SRI LANKA: Reforming Public Administration

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The Sri Lankan Government is firmly committed to the pursuit of "market friendly policies where the private sector becomes the principal engine of growth."[7] However, as indicated in the Asian Development Bank's Board Paper on Governance, governments have a vital supporting role to play in performing certain key functions, namely: (i) maintaining macroeconomic stability, (ii) developing infrastructure, (iii) providing public goods, (iv) preventing market failures, and (v) promoting equity.[8]

An essential element in discharging these functions — indeed possibly the most important public good governments can provide is an efficient, motivated, results-oriented, and in Sri Lanka's case, a vastly slimmed down public administration. This is the goal that the Government is presently pursuing with support from the ADB, the World Bank, and the international donor community.

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This paper focuses on three issues:

- the linkage between the Government's medium-term economic reform agenda and the reform of the public sector, especially public administration;
- the nature of the administrative reform envisaged; and
- the longer-term development challenge that this reform seeks to meet.

A. The Relationship between the Economic Reform Agenda and Public Sector Reform

Sri Lanka's economic reform agenda can be simply stated. It is the need to reduce, and eliminate as

7 Hon. Chandrika Bandaranaike Kumaratunga, *Policy Statement of the Government of Sri Lanka, Colombo,* 6 January 1995.

8 Asian Development Bank, *Governance: Sound Development Management*, 1995.

rapidly as possible, overall budget deficits which since 1993 have ranged between 9 and 10 percent of gross domestic product (GDP). These deficits were financed by substantial net domestic borrowing averaging 5-7 percent of GDP, principally from captive Employees Provident Fund sources. Since national savings have been about 19-20 percent of GDP, the Government has been preempting between one quarter and one third of these savings for its budget, and denying them to the private sector. This phenomenon, which economists term "crowding out" the private sector, has led to the high cost of finance identified by the World Bank on the basis of firm level surveys as the principal obstacle to the expansion of private investment in Sri Lanka. During the early 1990s, nominal prime interest rates reached 20 percent, and real prime rates have fluctuated since 1985 between 5 and 8 percent, a relatively high figure by international standards.

The more recent macroeconomic situation, it should be noted, is a distinct improvement over that of the preceding decade. Over the period 1978-1993, the overall budget deficit averaged as much as 14 percent of GDP, financed by a combination of money printing, concessional foreign borrowing for development projects, and net domestic borrowing. The latter averaged 7 percent of GDP, swallowing up half the national savings which averaged around 14 percent of GDP. Large budget deficits, in turn, meant substantial inflationary pressures on the economy. The budget deficits were the inevitable result of Sri Lanka's unique combination of high human development and high unemployment, averaging 12-16 percent of the labor force over three decades. In the absence of rapid private sector growth, these circumstances created enormous pressure on the State to become the employer of first resort, resulting in a swollen public service; and to embark on grandiose megaprojects, the costs of which have a habit of ballooning out of control. The inevitable failure to meet popular expectations in this way was punished by periodic bursts of youth unrest which, in turn, slowed down the growth process itself. While growth was 6 percent over the 1978-1982 period, the average for the period 1978-1993 fell to 4 percent as a result of the unrest during the late 1980s.

The principal short-term goal of the Government's economic reform agenda is the elimination, no later than 2000, of net domestic borrowing altogether, so that the crowding-out phenomenon is ended, and the budget is financed solely by a sustainable level of concessional finance. The five percentage points or so in relation to GDP that the Government will cease to preempt for the budget can then be added to private investment, enabling the private sector to truly become the engine of growth. This will raise total gross investment in the economy from last year's level of 25 percent of GDP to at least 30 percent. Gross investment needs to rise by at least another five percentage points to 35 percent of GDP — to realize GDP growth of at least 8 percent in the next decade. The additional steps needed are explored in the concluding section of this paper.

The linkage between public sector reform and the elimination of the overall budget deficit is straightforward.

The linkage between public sector reform and the elimination of both crowding out and the overall budget deficit is straightforward and easily stated. If net domestic borrowing is to be eliminated and the amount saved added to private investment, a corresponding reduction in the Government's budgetary expenditures will be required. Government capital expenditure, at around 7 percent of GDP compared with 15 percent in the mid-1980s, has already been cut to the bone, and Government revenues at around 20 percent of GDP are in line with countries of a similar per capita income and can be expanded only with rapid economic growth. The cuts needed to eliminate domestic borrowing must therefore fall on current expenditure.

Three categories of current expenditure commitments are fixed and immutable in the short term, and swallow up 70-80 percent of our revenue, equivalent in recent years to around 15 percent of GDP. These are, first, military expenditure; second, the interest cost of domestic debt incurred as the legacy of financing the large deficits of the past through borrowing; and third, transfers to households representing the irreducible minimum commitments on targeted poverty alleviation, welfare programs, and pensions. Each of these categories accounts for roughly 25 percent of revenue and 5 percent of GDP.

The balance of revenue available for meeting the remaining current expenditure has therefore been 20-30 percent of revenue, equivalent to 4-6 percent of GDP. This has consistently fallen short of the residual current expenditure needing to be financed, equivalent to 36-38 percent of revenue, and 7-8 percent of GDP. This shortfall represents the Government's current account fiscal deficit or dissavings, ranging between 1 and 3 percent of GDP, and has had to be financed by recourse to nonrevenue sources, i.e., net domestic borrowing. This also means that the capital budget too has been entirely dependent on foreign loans and grants and domestic borrowing for its financing.

In the short term, therefore, with revenue being inflexible upwards and capital expenditure inflexible downwards, the burden of fiscal adjustment must necessarily fall on the residual current expenditure, running in recent years, as mentioned, at 7-8 percent of GDP. Since it is nonbank net domestic borrowing which has in effect been financing much of this expenditure in recent years to the tune of 5-6 percent of GDP, (and 5 percent of GDP in 1996) the room for manoeuvering in an effort to end crowding out overnight is small. This initiative must therefore occur in a phased fashion. This means eliminating loss-making enterprises through corporatization and/or privatization, reducing other subsidies, and reducing the civilian public service wage bill in the aggregate, (it presently amounts to more than 5 percent of GDP). The pension burden, (more than 2 percent of GDP), while inflexible in the short term, is amenable to medium-term reform. The latter two areas, through appropriate public service and pension reforms, involve slimming down the public service and introducing contributory pensions. The privatization of public enterprises can provide additional fiscal space on an enduring basis only to the extent to which it is used to retire outstanding public debt, and reduce its domestic interest cost, rather than to finance the current budget.

This underlines the importance of public sector and pension reform in establishing a stable macroeconomic framework conducive to private sector growth in Sri Lanka's constrained fiscal situation. It also explains why there is no free lunch when it comes to reducing — and eventually eliminating — net domestic borrowing; and in due course the budget deficit, in order to enable the private sector to become a truly effective engine of growth. There is simply no alternative to slashing current budgetary expenditures.

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Sri Lanka's 1997 budget made a credible move in this direction by seeking progressively to reduce the overall budget deficit within a three-year framework to 7.3 percent of GDP in 1997, 5.2 percent in 1998, and 4.5 percent in 1999. Significant consequential reductions in net domestic borrowing were projected, falling in easy stages from 4.5 percent of GDP in 1997 to 2.5 percent in 1998 and 1.7 percent in 1999. Crucial to reaching these targets is a reduction in current expenditure by nearly 2.5 percentage points in relation to GDP, from nearly 20 percent in 1997 to 17.5 percent in 1999.

In the context of the tough fiscal decisions taken in 1996 to contain the overall deficit for the year at 9 percent of GDP by, for example, eliminating a subsidy on flour, the 1997 budget has been widely acclaimed as involving a renewed and irreversible Government commitment to economic reform. The key elements that have elicited this acclaim are threefold.

- The investment incentive package contained in the 1997 budget.
- The announcement of an intention to reduce both corporate tax rates and maximum personal income tax rates from 35 to 25 percent by 1999.
- The budget's targets for reducing both the overall deficit and net domestic borrowing.

The budget has unambiguously signaled that the Government is serious about implementing its announced intention to make the private sector the principal engine of economic growth by ending crowding out once and for all.

One indication of the positive impact of the budget is that the usually conservative Economist Intelligence Unit, in its country forecast for Sri Lanka for the first quarter of 1997,[9] has revised its estimate of economic growth for the 1997-2001 period upwards by nearly one percentage point, i.e., to 5.5 percent per year compared with its previous estimate of 4.6 percent. The survey concludes that "by 2001 the stage will be set for a period of sustained growth and annual GDP growth rates of 7-7.5 percent will be well within reach. Growth will still be led by exports but the export base will have shifted into non traditional high value added

[9] The Economist Intelligence Unit, *Sri Lanka Country Forecast, 1st Quarter 1997 Main Report*, London 1997.

industrial exports." This is clear international recognition that the growth momentum set by the 1997 budget is irreversible. We nevertheless need to do significantly better than 7-7.5 percent growth, as explained in the concluding section of this paper.

B. The Nature of Sri Lanka's Administrative Reform

As explained, public sector reform, including pension reform, has become crucial in Sri Lanka's constrained fiscal situation for releasing the resources needed to eliminate the dependence of the budget on net domestic borrowing for its financing, and the resulting crowding out of the private sector. It therefore constitutes the necessary conditions for expansion in private investment, enabling the private sector to become the true engine of economic growth. No less important is the nature of the public sector reform itself, with its overriding objective of creating an administrative framework for sound development management, such as the discharging of the several supporting functions identified in the ADB Board Paper on Governance.

The nature of the public administration reform being envisaged is outlined in the Summary Report on the topic presented to Her Excellency Chandrika Bandaranaike Kumaratunga, President of Sri Lanka, by an ADB Team (which included consultants from New Zealand and Malaysia) toward the end of last year. The summary has been adopted by Sri Lanka's Cabinet, and steps to implement it are now under way. The ADB report represents, in my view, the first cautious step toward adapting *New Zealand's Remarkable Reforms*, the title of last year's Fifth Hayek Memorial Lecture by New Zealand's Central Bank Governor, *The goal which the Government intends to pursue is that of creating a results-oriented public service aimed at ensuring that public sector organizations behave like those in the private sector.*

Dr. Donald T. Brash.[10] He cites a description of New Zealand "as a country reformed by Hayekians, run by pragmatists, and populated by socialists." As one of the principal architects of the reforms, he confesses to having been totally innocent of Hayekian influences "having like many of [his] peers been brought up on an undiluted diet of Keynesian economics and an almost undiluted diet of Fabian socialist politics." This description of New Zealand, together with Dr. Brash's qualification, is applicable to much of South Asia, and certainly to Sri Lanka and to my generation of economic reformers.

Its reforms have caused New Zealand to be ranked first for its quality of Government in 1993 by the World Competitiveness Report of the Geneva-based World Economic Forum. Since that time, Singapore has looked to New Zealand as a model for its public sector reforms. In mid-April, Singapore announced the implementation of its adaptation of the New Zealand model. Sri Lanka is therefore in very good company indeed, in seeking as its eventual goal to travel along the same road with the support of the ADB. To summarize it in a phrase, the goal which the Government intends to pursue is that of creating a results-oriented public service aimed at ensuring that public sector organizations behave like those in the private sector, and the ADB report represents the first step in this direction.

The administrative reform currently under way has six key components:

- Adaptation of strategic policy formulation and policy coordination to more effectively achieve policy outcomes.
- Adoption of a result-oriented philosophy as the guiding management principle.

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[10] Donald T Brash, *New Zealand's Remarkable Reforms, Fifth IEA Annual Hayek Memorial Lecture, given in London on Tuesday, 4 June 1996,* published by The Institute of Economic Affairs, 1996.

- Separation of policymaking, service delivery, and regulatory functions of government.
- Realignment of responsibilities to more effectively support the goals of government.
- Training staff to more effectively respond to the new environment and thereby realize their potential.
- Redeployment of surplus staff, if any, to new functions within Government or to new opportunities in the private sector.

There are two main instruments of reform. These are an Administrative Reforms Management Division (ARMD) within the Presidential Secretariat, charged with designing the detail of the reform program and overseeing effective implementation of all its elements; and a Management Council, chaired by the President of Sri Lanka, which provides the critical component in a mechanism to ensure development and implementation of strategic policy.

Of the two instruments of reform, ARMD is a totally new entity charged with, as mentioned, the oversight of the reform process. Its supervision is vested in an Advisory Board on Administrative Reform, which, in addition to an existing *ex officio* Committee of Secretaries of Government, includes three nonofficial members to provide intellectual and professional diversity. One of them is drawn from Sri Lanka's private sector, the second has professional experience in the process of reform, and the third has respected professional credentials.

The second instrument of reform, the Management Council, represents a rationalization of processes already in train to help with strategic policy formulation. The institutional mechanisms already in place prior to the ADB mission included the National Development Council (NDC) and the Department of National Planning within the Ministry of Finance. Operational authority on fiscal policy was vested in the Ministry of Finance, while authority on monetary policy was vested in the Central Bank. The principal objective of NDC was to initiate a dialog with the private sector on policy formulation of the kind pioneered and developed in East Asia, but by and large conspicuously absent (except perhaps in a ritualistic sense) in much of South Asia. NDC currently comprises 14 members under the chairmanship of the President. It includes 4 Cabinet Ministers, 3 persons representative of the two key private sector chambers of commerce and industry, the Governor of the Central Bank, and the Secretary of Finance (as *ex officio* members), two academic representatives, a Deputy Chairperson, and an Executive Secretary who is concurrently Director General of the National Planning Department on whose staff the NDC is expected to draw. The NDC itself has a small nucleus of professional staff directly reporting to the Deputy Chairman, currently comprising three persons.

This structure has so far engaged in several *ad hoc* policy exercises through the medium of Inter-Ministerial Task Forces/Working Groups, all with private sector representation. A Presidential Task Force on Employment Policies and Strategies has reported to the President on a revised labor relations regime which is being considered by a Cabinet Sub-Committee. A Working Group on Agricultural Policy has reported to the President, and its recommendations are in process of implementation. NDC Working Groups on Health Policy and on Information Technology have been the workhorses of Presidential Task Forces on these subjects. A Working Group on Fiscal Policy involving the private sector, the Ministry of Finance, and the Department of Inland Revenue was instrumental in providing an input into the 1997 budget, which culminated in the introduction of a Malaysian style investment tax allowance.

The crucial contribution of the ADB team in coming up with the Management Council concept was to rationalize and make more coherent what was previously an ad hoc policy formulation mechanism. The ADB team identified the need to group the functions of Government Ministries into three sector areas dealing with the economic sector, the infrastructure sector, and the social sector. It is suggested that a fourth sector area dealing with cross-sectoral issues be added. Ministers could be assigned to chair sector committees covering each of these four areas. The Management Council, accordingly, is made up of the Ministers chairing these sector committees, plus the Ministerial members of the NDC. The officials who attend the meetings of the Management Council comprise the official membership of the NDC along with others. They would include the Deputy Chairperson of the National Development Council, the Head of the Management Council Secretariat, the Governor of the Central Bank, the Secretary of Finance, the Secretary to the President, the Secretary of Plan Implementation, the Secretary of Public Administration, the Director General of National Planning, and other relevant officials.

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The Council's responsibilities include:

- preparing strategic policies for presentation to the Cabinet,
- reaching agreement on key sector imperatives,
- ensuring that sector committees pursue imperatives and subsequently review progress,
- proposing outputs to be included in the budget to the Cabinet, and
- consulting regularly with the private sector through the NDC.

An urgent task for the Management is to prepare a concise strategic policy position for discussion and adoption by Cabinet, which in turn must delineate the rest of the policy process and the administrative reforms. This process builds on and clarifies existing statements.

Specific decisions and priorities recommended by the Council to Cabinet determine the allocation of operational and capital resources in the budget.

Ministers attend on Council where their portfolio issues were under consideration.

The Management Council is thus conceived of as the Governmental subset, as it were, of the NDC, reinforced by additional Ministerial and official representation. The ADB team has recommended that the Management Council, in order to benefit from private sector viewpoints, should combine with the NDC on at least a bimonthly basis. In the interests of avoiding "multilateral monologue" it would be wise for the membership of these joint meetings not to exceed 20 persons.

Since the ADB recommendation is essentially a rationalization of existing arrangements, a dedicated Secretariat to service the Management Council is essential. Thought is currently being given as to how best this Secretariat can be put together, drawing on staff involved in sector policy development, both within the Department of National Planning and elsewhere, and in the NDC.

Two additional elements of the reform process need to be mentioned to round out the picture. These are, first, the vesting of public service appointments under the authority of an independent and revitalized Public Service Commission. This harks back to a long-standing tradition Sri Lanka inherited when it attained independence, but which has since been allowed to lapse. The second element is the identification of redundant departments and institutions as candidates for euthanasia as a vital part of the process of slimming down the public service in the interests both of efficiency and of prudent fiscal management.

C. Sri Lanka's Longer-term Development Challenge, 1997–2011

To recapitulate, administrative reform focused on slimming down the public sector is a necessary condition for creating the fiscal space needed for eliminating net domestic borrowing and ending the crowding out of the private sector. Given Sri Lanka's constrained fiscal situation, the adjustment needs to occur in a phased fashion, but no later than 2000, in view of the enormous development challenge the country faces. Public sector reform is also necessary to enable the Government to provide the supporting functions needed for sound development administration, and its nature has been briefly summarized. Both these exercises — the medium-term economic reform agenda and gearing the public service for development — complement each other in enabling Sri Lanka to meet the development challenge that lies ahead in the first decade of the 21st century. This challenge has two principal components.

Slimming down the public sector is a necessary condition for creating the fiscal space needed for eliminating net domestic borrowing and ending the crowding out of the private sector.

First, the large budget deficits of the 1980s could only have been accommodated by heavy cutbacks in expenditures on the social sector — education, health, and basic nutrition — and on infrastructure that was not foreign financed. Social sector expenditures fell by nearly one half, in relation both to GDP and the budget, to 6 percent of GDP and to 17 percent of budgetary expenditure, compared with the 1960s and 1970s. Expenditures during the 1960s and 1970s had averaged annually around 9-10 percent of GDP, and accounted for between 30 and 35 percent of budgetary expenditure. In particular, a food subsidy and related services accounted for as much as 4 percent of GDP and 14 percent of budgetary expenditure. Expenditure on core infrastructure — energy, water (excluding irrigation), transport and communications — much of it foreign financed, averaged barely over 4 percent of GDP during the 1980s, falling to 3.4 percent in the 1990s in contrast to several East Asian countries — Indonesia, Malaysia, the Philippines, and Thailand — whose infrastructure expenditures were in the range of 6-8 percent of GDP. The World Bank's firm level surveys in fact rank inadequate infrastructure in the areas of telecommunications, road capacity, and electric power, as third in the hierarchy of obstacles to expanded private sector investment in Sri Lanka (after the high cost of finance and the tax level).

Second, Sri Lanka's high level of human resource development has enabled it to make the demographic transition relatively rapidly. The combination of high female literacy and low infant mortality means that there is no need for parents to produce children as insurance for their old age. The resulting fall in fertility means that Sri Lanka's population will stabilize at 23 million by 2025 as against today's 18 million. This has four implications.

- Our labor force growth will dwindle rapidly after 2010 and stabilize by 2016 at 14 million. We will by then be short of labor like Malaysia and Singapore are today.

- Sri Lanka's population will be growing older faster than any other country in recorded history. It took France 130 years for the population over the age of 65 to double from 7 to 14 percent, the US 70 years, and Japan 25 years. In Sri Lanka's case this will happen in the next 20 years — between now and 2016.

- Most countries have achieved this transition in the past at per capita incomes in excess of US$20,000, by and large adequate for those at work to support those in retirement. If Sri Lanka were to grow at 7 percent per capita, so that overall GDP grows at 8 percent (allowing for 1 percent population growth), income per capita would double every 10 years. Since our starting point is US$700 per capita in 1996, this means that we will still be somewhat short of Malaysia's 1993 per capita income of US$3000 by 2016. Even if per capita income grows at 10 percent so that it doubles every seven years, with overall GDP growing at 11 percent, it will still fall short of Malaysia's 1993 per capita income by 2011. It will not at this rate exceed US$20,000 until the year 2030. Double digit growth rates have never been sustained (except for relatively short periods and only in a few countries, notably China in the last decade, and Japan and Singapore between 1966 and 1973).

- By 2025, 20 percent of Sri Lanka's population will be over 60 years old, and one third of the population will be pensioners, assuming the current pension age limits hold.

The challenge Sri Lanka faces in the future is nothing less than compressing the kind of development achieved by East Asia over a 30-35 year period into a 15-20 years. It should be borne in mind that in 1960 Sri Lanka's per capita income was US$150 — the same as Korea's and Taipei,China's — admittedly less than Singapore's and Malaysia's, but significantly higher than Indonesia's or Thailand's. By now of course all these countries have forged ahead. Sri Lanka has only grown 4 percent in terms of GDP between 1960 and 1995, while East Asia has averaged

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about 8 percent. This means that Sri Lanka must aim for the maximum feasible rate of overall GDP growth in the range of 8-11 percent by 2011 when our labor force growth drops off sharply, and certainly by 2016 when it ceases to grow at all. Such a high growth strategy has several implications for development policy, even if crowding out has been eliminated in the medium term, (i.e., by 2000), and if the public sector reform is fully completed by then.

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Rapid growth requires the elimination of the twin constraints of inadequate skills and inadequate infrastructure which East Asia has so successfully dealt with. The expanded investment in education and skill development, and in ensuring literacy in English, that Sri Lanka needs to equip itself for the information technology age can only be undertaken by the public sector. There will be a similar need to expand the health budget of the country to cope with the needs of an aging population, in addition to various kinds of insurance arrangements. Both will require a reallocation of resources in the Government budget in favor of the social sectors, especially in the context of the cutbacks of the 1980s. Both health and education expenditures, are public goods *par excellence*, typically involving areas of market failure which could be adequately addressed only by public provisioning, and requiring a public service geared to sound development administration. This leaves little choice consistent with reducing and eliminating the overall budget deficit, ending crowding out, thus unshackling the private sector, other than to entrust the infrastructure investment effort, wherever possible, to the private sector. In order to facilitate this process, and to provide 20-year loan financing for private sector projects, a Private Sector Infrastructure Development Company with support from the World Bank and the Kreditanstalt für Wiederaufbau was formally launched in early April.

Rapid GDP growth of at least 8 percent overall in the next decade calls for increasing, by at least 10 percentage points, today's investment rate of 25 percent of GDP to the 35 percent average characteristic of East Asia in 1990. Half this amount, or 5 percentage points, can be realized by eliminating domestic borrowing altogether (also about 5 percent of GDP), and ending crowding out as soon as possible, but no later than 2000. The amounts saved will then be added to private investment. This leaves another 5 percentage points in relation to GDP to be added to investment. At least 2 percentage points of this could be realized much sooner by savings resulting from the negotiated cessation of hostilities in Sri Lanka in relation to the 5 percent of GDP currently spent on the defence budget. The bipartisan agreement between the Leaders of the Government and the Opposition announced in April on the *modus operandi* governing such a negotiation constitutes an important breakthrough and provides ground for optimism. Coming on top of the 1997 budget, the news sparked off a bull run on Sri Lanka's stock exchange.

This leaves an additional foreign investment effort of about 3 percent of GDP needed to raise investment rates to the critical threshold of the 35 percent required for an East Asian style economic take-off. Last year's net foreign direct investment in Sri Lanka was nearly 0.5 percent of GDP, peaking at around 2 percent in 1993. The largest recipient of foreign investment in relation to GDP among developing countries in 1993 was Malaysia at 7 percent. Against that background, Sri Lanka should have little difficulty (assuming a climate of internal peace and harmony) in attracting the additional required foreign investment equivalent to 3 percent of GDP. It goes without saying that a substantial proportion of that foreign investment will have to be in infrastructure development if this key constraint to rapid economic growth is to be overcome in Sri Lanka.

Sri Lanka has quite distinct advantages as a venue for foreign investment.

First, it was foreign investment which transformed our economy from one dependent on primary product exports (principally tea, rubber, and coconut) to the tune of 85 percent of total exports in the 1970s, to the structure we have today where manufactures account for no less than 73 percent of total exports, and garments and textiles for 50 percent. Foreign firms accounted for a large part of this diversification effort — 74 percent of Sri Lanka's manufactured exports in 1992. Sri Lanka is now the largest exporter of manufactures per capita among the low-income countries.

Second, the primary motive for foreign investors to locate in Sri Lanka is the quality and productivity of our labor force. As far back as 1980, a study by the European Commission found that Sri Lankan labor, then costing a dollar a day in our free trade zone, was as productive as German labor after six months training. Surveys conducted by Japan's External Trade Organisation a decade or so later, in 1993, and by the Embassy of Japan in 1995, concluded that almost 85 percent of Japanese investors were satisfied with their investments in Sri Lanka. Around two thirds of the companies surveyed indicated the availability of high quality labor at a very competitive cost, and of liberal fiscal incentives, as the primary reasons for investing in Sri Lanka. With a monthly wage for a worker averaging still around US$1 per day at the current exchange rate, many Japanese and other investors have expressed the view that Sri Lanka labor demonstrates levels of manual dexterity and hand-eye coordination as the best available anywhere at this wage level. These attributes are ideally suited for precision production techniques required for industries such as electronics. For example, a leading Japanese investor in Sri

Lanka, the FDK Corporation, which manufactures magnetic heads for floppy disks, claims that its plants in Sri Lanka have achieved levels of output per worker productivity equal to the Company's factories in Japan and Taipei,China.

Third, Sri Lanka is geographically an ideal position to serve as a hub for accessing the South Asian market in much the same way as Hong Kong serves the People's Republic of China and Singapore serves East Asia. What has come to be known as the Gujral Doctrine, articulated by India's former Foreign Minister and current Prime Minister, whereby neighboring countries are granted access to the Indian market on a nonreciprocal basis, carries with it considerable promise for foreign investors today in Sri Lanka.

Meeting Sri Lanka's development challenge in the first decade of the 21st century requires the coordination of policies on a broad front. It demands political and administrative leadership of the highest caliber, for the task is nothing less than the compression of East Asia's development achievements into about half the time it took East Asia to realize them. A public service geared to rapid development, and a policy formulation mechanism that can harness its talents to the best advantage, are the essential prerequisites. The reforms initiated by the ADB team are vital first steps towards reaching these goals.