new monitoring arrangement has been setup in the Ministry of Finance and Planning. This should ensure speedy implementation of major projects. The entire project profile on the ground as well as the new projects to be executed are now on a web-page for easy monitoring. The new unit entrusted with budget monitoring and aid utilization, together with the National Procurement Agency, are working on execution schedules to facilitate this task. In order to further strengthen this an Inter-ministerial Cabinet Sub-Committee headed by Her Excellency the President has now been set up for vigorous performance monitoring. As Project management teams play a very critical role, the government also proposes to introduce a reward mechanism based on the performance assessment of each

project. This new system will rank each project in terms of its performance outcomes. We propose to link this system to the 270 Divisional Secretariat.

59. Enterprise Development Bank (SME Bank)

The principal thrust of our economic policy will be to transform SME as a nerve center in our development process in order to achieve a balanced rate of economic growth, regionally distributed benefits and a high level of employment and productivity. There is therefore an urgent need to establish a multi prong, support mechanism to promote SME entrepreneur competitiveness including **full assistance** to exporters who engage in high value addition to domestic resources.

60. Collateral dependent debt, and shortfall in equity financing has been identified as problems faced by all SME entrepreneurs across all sectors. High interest rates and low availability of credit are the main barriers to business expansion and productivity. A recent Asian Development Bank (ADB) survey revealed that absence of a SME business friendly bank and prevalence of complicated loan application procedures is a significant factor inhibiting SME access to credit. In terms of SME entrepreneur and enterprise weakness, the absence of business plan, and lack of total management skills are attributed as reason for failure and consequent inability to repay loans. Therefore, the initiative was taken by Her Excellency the President to set up a bank to service the funding and business development needs of small and medium enterprises in Sri Lanka. Our Government also welcomes the initiative taken by the International Finance Corporation (IFC) of the World Bank to setup a SME Fund in our country. The Japanese Bank for International Corporation (JBIC) and the ADB have also included SMEs in their lending portfolios to support a 'breakthrough' development in the SME sector.

Knowledge and Skills Development

61. The education capital budget declined steeply from 5% of Government capital spending in 1999 to about 2.5% in 2002. In the Education budget capital expenditure has decreased from about 20% to 16% 2002. This fall in capital investment constrained progress of the education system. Less than 20% was invested in quality inputs such as equipment and technology, furniture and tools. Many rural schools have empty classrooms, while urban schools are heavily congested. Construction activities in the university system are also uncoordinated with heavy expenditure devoted to buildings without a clear plan based on the needs of the university system as a whole. As a consequent of

the low investment in quality input, we are now on the wrong side of the digital divide. We are seriously constrained in equipping the future generation with modern knowledge, skills and competencies. The vision to increase access and progressively upgrading the education sector is based on restoring performance, maximizing available opportunities and enhancing the prospects for school and university students to compete qualitatively with their peers in the other parts of the world.

62. Mr. Speaker, today the world is characterized by a knowledge led economy. Therefore our education system must play a vital role in ensuring that our nation is equipped with a productive work force, possessing appropriate knowledge and relevant skills. In order to achieve these, goals we have not only to develop a comprehensive education program, but also begun the process of transformation.
63. Keeping with our commitment towards achieving the millennium Development Goals (MDG) and the National Action Plan for Children schools in rural and disadvantaged parts of the country will be equipped with adequate physical moves both from the Consolidated Fund and through a variety of Donor Funded Projects.
64. As a priority, we will be strengthening the intake and output capacities of all our primary, secondary and tertiary education institutions, including the much neglected technical and vocational schools. New institutions will also be created to fill knowledge gaps. Streamlining admissions to schools and other administrative systems, introduction of modern class room teaching methods and resources such as IT infrastructure, computer laboratories, revised text books and e-libraries, are part of a package of extensive measures that will be proposed in this budget.
65. Under Her Excellency President Chandrika Bandaranayaka Kumaratunga's initiative, the Navodaya school development program targeting 397 schools will provide good quality education for rural children. These schools will be equipped with IT and Science labs, libraries, sports and musical facilities in order to provide a wide range of skills training. The Central School revival program and a special program for developing schools in the plantations and in the war affected North and East, occupy a priority position in our education infrastructure upgrading program.
66. The introduction of English and Information Communication Technology ICT as new subjects in the school curriculum will be progressively expanded from the higher grades to the lower. The present 50-1 pupil-to-teacher ratio will be

reduced to accepted international levels. We are also developing a program to improve the quality of our teachers through the re-opening of teacher training schools and introduction of modern methods of teaching. New books are being published and distributed to schools to substantially improve standards of text books made available to students.

67. In addition to school, the current work force will also be encouraged to equip themselves with new knowledge and IT skills. The thrust sectors of our economy will be encouraged to establish links with leading tertiary education institutions and corporate sector knowledge leaders overseas to build up local knowledge development and skills training capacity. Special attention will be paid to inculcating moral values and a sense of social responsibilities through the teaching process. In the Budget I propose to encourage such teaching and confer some benefits to the Sunday schools which play a very important role in disseminating religious and cultural values to a large number of our children.

Agriculture

68. The majority of our population depend on agriculture for their livelihood. Yet agriculture has been neglected. To our great cost, we have become dependant on imports for day to day living. The cost of food imports which include rice, flour, sugar, potato, onions, milk powder, etc is around US\$ 700 million. This is almost the same cost as for the import of crude oil
69. Many of our conventional economic indicators such as GDP, stock market, balance of payments, budget deficit, information technology etc do not mean anything to those living in the rural economy, trapped in poverty. To them, what matters are water, seed, fertilizer and markets for their cultivation, s low transport costs to distribute their produce, roads, electricity, better health and education facilities and improved life chances for their children. Economic indicators are not meaningful unless they reflect hard realities on the forward.
70. Therefore, rapid development in food production while protecting the environment, water resources, and bio-diversity will be given high priority in our policies. Fragmented land use, insufficient availability of water, credit, seed, technical know-how, technology, marketing, storage and transportation continue to weaken productivity in agriculture. Agricultural extension services that have been allowed to wither away needs to be revitalized. 100,000 hectares of agricultural lands that have been neglected will be brought under cultivation through the rehabilitation of 10,000 tanks under "Dhasak Maha Wev

programme". Budgetary allocations for Research and Development in agriculture, which has been run down abysmally needs to be raised. Bad water usage practices that have aggravated droughts will be corrected by farmers who will be encouraged to preserve water through timely cultivation and better knowledge of the value of conservation. New high yielding varieties will be introduced. Innovation and development in indigenous technology should also be considered. In addition, minimizing of post harvest losses and low quality production needs to be addressed to improve productivity. This requires storage, packing and better transportation facilities. The major part of local demand for dairy products can also be met from within our country. Dairy Co-operatives, have been formed to encourage livestock development. Agricultural development cannot take place in a vacuum. It should be linked to agro based industries and services.

Industrialization Strategy

71. The pro-growth strategy Sri Lanka needs in the present global context is one, which would actively favor agricultural production and manufacturing. There has to be a gradual but a definite shift towards high value added domestic resource based production activities. Manufacturing activities offers opportunity for product diversification, expansion and productivity increases. Therefore, industrial policy should strengthen the existing export orientation of the country's manufacturing sector. On the other hand industrial policy need not completely ignore import substitution. Our strategy will be to promote such industries in line with their own potential in terms of market size, liberalization commitments, and trade agreements in order to ensure competitiveness. Mass consumption items such as processed foods in fact offer chances for successful export and opportunities for penetrating world markets. Industry promotion requires a system of policy based financing.
72. Financial sector reform therefore must be guided by the need for development financing the economy in addition to strengthening of state banks as strategic enterprises. Adverse impact on domestic entrepreneurs of interest rate differentials between Sri Lanka and its competitor countries need to be minimized through proper policy actions. In order to complement the existing commercial and merchant banks as well as development financial institutions in providing working capital as well as medium term fixed capital the proposed Enterprise Development Bank-SME Bank, will have a role in providing concessionary working capital for entrepreneurs either directly or through other financial institutions backed by risk sharing arrangements. Regulatory supervision and surveillance by the Central Bank needs to focus on reducing

high intermediation cost in Sri Lanka's banking system to provide a positive rate of interest to depositors and keep low lending rates.

73. Labour market reform for flexibility in the management of capital labour relationships are no doubt essential but the introduction of a strict hire and fire legislation is hardly a solution to our labour problems. We must cultivate a culture of collaboration between the employer and employees, where the economic fundamentals of the organization, and the cost drivers are transparently known to the work force and a productivity linked incentive pay structure is developed. The compliance of ILO standards have in fact enabled many of our industries to consolidate their market position in the global economies which value best practices in corporate governance.
74. In the Exchange Rate policy our main focus shall be competitiveness in the currency to promote more exports as well as a competitive import substitution industry. Competitiveness is not ensured by merely allowing demand and supply forces to determine the exchange rate. Many forces underpinning the supply of foreign currency into the local foreign exchange market have little or nothing to do with the productive focus of the domestic economy. Therefore, a tendency towards overvaluation will be avoided in our exchange rate policy. In fact our exchange rate is undervalued and quite favourable to exports. At the same time, the Government will enable the local banks and funds to offer attractive rates for foreign currency deposits, including the introduction of multi-currency investment instruments that export income earners could use.
75. In reviewing our industrial policy, it was very clear that the contribution of the SME sector has gone unrecognized and that there were no special measures to assist them and empower them. The rest of the world understood the value of SME. Even large companies in those nations took advantage of the flexible strengths of SMEs. Our industrial establishment was not current in their thinking about the best industrial practices, when it came to vertical and horizontal integration and the establishment of backward and forward linkages. All large companies must as a national responsibility assist the SMEs by purchasing components and inputs from them. Similarly, Government and the private sector should attempt to purchase goods and services from SMEs against a competing product that is manufactured overseas. Towards, this end, this government has already encouraged local textile manufacturers to produce free school uniform material locally. As a result of this, the industry is now assured a ready made market for their products, saving foreign exchange. While most of the industrialization activities are concentrated in the urban areas for obvious reasons rural economic imperatives make it necessary that we tap the potential of rural areas. The rural industrialization process cannot have a

life of its own. It must fit in with the local resource base and value addition and be guided by market conditions in order that the produce can be sold at remunerative prices. We need to support our local producers. That is how we build up spending power and our own economy. Mr. Speaker, it is time that we promoted national minded consumer behavior.

Investment Strategy

76. Foreign direct investment provides foreign exchange and employment opportunities and catalyzes the development process. FDI flows are around or under 10% of our aggregate investment of around 28% of GDP and still remain small. We shall therefore plan to attract increased FDIs. Public-Private partnership arrangement will be used to promote large-scale infrastructure projects. Dormant textile mills at Pugoda, Thulhiriya and Mathegoda will be revived to strengthen backward linkages in the apparel industry.
77. Mr. Speaker, for too long our nation has relied on debt finance, to develop our infrastructure and industry, without making a concerted effort to tap the vast private equity capital that is available globally. These venture capital and private equity funds, are solely focused on return on investment (ROI) and the potential for securing an exit for their investments preferably through a listing on a local or international stock market. These are institutional investors who as equity participants adding value to our economy. Therefore, Mr. Speaker, Sri Lanka should aggressively target private equity funds, and increase the foreign direct investment flows to the country, and work directly with commercial banks to secure funds for many of the projects that have a revenue model attached to them.
78. Mr. Speaker, to attract the high value financial services industry to Sri Lanka, We need to create the enabling environment to secure the most important input for a thriving financial services industry namely human capital. It is the investment portfolio managers, brokers, insurance agents, lawyers, accountants and bankers who drive this industry. Many expatriates working in the region have chosen Sri Lanka as their second home, as most of them find our Island an attractive place to live in. Many of them are in the financial services sector, and would be motivated enough to develop the off-shore financial services together with Sri Lankan partners, provided the right tax and regulatory incentives are in place. We would like to tap their expertise by offering incentives that match and indeed exceed other financial centers in the region. Many established companies will be persuaded to relocate their operational headquarters in Sri Lanka. The High local concentration of CIMA

graduates and those with IT capabilities will be used to attract investments particularly in outsourcing markets.

Trade and Tariff Policy

79. Government trade and tariff policy will aim at providing a stable and predictable medium term policy framework. This is a way to generate high growth and employment and thereby reduce poverty. Given the increasing integration of the Sri Lanka economy with global markets the policy framework will also be geared to facilitate a fair-trading environment for both export and import sectors.
80. Sri Lanka's bilateral and regional trade initiatives have achieved other significant results. Through Free Trade agreements and broad ranging trade agreements we will assist exporters in maintaining and improving their market share. Such agreements also attract foreign investments, into the country. The Indo-Sri Lanka Free Trade Agreement and the proposed comprehensive partnership agreement between India and Sri Lanka where both countries seek to go beyond trade in commodities to include services and investment, will provide a benchmark for future trade initiatives.
81. In order to enhance a competitive policy environment, Sri Lanka will also aim to strengthen standards on health, environment, labour and safety to comply with international best practices. Compliance with such standards will assist Sri Lanka not only to meet the challenges of modern trade initiatives but will also ensure that the rights of consumers are protected. It is proposed that an institutional mechanism to monitor such obligations is strengthened to ensure effective action against infringements of standards in respect of both locally produced and imported goods. In addition, a review of Sri Lanka's policy framework for trade remedies will be undertaken within the provisions of the WTO. Special reference is made to infringements in respect of goods being dumped or subsidized to the extent that local production is threatened. The review will ensure that such mechanisms are consistent with Government objectives of encouraging economic growth through the operation of open and competitive markets.

Transport

82. Mr. Speaker, as much as I want our nation to be prosperous and our people to enjoy all modern conveniences, there is one consequence of development that has inconvenienced everyone - namely the number of vehicles on the road. Our road capacity is not adequate to accommodate the vehicle population. As a

result, we suffer from not only intolerable congestion, but also from intolerable pollution. To add insult to injury, most vehicles are neither fuel efficient, nor passenger efficient. Our fuel consumption has increased dramatically, forcing us to spend more dollars to import more oil. There is also a productivity loss due to long hours spent on commuting. This is a serious issue that successive Governments have failed to address. We must take bold decisions now or we will face unpalatable consequences of gridlock soon.

83. Mr. Speaker, I want this house and the country to know that, however dilapidated and disorganized our public and private transport services may be, it is still the backbone of our passenger and cargo transport system, carrying 72 percent of the nation's passenger traffic. In contrast, private motor vehicles that occupy 80 percent of the roads, only carry 28 percent of passenger volume. Amazingly, about 200,000 three-wheeler operators carry 1 million passengers daily occupying the least amount of road space and using the lowest volume of fuel. We need to improve our public transport services, and shift usage towards public vehicles. The state bus operations which are presently heavily subsidized to cover operating and management inefficiencies must be put on a commercial footing. In order to improve bus services, the budget will provide subsidies for the introduction of new dedicated school buses, office buses and buses for un-served developing areas. These will be value added services designed to attract private vehicle users. In an effort to streamline the management of buses and improve safety and passenger satisfaction, bus routes need to be re-planned.
84. The Railway will be provided with funds for strengthening the track and a level of funding required to ensure good maintenance. New services such as the Airport Express link, the carriage of fuel and containers and fast monorail services would be pursued to increase railway revenue. The Government will introduce Public Service Obligation Agreements with the management to provide more quantifiable recurrent expenditure. The Railway Authority will not be set up and the SLR will be provided freedom to operate as a commercial enterprise within the departmental structure. A subsidiary unit would be formed to manage railway lands on commercial lines. Taxes, duties, levies and fees with respect to the use of motor vehicles would be gradually adjusted to represent the User Pay concept.

Plantation Community Infrastructure

85. Mr. Speaker, as you know the plantation community is still suffering from poor housing and health facilities. They lack many other facilities, including

electricity and energy for cooking. Fuel wood continues to be used at a great cost to our remaining forest cover, and the only way this could be reversed is by encouraging the reinstallation of alternative energy generation with incentives for the management companies to provide power to the homes of the workers. We propose that energy efficient homes be designed and built for them, utilizing modern technology. The 2005 Budget provides the initial capital provision to implement an estate sector housing program over a 3 year period to complete 50,000 housing units. A new Plantation Community Support Program and community development initiatives that will improve their basic education, health and skills standards, as well as basic needs such as housing, drinking water, and electricity are being formulated in order to mobilize greater donor funding for the development of plantation community infrastructure over the next three years. The line Ministries will channel Rs.900 million through their votes for plantation housing, schools, water supply and sanitation, health and electrification during 2005 out of Rs. 3,000 million earmarked to them for the next 3 years from the Consolidated fund. Plantation companies are also expected to contribute toward the development of community infrastructure in terms of their corporate social responsibilities.

North East Reconstruction and Rehabilitation

86. As outlined in our Economic Policy Framework the relief and rehabilitation effort in the North and East has the support of all stakeholders in the peace process. Her Excellency the President spearheads this task through the Ministry of Relief, Rehabilitation and Reconstruction and the implementation of many projects through the North East Provincial Council and District administration based on the Triple "R" Framework. Government has ensured continuity of the development initiatives for the North East Provinces funded by our development partners. The total funding available for the development of these provinces is in the order of US\$ 500 million for the next few years. Since we came into office, we have executed many such donor funded development programs.
87. Mr. Speaker, you may note that the World Bank has earmarked US\$ 218 million for helping conflict affected communities with rehabilitation of irrigation schemes, agricultural related activities and capacity building for social and economic re-integration of communities. It is targeting nearly 200,000 families. The World Bank assists in the rehabilitation of internally displaced persons restoring primary health care, water supply and building institutional capacity of the North East provincial council in implementing reconstruction activities. The North East housing reconstruction projects which were

negotiated in October this year will facilitate the reconstruction of 46,000 houses over a four year period.

88. The ADB provides about US\$ 160 million for a wide range of water supply and sanitation projects in Batticaloa, Polonnaruwa, Anaradapura, Hambantota and Trincomalee districts. The North East Coastal Community Development Project aims at uplifting standards and providing basic needs to the coastal community. It will provide micro credit for sustainable livelihood activities and resource management in the Trincomalee bay, Batticaloa Lagoon, Southern Ampara Bio Diversity Zone, coastal resource planning in Batticaloa and Trincomalee districts and fisheries development in Batticaloa, Ampara and Trincomalee. The Conflict Affected Areas Rehabilitation Project supported by the ADB aims at rehabilitation of 500 Km of roads, rehabilitation of power transmission, distribution and rural electrification and small scale community infrastructure rehabilitation.
89. The Government of Japan under JABIC's lending program provides for improvement of rehabilitation of roads, bridges, irrigation schools and hospitals. It also provides irrigation facilities and income generating activities through a 7 year development project.
90. The ADB, OPEC the Government of Germany and Netherlands jointly provide assistance for relief and rehabilitation of the North East on health, education, agriculture, livestock, roads, water supply, irrigation and vocational training. The targeted beneficiaries are around 572,315 at the cost of US\$ 54.3 million. The Government of UK sponsors rehabilitation 89 bridges and 2 ferries in the North East at a total cost of US\$ 36.9 million. The Government of Norway provides assistance for water conservation, environment management and road development in the Batticaloa district.
91. Small scale development projects coming under various other sources include Manner district rehabilitation and reconstruction community projects, provision of quality seed and rehabilitation of schools vacated by Armed Forces and rehabilitation of the railway track between Valachanai and Batticaloa. Consolidating these development effort, the Government has made a provisioning of Rs. 80,000 million over a three year medium term framework of which Rs.20,100 million is to be utilized during 2005.

Initiatives to Strengthen Governance

92. Achieving a sustainable rate of economic growth requires a governance structure that ensures a transparent, accountable and equitable legal and institutional framework. Such a framework in turn minimizes corrupt practices, reduces business risks and improves competitiveness. It is the poor that suffer most from corruption, irregularities, waste, delays and inefficiencies, whether they be in the private sector or the public sector. Good governance therefore, benefits the poor more than the rich and the elite. Recognizing that an up-to-date legal framework is essential to create an enabling environment for growth, key legislation including the proposed Companies Act, Information Technology Act, Data Protection Act, Banking (Amendment) Act, Prevention of Money laundering Act, Debt Recovery (Amendment) Act, Payments Transactions Law and Misrepresentations Act, Electronics Transaction Act, Financing Leasing Act, Bankruptcy Protection Act and Credit Information Bureau (Amendment) Act are being drafted.
93. Towards improving legal and judicial facilities this Government has revived the Legal and Judicial Reforms Project (LJRP) with the assistance of the World Bank. As a result, capacity building in institutions responsible for law reform and legal education through a professional development process is being strengthened. A Judicial training program has been launched both for sitting judges as well as new recruits to the judiciary. I am pleased to inform the House that the World Bank has now upgraded this project based on our performance during last few months.
94. A comprehensive governance framework within which corporate entities could carry on their business operations has been envisaged in the proposed Companies Act. Automation of the Company Registrar's Office (CRO) which has been planned to be completed by June next year will enable online access to registered company information, company registration and filing of returns. An effective compliance and surveillance mechanism would evolve through this automation process which will help reduce corruption.
95. The Auditor Generals Department (AGD) which has been setup to ensure transparency and accountability in the public sector, is being restructured. A new Audit Act is being finalized for enactment through which it is proposed to grant the AGD greater financial independence and control. Information Technology at the AGD is being enhanced to facilitate strategic planning, human resource development, communication etc., and to be used as an effective tool to provide more efficient and objective audits. The aim is to transform the AGD to an agency that promotes governance through high

quality audits and objective reporting to Parliament. In order to improve this process, I have also directed my Ministry to extend maximum assistance to the Oversight Committees of the Parliament.

96. A re-orientation effort is in progress at the Board of Investment (BOI) which is the facilitator of foreign investment. The multifaceted functions that the BOI is entrusted with are being revisited to make it more proactive and focused. In-house capacity building and strategic planning have been given priority. Investment climate monitoring is being improved to ensure the nation's competitiveness profile. All this is aimed at making the BOI a strong facilitator. Many investment projects which have been submitted by foreign as well as domestic investors are stuck in various agencies, denying a valuable flow of investment funds to the country. This practice of sending investors from pillar to post should be stopped forthwith. BOI therefore need to be the only contact point for investment and it should have the authority to clear all approvals. A high powered Cabinet Sub-committee bringing an inter-ministerial leadership and providing an Investor Assistance Forum has been set up to strengthen the BOI and clear all bottlenecks to ensure speedy clearance of investment approval so that investors can take business decisions in a country, free from corruption and frustration.
97. Revenue institutions are being modernized to make the country's revenue collection mechanism more effective and to develop public confidence. The Department of Inland Revenue is being modernized with the introduction of a corporate structure, to make tax administration more effective and efficient. Measures are being undertaken to exploit the potential of the existing staff through training and motivation. Information technology will be used to the fullest capacity towards achieving these goals. A Code of Ethics is being developed targeting a mindset change of tax collectors and taxpayers. A Tax Charter has been developed encompassing rights and obligations pertaining to taxation, to create greater civic awareness. The Department of Customs and the Department of Excise are also being restructured to strengthen their institutional capacity and skills and to enhance enforcement.

National Poverty Reduction and Growth Strategy

98. The principal objective of our economic growth strategy is to increase the income of the poor, which is around 50% of our population. The foundation for this strategy is based on the recognition of hard facts revealed in the 2002 household survey conducted by the Department of Censes and Statistics. Growth is necessary. Nevertheless it must be focused on the need for

substantial reduction in poverty. For growth to be pro-poor it must stimulate productivity which will attract unemployed and under employed as well as the new entrants to the labour force. Therefore, our goal is to ensure productive employment to all who can work and to enable everyone to earn a decent income from their work. This is why composition of growth is equally important in achieving high economic growth

99. Poverty in our country is predominantly concentrated in 8 districts in the North East, 6 districts in the South including several plantation districts and in a few other small areas. Therefore, successful poverty reduction must address specific poverty profiles in those areas by either creating productive jobs there or enable people from there to move to productive jobs elsewhere. The centerpiece of this strategy is the massive infrastructure development in neglected areas as the basis for development of agriculture, industry, tourism and other activities to provide employment. To the maximum possible extent, poor will be involved in rural infrastructure development projects so that they will have work to augment their income.
100. There is a minority of the poor for whom the availability of jobs provides no solution because they have no family members who can work enough to support the family. They are too young or too old or physically handicapped. For this group special income support programs are needed. There is a large group of low income families who are temporarily pushed into poverty through no fault of their own but through droughts, floods or other natural disasters. For them there is a need for a safety net of temporary employment. Welfare payments need to be reserved for those who have only limited or no capacity to work and to help the groups I have mentioned earlier during difficult times
101. A major factor affecting the poor is the failure to reduce unemployment. Countries which have grown rapidly with employment creation are the ones that have maintained high per capita income growth by growing at least over 5 percent in GDP over their population growth. The required rate of investment for such a level of economic growth has been around 30 - 40 percent of GDP and domestic savings of 20 – 25 percent. In Sri Lanka investment has averaged around 25 - 28 percent of GDP and domestic savings has been around 15-18 percent. Foreign investment has been as low as of 1- 2 percent of GDP.
102. In the context of our country, a growth rate of less than 5% is not sufficient either to absorb excess labour or to develop our backward regions. In the near term reaching GDP growth rates over 8 % is not practical . The Government has set a growth target of 6 – 7 % for the medium term. It is very necessary to set a sustainable growth path which will be realistic in the

next 3 - 4 years and ensure over a 5 % per capita income growth. In a nut shell our aim is to increase the income of the poor and the regions at a far more rapidly pace than in the last several years. Our country needs 6 – 7 % rate of economic growth and more labour intensive strategies that create productive work to the unemployed as well as increase the productivity of those already employed. Such a strategy necessitates the following:

- a. Mobilizing more investments, private or public; local or foreign, into labour intensive activities and into the less developed regions.
- b. Ensuring an economic environment with stable financial conditions, which is conducive to long term investment decisions by the private sector particularly by SMEs.
- c. Providing a wide range of infrastructure facilities such as electricity, road , transport, communication and water supply at competitive prices.
- d. Increasing efficiency to lower cost of government enterprises that supply utilities to the private sector.
- e. Encouraging the creation of an educated and skilled labour force and better working environment.
- f. Increasing Government investments in infrastructure, particularly in less developed regions that have potential for value creation
- g. Mobilizing higher Government revenue so that the public investment is protected and debt financing is reduced.
- h. Improving the environment by conserving and developing natural resources namely, land, water, perennial vegetation etc.,
- i. Improving production and productivity of crops, animals and environment to improve income and employment opportunities for the people, particularly the landless poor and women.
- j. Encouraging the use of technology in agriculture and industry to ensure a high volume production.

103. Economic development can promote peace. The conflict in the North and the East have taken a heavy toll on the resources of the country and has also weakened investor confidence. Therefore, promotion of a regionally balanced

quick economic growth becomes necessary to secure peace and prosperity. As part of the regional development strategy of the Government, a substantial investment on infrastructure development in the North and the East should therefore be reflected in the national growth strategy.

104. Mr. Speaker, the poverty profile in the plantation community also must be addressed. Their health and education standards as well as access to basic sanitation conditions are well below national standards. We see also the adverse effects of heavy alcoholism, which has affected productivity by as much as 50%. In this context, the national poverty reduction strategy must have well focused initiatives that will improve their basic education, health and skills standards, as well as address needs such as housing, drinking water, and electricity.
105. The pro-poor growth strategy will also require a decentralized level of implementation in order to get the community involved in development. Local roads, irrigation, drainage, drinking water, health centers and primary schools could be developed with greater community participation. Our strategy therefore would be to strengthen the Divisional Secretariats as the coordination center for overall administration relating to poverty reduction programs. Towards this end certain public expenditure items at each Divisional Secretary has been identified and they will be expanded further. This will help the Divisional Secretary to monitor and coordinate the use of resources made available at district level. The government, private sector, social organizations, religious leaders, donors and above all the community would be partners in this process of poverty reduction.

The 2005 Budget

106. Mr. Speaker this Budget will provide a basic financial framework and medium term incentive structure to consolidate our development plans. The 2005 Budget is thus built on 7 pillars:
1. Enhancing effectiveness of public financial management and the efficiency of the delivery system to the people.
 2. Transforming the economy to knowledge and technology based as a catalyst of economic growth by ensuring a high value added production using domestic resources.

3. Improving access through infrastructure at provincial levels/national as well as to attract public and private investment.
 4. The production base that is largely owned by private small and medium enterprises will be made the nerve center in the production process.
 5. Strategic state enterprises and the public sector will play a complementary and proactive role in making development more meaningful to the people.
 6. Reduction in poverty through rural sector development and employment creation.
 7. Promoting a caring society. respect for cultural and religious values, leading to a stable democratic society.
107. Mr. Speaker, in support of these seven pillars, this Budget which is part of a three year medium term framework provides Rs.54,428 million for the education sector - an increase of Rs. 12,477 million over the last year. It provides Rs. 40,408 million for health - an increase of Rs. 10,113 million. Therefore total expenditure on human resource development which is one of our key priorities will increase by Rs. 22,590 million in 2005. Infrastructure development will provide access to growth for our people. Therefore we allocate Rs. 55,479 Million for national and provincial infrastructure development such as roads, electricity, transport, communications, ports and airports. These include Rs.14,180 million to improve access to drinking water. Within this three year framework an accelerated development of irrigation facilities covering the 10,000 tank program , Deduruoya and Manik Ganga diversion, dry zone minor irrigation schemes, Udawalawe Left bank, Mahaweli Systems upgrading and River Basin Development programs are provided with Rs. 4,418 million. In support of production sector activities in agriculture , plantation, livestock fisheries, small and medium industries, enterprise development and tourism, a sum of Rs. 26,561 million is provided.
108. Overall social welfare and poverty reduction is also one of our main concerns. Therefore, this budget provides Rs. 32,522 million for Samurdhi, Women Empowerment, assistance to displaced persons in conflict areas, assistance to disabled solders, social services and community development activities. The budget provides Rs.32,857 million as retirement benefits to pensioners and Rs. 7,371 million for widows and orphans. All these activities are supported with the commitment to preserve our social, cultural and religious values and hence, Rs. 2.306 million has been allocated under various religious cultural and youth development programs. Therefore, Mr. Speaker this is a budget for island wide

infrastructure development, improvement of human resources, rural development and poverty reduction, incentives for production sectors and promotion of social and cultural values – all essential for durable economic development and value creation in our country.

109. Mr. Speaker, the fiscal policy options before any Government to balance a budget, is to either reduce costs or increase revenues or accept a deficit and increase borrowings. The UPFA Government chose to increase revenue, as there is much to be collected. We also chose to eliminate hidden subsidies that benefit the rich and not the poor. Mr. Speaker, the fertilizer subsidy is nothing compared to the diesel subsidy that the vehicle owning population enjoyed for leisure travel. In fact, tax concessions, customs duty reductions, exemptions, VAT rebates, and such other concessions the business community constantly seeks and secures from the Treasury, are much more than the entire budgeted subsidy bill! These are the hidden subsidies, which the more affluent and influential sections of our community enjoy in our country at a tremendous burden on the annual budget.
110. Mr. Speaker, before the tea break, let me now, summarize our budgetary strategy for the next three years
1. Within a medium term framework, Government revenue will be raised towards 19% of GDP and generate a revenue surplus in the budget equivalent to 3% of GDP
 2. Public investment will be raised towards 8% of GDP to provide the enabling infrastructure, provincial and rural infrastructure, as well as north and east rehabilitation and human resource development facilities.
 3. Domestic debt financing will be brought down to 2% of GDP to enhance available resources for development of SME led capital formation and income generation activities.
 4. The medium term fiscal strategy will support a macro policy environment that will stabilize exchange rates and the interest rate regime through reduction of interest differentials between Sri Lanka and her trading partners.
 5. Underpinning this strategy is a nation wide development towards poverty reduction and economic growth

I am placing before this Honourable House the underlying Medium Term Macro Economic Framework as well as the Medium Term Macro Fiscal Policy Framework for your information and study.