

Development & Effective Governance¹

By Dr Lloyd Fernando

We read today that winds of nationalism are blowing through Latin America. They are blowing across Argentina, Brazil, Chile, Ecuador, Uruguay and Venezuela. Mexico too is expected to join them when it goes to the polls in July. These new regimes are being characterised as leftwing – mostly left of centre – with sympathy in varying degree towards the Cuban revolution. The fundamental problems facing these countries are the same – poverty, unemployment, rising cost of living, regional disparities and mounting youth disillusionment. The pursued solutions are a hybrid of state led interventions in the economy, reflecting a challenge to the Washington Consensus of free markets and privatisation.

Here in Sri Lanka, we have a similar situation. The problems are very much the same – poverty, unemployment, rising cost of living, regional disparities and youth disillusionment. But here they are compounded by an ethnic conflict and violence, which makes the challenges more complex and the tasks of dealing with them more daunting. Here too it seems, the Washington consensus has failed. One might argue of course that the reason was lack of consistency of application. But consistency depends also on the socio-political realities and balance of political forces. In a democratic constituency which was replete with elections, it was almost impossible to carryout structural adjustment programmes consistently, since they carried with them all the consequences of relative price adjustments and short-term disruption of life. Further, the free trade dogma carried with it threats to indigenous capital formation and investment, with little or no time for “learning by doing processes”. This is the reason why there has been a fusion of the nationalist movement with aspirations of egalitarianism and socialism.

Mahinda Chinthanaya – the Election Manifesto of President Mahinda Rajapakse – which lays down the objectives and guiding principles of his regime, is also a hybrid of solutions that seeks to respond to the nationalist and socialist aspirations of the people who carried him to power. Mahinda Chinthanaya reflects complete disillusionment with the Washington Consensus and Structural Adjustment Policies that

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guided economic policy in Sri Lanka during the last two decades. It seeks to accelerate economic growth, with a more balanced distribution of benefits. It seeks to provide income earning and employment opportunities and reduce poverty throughout the country. It seeks to develop indigenous capital, entrepreneurship and skills to meet the challenges of competition in a globalised world, within reasonable walls of protection. And all this, without reducing any of the rights and privileges the organized working class has won over the years.

Doubts are however being expressed, in many quarters, both in regard to the Latin American adventure and its Sri Lankan variety. It is being asked whether these so called leftwing policies could provide a viable alternative to the Washington Consensus. Post-war history is replete with examples of developing country failure to harness the market and promote development insulated from the international economy. The political backlash, both in the aftermath of Allende's Chile and Sukarno's Indonesia is a grim reminder that fascist forces come into power usually with the support of disillusioned masses.

My view is that nationalism is an essential ingredient in mobilising people for socio-economic development. No country in the world – whether developed or developing – from post-war Europe to Singapore, Malaysia and Korea – have succeeded without this essential mobilising force. However, nationalism alone is not enough. Success has come because there has been effective governance. I have avoided the term 'good governance' for the connotation is ethically biased. It is not that ethics and moral behaviour are not important, but there are examples of countries developing rapidly in spite of corruption. Perhaps the achievements would have been greater, with better distribution of benefits, had there been no corruption.

What I see in effective governance is a technical relationship with development, apart from its ethical and moral aspects. But, before I go into that subject, I think, I should also explain what I mean by development, for it means many things to many people. The UNDP has come closest to a definition with the identification of the components of the Human Development index. There is widespread acceptance today, even among economists, that per capita income is not a comprehensive index of development. Therefore, measurements of health and education status have been incorporated into the index. The UNDP, however accepts that the concept of human development is wider than its index for there are non-measurable aspects such as

gender, youth and child development, as well as environmental protection and political freedom and security which are essential features of the state of development.

Since per capita income is not an adequate measure of development, economic growth is only one aspect of the process. It is however, pivotal. There is a symbiotic relationship between economic growth and all the other aspects of development. For instance, while health and education development contributes to economic growth, they in turn benefit from economic growth with greater resource availability for further development. This is perhaps the reason why Mahinda Chinthanaya lays emphasis on a sustained growth rate of 8 per cent per annum. Over a ten year period, this rate would enable, given a population growth of 1 per cent per annum to double Sri Lanka's per capita income. In the process, Sri Lanka would be able to reduce its unemployment level to a more manageable 3-4 per cent of the labour force – the level that is consonant with structural change in production and labour mobility.

The arithmetic, however is daunting. That is why scepticism is being expressed in various quarters about the possibility of achieving an 8 per cent sustainable growth target. During the last ten years, to achieve an average growth of approximately 5 per cent, the country invested 25 per cent of its GDP. With the same ICOR - incremental capital output ratio of 5, it would require a 40 per cent investment to get 8% growth. There is no reason why an ICOR should remain the same. It is possible to lower it with achievements of higher productivity. However, in a country starved of infrastructure services and technical skills, productivity alone will not help increase the growth rate in the medium term. This is because of the long gestation period for investments in these areas to bear fruit. Even if the country manages to reduce the ICOR to 4, the investment requirement for 8 per cent growth would be in the range of 32 per cent. In the past, only about 18 per cent of gross investment came from domestic savings. The rest came from foreign aid (6 per cent) and 1 per cent foreign direct investment. Raising domestic savings in the short to medium term is possible only through restrictions on consumption, with the heaviest burden falling on the poor – the biggest consumers on the aggregate. Foreign aid is drying up and it would be quite an achievement for the country to receive continuously 6 per cent of GDP from this source.

The answer therefore lies in foreign direct investment, until such time as the growth process would be able to spur domestic savings and continue on a path of self-sustained growth.

My contention however, is that all this arithmetic is still within the realm of possibility. But, there is a caveat – indeed a very strong caveat – effective governance.

Effective governance starts with effective leadership. The bedrock of effective leadership is credibility. Without credibility, it is impossible to forge the partnerships that are required to take the country forward and achieve the targets set out by the Government. The Government, the private sector and civil society must work together based on trust in order to achieve common goals. A government which hides the truth, however unpalatable it is politically, loses credibility when found out. The other side of the coin is predictability. If the government keeps on changing its mind, with policies changing all the time, investors would have little confidence in risking their capital.

This does not mean however, that Mahinda Chinthanaya should remain a rigid cast iron document. After all, it is the result of a consensus building exercise negotiated with the government's coalition partners before the Presidential election. Some of these partners do not seem to be interested in taking the responsibility for its implementation. That is why they have not joined the government. What is not changeable are the basic objectives and the main strategy and thrust of the Mahinda Chinthanaya. But, there is no reason why the instruments of implementation should not be changed in line with changing circumstances. This is where leadership matters – the ability to take the decision to change if necessary and carry the people along with it. As long as credibility is maintained, it will not be difficult to convince the people about the need for such changes. Telling the people the truth about the feasibility of the original proposals will in fact help enhance credibility. After all, the Mahinda Chinthanaya is not a dogma and that way it should be different from the Washington Consensus.

Even though effective governance is not a mere ethical concept, it has to deal with the problem of corruption. In technical terms, corruption increases transaction costs and diverts resources to high cost and less efficient production and services.

Further, it could be contagious. It could spread to all levels and forms of public life, threatening to tear apart the very fabric of governance, legitimacy and credibility of government. Transparency and accountability are therefore indispensable elements of effective governance. However, the historical evidence is that governments while being prepared to deal with small time corruption of officials are prone to ignore misdemeanours of political supporters. This is because of the weakness in our election laws that do not contain sufficient provision to curb campaign expenditure. Campaign financiers invariably expect a return on their investment, through political patronage from Ministers, whom they help to win.

I mentioned earlier the crucial need to attract foreign direct investment in order to meet the savings – investment gap. In the best instance, with a lower capital requirement of 32 per cent of GDP, we could manage to reach that target if we receive 6 per cent of GDP from FDI – that is six times more than what Sri Lanka gets at the moment. Of course, there is no doubt that not all FDI could be beneficial to the country. It is possible to end up with “fly by night” investment - investors packing up their bags after they have remitted back many times more than what they have brought in. They could also throttle local investors, bring no technology, nor skills development. Basing these deficiencies, FDI will have to play a crucial role in enhancing Sri Lanka’s capacity to reach the required gross investment targets. It is therefore up to the Government to ensure that mechanisms are in place to attract the right kind of investment.

If it is long-term commitment that we seek from FDI with the right kind of contribution to the economy, in the form of sustained markets, technology, skills and management development, with linkages to domestic industry and the countryside, a necessary condition is political stability and peace. But peace in this county, as much as anywhere else in the world, depends largely on the confidence of the people who feel alienated and seek non-political solutions. Negotiations with the LTTE are important to avert war or perhaps postpone it. Ultimate peace however will depend on the perceptions of the Tamil people who feel completely alienated and insecure. As long as they refuse to recognize this fact, all Governments of Sri Lanka dominated by a Sinhala majority will continue to grope in the dark. There is no way in which a solution could be imposed on the Tamil people on the basis of a notion of what is best for them. It is they who will banish terrorism, invite democracy and cultivate human rights. Whether it is federalism or otherwise, it is the Tamil people who will decide

what is best for them. Terrorists will have no place when the Tamil community becomes confident that the majority government will not allow them to be treated as second class citizens. Today they are at the mercy of terrorists, not only because terrorists command the guns, but also because of their lack of confidence in Sinhala regimes. The Government has taken a very good step in this direction with the recent Cabinet decision to provide Tamil language training to Sinhala public servants. According to the new policy, all new recruits to the public service will have to pass a competency test in Tamil. Others, that is those who are already in service will be provided incentives and facilities for this purpose. Similarly, Tamil public servants will be required to learn Sinhala. It is also reported that the Government will introduce programmes for cross cultural appreciation, which is not too difficult, given the closeness of the two religions – Buddhism and Hinduism.

Before I close, let me also make myself clear on the Washington Consensus. Not all what is proposed by the World Bank and the IMF is wrong. When they say keep your budget deficits under control, one cannot take offence with them. When they say poor relief programmes must be better targeted, can we disagree? But when they ignore indiscriminate reduction of these programmes and allocation for education and health, simply to achieve budgetary targets, come what may, they reveal their primary objectives.

In the Washington Consensus, all roads must ultimately lead to more liberalized trade, smaller government and increased privatisation. These are the benchmark achievements against which visiting staff performance is evaluated at the Headquarters. It is not the personal views of the staff, which are often sympathetic towards the host countries that matter, but how much they achieve in respect of the benchmarks.

Developing country governments have no doubt burnt their fingers through excessive spending, indiscriminate trade barriers, import substitution patterns of development and loss-making public enterprises. But, these are issues that must be tackled within the context of social, political and economic realities of each country. There is a role for large budgets, in fact industry protection and public enterprises, according to circumstances. To deny this is to cling to a dogma.

It is not possible to elaborate on the guiding principles in regard to each of these matters. How they should be dealt with, in the interest of each country, could be determined by effective governance. In this regard, a highly motivated and professional public service would have to play the key role. The fundamental Bank Fund approach to the public service is to reduce its size. Not too long ago they encouraged the government of Sri Lanka to introduce a Voluntary Retirement Scheme, with which they themselves had burnt their fingers through adverse selection. Smaller, more efficient governments are fine when the private sector is ready for absorption. In the current context, what is required is to promote rational structures of government with a massive human resource development effort to make the Government function more affectively and efficiently. This is where the Bank and Fund should indeed use its leverage to seek conditionality.

Finally, to recap, the winds of nationalism blowing across Latin America and Sri Lanka's backyard are a reflection of a search for an alternative to the Washington Consensus, to achieve rapid progress. It is an attempt to mobilise all segments of the people without discrimination under one flag, to meet the challenges of globalization in resolving societal problems. There is, however, the danger that these attempts could fail and there could be backlash from ultra rightwing or indeed leftwing forces, ending in chaos and loss of human liberty.

The enemy to progress is not necessarily outside the borders of a country. It could be within. Poor governance is the biggest enemy.