Greece Bonds – the reality

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In terms of Section 66 (1) of the Monetary Law Act, the Monetary Board is responsible for the management of the international reserves. In keeping with such authority and responsibility, the Monetary Board has approved Foreign Exchange Reserve Management Guidelines to empower and guide the officials of the Central Bank of Sri Lanka (CBSL) to manage the international reserves.

The decision making structure and process is described in the Guidelines which set out, inter alia, that the Governor has been delegated the authority by the Monetary Board to define and set the overall parameters for reserve management operations and the control of risks including the preferred trade-off between different risks faced and the Bank's tolerance for loss in any given year. The Guidelines also require the performance of the portfolio to be reported to the Monetary Board on a quarterly basis or as and when deemed necessary. Further, the Guidelines provide for a Foreign Reserve Management Committee (FRMC) which is responsible for making policy recommendations to the Deputy Governor and the Governor on matters concerning the management of the foreign reserves and making decisions pertaining to operational aspects of foreign reserve management.

As a policy, the CBSL manages the foreign reserves in order to safeguard and enhance the value of its overall reserves as well as generate a reasonable income from its investments. Such management of the investments of the Reserves are carried out on a "pool" basis, which is the manner in which reserves are managed all over the world.

The track record of the investment activities of the Central Bank over the past 15 years is set out in the Table below. From such Table, it would be observed that the returns generated by the reserve management activities in the 2 years (2010 and 2011), had been well above the benchmark average US Fed Fund rate, and had yielded substantial profits of US$ 341 million in 2010 and US$ 430 million in 2011. The profit in 2011 has been arrived at, after making provision for all losses, which clearly shows that reserve management in 2011 had been highly successful in enhancing the value of the total portfolio, whilst also providing for the losses that had occurred in the highly challenging and volatile global environment.

In April 2011, when the CBSL purchased Greece Government Bonds, Greece's Credit Rating by Fitch Rating Agency was BB+, which is 3 rating notches higher than Sri Lanka's present credit rating of B+ (Negative). Thereafter, on 20th May 2011, Fitch downgraded Greece to B+ (Negative), which is the same rating as that of Sri Lanka at present. About 7 weeks later, on 13th July 2011, Fitch downgraded Greece further to CCC when Greece was on the verge of default.

Therefore, if it is now contended (in hindsight, of course) that Greece Government Bonds were not a viable option to invest in, in April 2011, it logically follows that Sri Lankan Government Bonds, at the present time, will be a worse investment option, as per the International Rating Agencies' ratings. If a contention is made by a person in authority to that effect, it will be noted that such assertion could also place the Sri Lankan Government's current outstanding debt (Government debt as at 30/06/16 was Rs. 9,062.2 billion as per Central Bank data) in a highly vulnerable position, as well.

Profits on Management of Foreign Reserves (2001 to 2015)

Year	Total Reserve Income US$ Mn.	% Rate of Return	Average Fed Fund Rate %	% over Average US Fed Fund
2001	52.7	5.7	3.7	2.0
2002	67.5	5.5	1.7	3.8
2003	54.5	3.1	1.1	2.0
2004	75.6	4.2	1.2	3.0
2005	71.1	3.7	3.2	0.5
2006	100.7	4.3	5.0	(0.7)
2007	125.0	4.8	5.0	(0.2)
2008	145.2	5.1	2.0	3.1
2009	100.9	3.9	0.2	3.7
2010	341.2	6.2	0.7	5.5
2011	430.2	6.6	0.4	6.2
2012	222.7	4.0	0.3	3.7
2013	197.0	3.3	0.3	3.0
2014	173.3	2.3	0.3	2.0
2015	111.0	1.8	0.3	1.5

Source: CBSL

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After the matter regarding the investment in Greece Bonds by the CBSL was raised at the Committee on Public Enterprise (COPE), the circumstances surrounding the investment were examined in depth by the Auditor General (AG). Thereafter, the AG confirmed that no irregularity had occurred and gave a report on 11th October 2012 to the Chairman of COPE, while also acknowledging that the CBSL had made a substantial profit in that year. After such report, COPE acknowledged that, although a loss had occurred, no wrong or illegal activity had taken place. It was also noted that the required procedures were followed by the CBSL and that proper disclosures and reporting requirements were adhered to. Accordingly, the final COPE report on the subject did not refer to the investment in the Greece Bonds, and no further follow up action was recommended by COPE.

In the meantime, in 2012, a Fundamental Rights Case No: 457/2012 in relation to the Greece Bonds investment was also filed against the Monetary Board by Sujeewa Senasinghe, MP. It was argued by Upul Jayasuriya, PC. The Attorney General appeared for the Monetary Board. After hearing the FR case for nearly 2 years, "leave to proceed" was refused by a 3- Judge Bench of the Supreme Court comprising Justice K. Sripavan, (now Chief Justice), Justice R. Marasinghe and Justice S. De Abrew with the order that, "Considering the totality of the circumstances, it is neither possible nor desirable to hold that the Members of the Monetary Board in taking a decision to invest in Greece Bonds, have acted arbitrarily, unreasonably and in a fraudulent manner." (See the Supreme Court Judgement dated 18.09.2014 in the website of the Supreme Court).

In this connection, a few significant extracts from the Supreme Court Judgement may be relevant:

"The Auditor General in his letter dated 11th October 2012 addressed to Hon. D.E.W Gunasekara, Chairman on Public Enterprises (with a copy to the Governor, Central Bank) has stated though the Central Bank had incurred a loss from the investment in Greece Government Bonds, it has earned a total net profit of US$ 430.2 million on International Reserve Management during the year 2011...."

"The investment in Greece Bonds and its trade forms part of the risk management strategy. If all investments are maintained as risk free investments the return would be negligible. The Central Bank therefore has to select a mix of low risk and risk bearing investments expecting a reasonably high return."

"The decision to invest in such Bonds was based on the trade-off between different risks faced and the Central Bank's tolerance for higher risk on a very small part of its portfolio (only 0.6% of its portfolio was invested in Greece Bonds). Investing in high yielding sovereign paper is an integral part of fund management of many funds in the world and the Central Bank too had followed a similar practice in investing a tolerable proportion of its resources (0.6%) in Greece Government Bonds. When the Euro Zone took a turn for the worse several weeks after the investments were made, in mid July 2011, the Central Bank sold a part of Greece Bonds at a loss of US$ 6.6 Million. This measure was taken to mitigate the risk of the Greece investment losing further value due to subsequent development in the Euro Zone. Such loss has been taken into consideration in computing the profit/gains for the year 2011 amounting to US$ 430.2 Million."

Internationally, the (hypothetical) benchmark safest investment is considered to be in US Government Treasuries. On that basis, a totally risk averse Investment Fund could decide to place its entire funds in US Treasuries only, and thereby (theoretically) suffer no loss. If the CBSL too had followed that total risk-averse path, (as also referred to in the Supreme Court judgement), and invested the entirety of its average reserves of around US$ 6,500 million in 2 year US Government bonds in the year 2011, the total return that the reserves could have earned would have been a mere US$ 16.2 million only. As against such a return, the CBSL has been able to generate an income of US$ 430.2 million through its investment strategies, which then works out to an additional US$ 414 million or 26 times the return that would have been the yield on hypothetically "no risk" instruments only.

It must also be mentioned that, as per CBSL financial statements, CBSL made its highest-ever average return of 6.6% on its reserve, and its highest-ever reserve management profit of US$ 430.2 million, in 2011. (See Table). In comparison, in the year 2015, after managing a foreign reserve of a value similar to that of 2011, the CBSL made a profit of US$ 111 million only. In that context, if the CBSL administration in 2011 is blamed by some persons for the particular "losses" in the investment in Greece Bonds even while making an overall profit of US$ 430.2 million in 2011, such persons will have to blame the CBSL administration in 2015 a lot more for being able to generate a profit of only US$ 111 million in 2015.

Time to move to Aerotropolis projects

Prime Minister Ranil Wickremesinghe's vision to make Sri Lanka an economic hub in South Asia in 2030 is a long way, away!

Our country is blessed with natural resources located in the East to West shipping route. The government should reform the current economic set up - to an "Open Door" market oriented policy. Opening its economy will improve its citizen's standard of living.

The country should open special economic zones in the ports of Hambantota, Colombo, Trincomalee and Jaffna. Free Zones have emerged on the scene as a planning tool to help boost economic development. Free Zones ideally located next to a sea port or airport generally falls into one of four categories: Free trade Zones (FTZ), Export processing zones (EPZ) special economic zones (SEZ), or industrial zones. But lately there has been a trend away from traditional free zones towards the more channeled variety of special economic zones and industrial zones, in part to boost value added and revenue, but also to promote economic diversification and generate more employment. Free Zones have many merits and have boosted investments in many countries.

Take the Free Zone at Jebel Ali for an example, a deep port in Dubai established in 1985 and widely considered to be among the most successful. It started as a transshipment port. Jebel Ali triggered a wave of new free zone type initiatives and the UAE now accounts for over a third of all Middle East and North Africa (MENA) free zones. This has led the UAE governments, especially Dubai, to establish industrial zones to target particular sectors. Today there are 24 such zones.

As of now, there are more than 7000 companies having business registration within the Jebel Ali Free Zone. Jebel Ali FZA is now evolving as a dynamic business base for companies from over 100 countries and attracting more than 30% of the UAE's foreign direct investment. Another interesting fact showing the contribution of JAFZA to Dubai's total economy is that Jebel Ali Free Zone is witnessing for more than 50% of all exports happening in the entire Dubai emirate with a trade value of USD 100 billion. Today Jebel Ali free zone contributes more than 35% to Dubai's economy.

PROFILE SRI LANKA TO BE THE INVESTOR'S TOP CHOICE

We need to profile Sri Lanka to be the investor's top choice to succeed as a preferred investment destination through excellence, commitment and creative solutions, which will strengthen the economic growth of the country. The government should consider a change in the economic and tax policy structure. The ongoing policies may not suit the modern business model or current economic climate of the country. Sri Lanka's economy must change to become more competitive. The country geographically located between the East and the West can serve as a large re-exporting center. We need to attract FDI's rather than bilateral agreements. Attracting FDI's into high tech manufacturing sectors will support the economy to increase export volumes with cost effective labor. We need to build excellent infrastructure at low logistical and operational costs. An international outlook with liberal government policies will attract investors in a big way, in activities ranging from trade, transport, tourism, industrial and finance. These will help the economy to achieve a higher degree of expansion and diversification. Investors should enjoy a competitive combination of cost, market and environmental advantages, which create an ideal and attractive investment climate for local and expatriate businesses alike. Sri Lanka has long been recognized as the region's trading hub and has emerged as its key re-export center.

Ranil Wickremesinghe

AVIATION

Aviation industries play a vital role in developing countries. Sri Lankan Airlines curtailing its current operations to become more of a regional carrier will have an impact in the near future on Sri Lanka and its tourism. A great branding proposition has to be supported by a host of other things to make it a great experience for those who come to Sri Lanka.

We should implement the modern Aerotropolis projects, which will create business hubs in cities - The way we'll live next. The aerotropolis concept is an urban plan in which the layout, infrastructure, and economy is centered on an airport. Airports are key nodes in the global economy, and serve as engines of local economic development under the aerotropolis model to attract aviation - oriented business, such as time sensitive marketing and distribution facilities, hotels, entertainment, retail, convention as well as air travel intensive executives and professionals.

Having built the MRIA airport, the government is still struggling to get airlines to operate into Hambantota. Poor marketing and planning of these projects have resulted in losses. Similarly the port, as these two ports have not been marketed to attract airlines or shipping lines.

Creating a whole eco system around the airports will help development of passenger traffic. It is very rare that an airport can survive/sustain only with a cargo hub. We need to build commercial businesses to support the airports that will trigger growth, through the multipliers effect.

Airport cities or the modern Aerotropolis concept are the best for MRIA in Hambantota and other developing airports within the country, which will help aviation planning and economic growth. Proper planning of airport cities and the Aerotropolis results in attracting sustainable development well as the highest return on investments.

In fact, out of 80 airport developments in China, 62 are going to be based on the Aerotropolis concept. The true challenger is planning to get the Aerotroplis right. If there is no appropriate planning, airport - area development will be spontaneous, haphazard, economically inefficient, and ultimately unsustainable. The Aerotropolis model brings together airport planning, urban and regional planning, and business-site planning, to create a new urban form that is highly competitive, attractive and sustainable.

The Aviation industry plays a vital role for economic growth in developing countries. Low cost airlines will help the tourism industry with affordable air travel, while the low cost carriers could use under-utilized airports.

The Aerotropolis is thus much more of a dynamic forward-looking model than a static, cross sectional model that often reflects a historic airport area development, before air commerce played such an important economic role. The Aerotropolis is the frontier of the next phase of globalization.

In short-Aerotropolis development and sustainable "smart growth" can and should go hand in hand.

SHENNAL ANGUNAWELA
Director - Commercial and Operations

Fiscal challenges...

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The effectiveness of these tax incentives is questionable in the context of low FDI inflows which are still less than $ 1 billion per annum. There is no mechanism to assess the benefits of the tax incentives or to estimate the foregone revenue losses. The low mobilization of corporate taxes reflects that the incentive receiving sectors do not contribute sufficiently to government coffers to offset the revenue losses.

EXPENDITURE CUTS UNLIKELY

The space for cutting down expenditure is extremely limited as most of such outlays are already committed or cannot be curtailed for social and economic implications. The government will have to spend almost the entirety of its revenue for interest payments and amortization payments on public debt in 2017. Hence, it is compelled to borrow to meet other recurrent and capital expenditure.

The major current expenditure items include salaries and subsidies, apart from interest payments which account for around one third of recurrent expenditure. The expansion of the public sector staff mostly for political reasons has become a severe burden on the budget costing the government one fifths of its current expenditure for paying salaries. The transfers made to loss-making public enterprises year after year too balloons expenditure without generating adequate returns.

FISCAL SUSTAINABILITY RISKSIMMINENT

The projected fiscal outlook for 2017 onwards reflects vulnerabilities in the areas of financing needs and debt sustainability. The envisaged fiscal consolidation to overcome the sustainability risks entirely depends on increased revenue mobilization as no expenditure cuts are earmarked. In the background of the lack of an effective program to raise income tax collection or to rationalize the widespread income tax incentives, the total burden of revenue increase falls on indirect taxes, mainly on VAT. This leads to make the tax system further regressive hurting the poor. The downward effect of the tax revisions on GDP growth is inevitable further restraining revenue mobilization.

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