

Indian Finance Minister Pranab Mukerjee said today that while a military victory has been achieved in the country, there is also a great victory to be achieved in the political arena when every stakeholder owns the process and gain something from it." A political settlement can only mean one thing – a victory of all the people of Sri Lanka irrespective of their religion, ethnicity, numbers or race, he said while delivering the Lakshman Kadirgamar memorial lecture at the BMICH on Saturday evening. The full text of the statement follows;

‘Kadirgamar Memorial Lecture, Colombo

14/11/2009; 1700Hrs

“Economics as a Driving Force of International Relations”

Your Excellency, Mr. Ratnasiri Wickramanayaka, Hon. Prime Minister
of the Democratic Socialist Republic of Sri Lanka,

Mrs. Suganthie Kadirgamar,

Excellencies,

Ladies and Gentlemen

I am grateful to the organizers for inviting me to pay homage to a great Leader of Sri Lanka Dr Lakshman Kadirgamar. I would like to thank Mrs. Suganthie Kadirgamar for inviting me to deliver the 4th L.K Memorial lecture. I shall speak on “Economics as driving force of International Relations”, which is topical.

Indeed, the vision which Lakshman Kadirgamar had, both for close fraternal relations between India and Sri Lanka and for the future of Sri Lanka itself continues to inspire our thinking. It was he who dreamt of a world in which India and Sri Lanka would work together to build on our shared geography, history and culture in a

relationship defined in his eloquent words by “irreversible excellence”. It was also Lakshman who believed that Sri Lanka should remain united, and that its people should live together in an atmosphere of confidence and trust.

As Lakshman Kadirgamar himself said in September 2004 and I take the liberty of quoting him at some length and I quote, “I believe that all our peoples can live together, they did live together. I think they must learn to live together after this trauma is over. I see no reason why the major races in this country, the Tamils and Sinhalese cannot again build a relationship of confidence and trust. That is my belief. That is what I wished for and in working for that; I will not be deterred ...” (Unquote). It is indeed a matter of irony that when such a dawn finally arrives in Sri Lanka this year, after nearly three decades of conflict and pain, Lakshman is no more in our midst. It is now for—the people of Sri Lanka – to prove him right and to realize his vision by building mutual trust and confidence between all people on this island and live together as brothers and sisters within the framework of a united Sri Lanka.

Ladies and Gentlemen

The effective elimination of terrorism and secessionism from Sri Lanka offers you such an opportunity; an opportunity to shape history; an opportunity to permanently change the complexion of the relationship between the majority community and the minorities; an opportunity to address the legitimate grievances of all communities;

and an opportunity to bring permanent peace and stability to this great nation. These are *sine qua non* for building the Sri Lanka of the future – a future in which all communities will live side by side and enjoy the same rights and privileges and get the same opportunities.

After freeing the Tamils from terrorist forces, it is natural that the first and primary focus of the Government of Sri Lanka has been to ensure the immediate welfare and safety of its citizens. Thousands of Tamils have come out of the conflict zone traumatized by the conflict and harbouring deep concern and fear of what the future holds for them. These citizens need reassurance. They yearn to return to their homes and resume their livelihood. Several thousand Internally Displaced Persons have indeed been resettled recently and we welcome this development. However, many more await their turn for resettlement in camps. We are confident that their speedy return is receiving the highest consideration of the Government.

India has not hesitated to come to Sri Lanka's assistance at this crucial juncture. This is only natural. We have announced an assistance of Rs.500 crores for the rehabilitation and resettlement in the North and are willing to do more. We are moving from purely relief efforts to a broader rehabilitation and reconstruction phase. Our assistance had so far covered humanitarian supplies such as food, medicines and other essential supplies. We set up an emergency field hospital that treated over 50,000 people in the past six months. Four Indian de-mining teams are presently working in Northern Sri Lanka and three more are on their way. We are sending additional

shelter material. We are also providing assistance to revive agriculture and livelihood in the North. Both sides are also discussing assistance in reconstruction of critical civil infrastructure in Sri Lanka, including railways. We are now discussing larger projects for the population in key cities who stand traumatized by the conflict. At the same time, we have not lost sight of the urgent requirements in the Eastern Province as well as of the Indian Origin Tamils in up-country areas. India is doing and will continue to do whatever it can to assist Sri Lanka in this critical phase of its history.

But the vision of Lakshman Kadirgamar went far beyond the immediate. He believed that durable peace should be based on a constitutional arrangement acceptable to all communities in Sri Lanka based on democracy, human rights and the rule of law. As he himself said and I quote “There are several minorities in the country and their geographical spread is such that we need to ensure a full measure of human rights and safeguards and their participation at all levels of government from periphery to the centre.” (Unquote). While a military victory has been achieved, there is also a great victory to be achieved in the political arena when every stakeholder owns the process and gains something from it. A political settlement can only mean one thing – a victory for all people of Sri Lanka irrespective of their religion, ethnicity, numbers or race. It is important for all communities of Sri Lanka to realize that a political settlement is not a zero-sum game. It need not and should not come at the cost of another.

Lakshman Kadirgamar's vision also drew upon the experience of the working of the Indian model. He believed that the Indian experiment with democracy was relevant in that India had chosen a democratic system which was designed to preserve the unity and integrity of the country without allowing for its disintegration. Democracy has indeed served India well since our independence. Democracy is the protective sheath that preserves and protects our extraordinary diversity. Through effective devolution of powers, equal status before the Constitution and equal access to opportunities, we have ensured that divisive tendencies are contained and addressed in an open and democratic fashion. Clear separation of powers, rule of law, social justice, secularism, free press and vigilant citizens and civil groups have ensured that threats to your sovereignty from within and without are tackled with an inner strength that can come only through the ballot.

Ladies and Gentlemen,

There are many things in common between the two nations in terms of its history, culture, and philosophy and customs .You elected the first woman Head of Government in the world in 1960. Mrs. Indira Gandhi became Prime Minister in 1966. It was also with Sri Lanka that India signed its first Free Trade Agreement in 1998. It is, therefore, clear that Sri Lanka and India have the leadership and the determination to strengthen the process of engagement and to shape decisively our shared destinies in South Asia and beyond.

Our ties are rooted in the past and nourished over centuries. As Mahatma Gandhi said “It is, at least it should be, impossible for India and Sri Lanka to quarrel. We are the nearest neighbours. We are inheritors of a common culture.” (Unquote). Prime Minister Rajiv Gandhi said with great foresight and I quote “It is not mere geographical proximity which binds us. Ours is a relationship of heart and mind, finding expression in history and philosophy, literature and art, and in our contemporary concerns and daily lives.” (unquote) While contemporary history may have had its ups and downs, over the last decade or more, our relations have reached a considerable degree of maturity and closeness shorn of mutual suspicion. We have realized that our commonalities bind us stronger than ever before.

As you know, economics and international relations have a two-way relationship. The economic strength of a country furthers international relations and *vice-versa*, creating a virtuous circle of growth and empowerment. The relationship has not changed though the crisis has brought in lessons that are likely to redefine the link in the interest of promoting global stability.

As students of economics would understand, economic theory is an evolutionary process and undergoes change with every major crisis. The classical theory gave way to Keynesian economics after the Great Depression of 1930s. Thereafter, there were post-Keynesian and monetarist approaches to economic problems during 1960s to 90s. The present crisis, which has also been called Great Recession, would be another watershed in the evolution of

economics and is expected to bring about radical retooling of the theory.

The crisis has, in the first place, conclusively established that the pursuit of individual goals do not necessarily lead to public good. Adam Smith's 'invisible hand' cannot guarantee allocation of resources efficiently.

At the economy level, there is similar conflict between short and long-term economic goals that countries pursue. A key element that sustained the era of 'great moderation' (4-5 year period before the crisis) of high growth, low inflation and low unemployment, were 'global imbalances' characterized by high current account deficit in some countries and surplus in others. The flow of capital uphill, i.e. from developing to developed countries, which is against the conventional wisdom, led to lowering of interest rates in USA and fuelled the housing boom. The accompanying search for yield and the under-pricing of risk, together with financial innovations that allowed transforming sub-prime mortgages into highly rated asset classes, acted as the triggers for the crisis that soon engulfed the entire world.

There is therefore need for the 'visible hand' of oversight and regulation, without compromising market efficiency. Macro-prudential norms that aim at avoiding systemic risk through a watchful eye on asset price bubbles and imbalances, together with early warning

indicators would be the key to this effort. The IMF together with Financial Stability Board has taken up this cause at the global level.

Developing countries are more vulnerable to crisis, as they have fewer cushions against shocks. The immediate effect is increase in poverty and worsening of social indicators. The fact that the growth of emerging and developing countries as a group will fall to 1.7 per cent in 2009 from 6.0 per cent in 2008 (IMF, WEO Oct 09) indicates the extent of the impact. An estimated 90 million people in the developing world are likely to be pushed below the poverty line due to the fallout of the crisis. Lower revenues will lead to reduced levels of expenditure on rural infrastructure, health and education, which will hurt future growth and delay achievement of the Millennium Development Goals. Social and political tensions could increase, undermining the national consensus in support of the much needed structural reforms and adjustment.

The depressed state of the global economy also translates into considerable loss of export demand for the developing countries. Exports of non-oil developing countries are expected to decline by about \$900 billion in 2009, compared to the previous year. They will remain well below the earlier projected trajectory for several years. This is bound to reduce production, incomes and employment in the developing countries.

To resuscitate growth in the developing countries, we have to replace lost export demand by expanding other components of

domestic demand. The best option is to expand investment. An obvious area where additional investment is required is infrastructure, including energy, transport and other public services. These investments can be made ahead of requirements and therefore are an ideal form of countercyclical activity.

At the global level, G-20 has taken up the cause of global stability, policy co-ordination and growth. The Pittsburgh Summit, held on September 24, 25, 2009, has agreed that the G-20 would be the premier forum for international economic issues. A new framework for discussing global macro-balances, and the contributions that individual countries can make through their own policies, with a new process of *peer review*, was also agreed.

The objective is that members agree on shared policy objectives, set out medium-term policy frameworks and work together to assess the collective implications of national policy for global growth, identifying potential risks to financial stability and based on mutual assessment, agree on actions to meet our common goals.

Let me now turn to the India's economic situation in the context of the global crisis. The Indian economy has shown remarkable resilience to the crisis because the financial system had no exposure to the toxic assets. The Reserve Bank of India had also taken pre-emptive steps to contain bank exposure to the real estate bubble in the domestic economy. Moreover, foreign borrowing is regulated through External Commercial borrowing guidelines, which

regulate end-use and encourages borrowings with lower interest and longer maturities. This has prevented build up of debt to unsustainable levels and contained surge and reversal of flows seeking interest arbitrage.

Besides, the Indian growth is largely domestic economy driven, with merchandise exports accounting for only about 15 per cent of GDP. The extent of globalization however has increased over the years, which has been responsible for the setback that the economy received due to external shocks. The crisis hit the Indian economy initially through slowdown and reversal of capital flows, which impacted the stock market and the exchange rates. Thereafter, especially after the Lehman crisis, the real economy was affected through slowdown in exports, reduced investment activity and general risk aversion.

As a result, the economic growth, which averaged 8.8 per cent during the 5 year period from 2003-04 to 2007-08, slowed to 6.7 per cent in 2008-09. The growth in the last quarter of 2008-09 (January – March 09) was 5.8 per cent, after remaining at the same level in the third quarter (Oct – Dec 08), indicating beginning of the stabilization process. In the first quarter of 2009-10 (April – June 09), the growth improved to 6.1 per cent, which could be construed as start of the recovery process. Overall, the economic growth is expected to be in the range of 6-7 per cent in 2009-10, despite the setback due to poor monsoon. The effort now is to bring the economy back on the growth path of 9 per cent per annum.

Turning now to the state of Sri Lankan economy, I note with satisfaction that the economy has exhibited considerable resilience in the first few months of 2009 despite shocks from the global recession and the resultant slowdown in domestic economic activity. Favourable developments such as the continuous decline in inflation and a narrowing trade deficit have enabled a rapid recovery in key sectors of the economy. The ending of the 26-year long conflict and the approval of the Fund's Stand-By Arrangement (SBA) in July 2009 also bolstered confidence and helped improve investor perceptions. The economy registered a real growth of 1.8 per cent during the first half of 2009.

Benefiting from the relatively lower international commodity prices and a pick-up in remittances from Sri Lankan expatriates, the current account deficit has narrowed down significantly. The sharp increase in foreign investments in government securities, inflow of export proceeds, the receipt of the first tranche under the SBA and the general and special allocation of SDRs by the Fund, has turned the overall balance of payments into a surplus of about US \$ 1.9 billion in the first half of 2009 after a sizeable deficit of US \$ 1.4 billion in 2008. Consequently, the gross official reserves, which had declined to US \$ 1.1 billion by March 2009, increased gradually and exceeded US \$ 4 billion by mid-September 2009. The exchange rate, which had depreciated to its lowest level of Rs. 120 per US dollar in April 2009, has appreciated gradually and remains stable around Rs. 114 per US dollar. With stronger than expected recent economic

developments, the real GDP growth is projected at 3.5 per cent in 2009. Inflation remains subdued and is expected to be in single digit over 2009. Exports are showing signs of recovery and import demand is expected to pick up as economic activity gathers momentum.

The World Economy is showing signs of recovery after being in the doldrums for nearly 2 years. The global output is expected to expand by 3.1 per cent in 2010 (IMF, WEO October 2009). The developed countries as a group are targeted to grow by 1.3 per cent and emerging and developing economies by 5.1 per cent. The global trade is expected to increase by 2.5 per cent after falling by nearly 12 per cent in 2009. The risks however, remain and the recovery would be razor edge walk, especially because signs of asset price bubble and heightened carry trade activity are re-emerging.

Against this backdrop of our shared inheritance lie the sobering realities of the current economic crisis. Global economic and financial slowdown has put the spotlight squarely on Asia as a region which can lead the global economic revival. Developing countries were in no way responsible for the crisis but have been the hardest hit. India has also been affected but fortunately not as bad as some others.

India and Sri Lanka can indeed show the way for Asia. The signing of Free Trade Agreement (FTA) between us was an act of faith in our joint economic potential. Under the FTA, India has assumed asymmetric obligations vis-à-vis Sri Lanka and our commitment is enshrined in it. FTA has increased our trade to an

unprecedented US\$ 3.3 billion last year. The import-export ratio has fallen since 2000 in favour of Sri Lanka. Further, India has expressed its willingness to address implementation issues and set up mechanisms that will facilitate increased presence of Sri Lankan goods and services in the Indian market. It was this FTA which became the catalyst for SAFTA in the SAARC context. We also share membership in other multilateral regional arrangements such as Asia Pacific Trade Agreement (APTA) and BIMSTEC (Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation) that aim to promote further integration.

It is with a view to take our economic engagement to a higher trajectory that the two countries finalized the CEPA (Comprehensive Economic Partnership Agreement) last year. Given the preponderant importance of services sector to the Sri Lankan economy, we are confident that Sri Lankan companies can leverage their access to the Indian markets and realize economies of scale through greater investments. To replace lost export demand, an ideal option is to expand investments. But when protectionist voices and mutual suspicion gets juxtaposed against an economic downturn, there is bound to be some apprehension about how the CEPA will affect Sri Lanka. With lower growth and higher unemployment, calls for protectionism are bound to increase. While we wait for you to develop a domestic consensus on this issue, I can assure you one thing – at a time when global players are investing in India to leverage their synergies with us, including in services, CEPA can only be a win-win situation for both India and Sri Lanka.

There are, however, hopeful signs that the future is closer to us than we think. One of Sri Lanka's largest companies Brandix has started a fully integrated textile city in Vishakapatnam. Sri Lankan airlines is already the largest foreign airline in India. Colombo Port and Colombo Dockyard feed on substantial Indian business. Many other Sri Lankan companies have realized the potential India offers. Many Indian corporations are also investing in Sri Lanka the most prominent being TATA, CEAT, IOC, Airtel, Ultratech and NTPC. Indian banks and an insurance company operate in Sri Lanka as well. We are looking at power-grid interconnectivity. Physical connectivity has increased exponentially. There are more than 100 flights a week between the two countries. India already accounts for the largest number of tourist arrivals into Sri Lanka. Our development partnership has expanded to include several projects which India is taking up in Southern Sri Lanka including the Southern Railway corridor. Trade, connectivity, tourism and exchange of information and ideas are the key to greater economic engagement.

Ladies and Gentlemen,

The future of peace, security and development of our region has to be fortified through common economic prosperity. We are already engaged in this process through SAARC, which has moved from a declaratory to an implementation stage. The challenge today is to build inter-dependencies which not only integrate our region but also create a strong interest in each other's stability and prosperity.

Critical to this is connectivity of goods, people and ideas. India and Sri Lanka have the will and determination to take a leadership role in this quest.

Lakshman Kadirgamar had a vision for Sri Lanka. As he himself said, he was first and foremost a citizen of Sri Lanka but he was also a citizen of the world. That vision was for a future in which Sri Lanka and its people will live in peace and harmony. His vision was also for close friendship and understanding between India and Sri Lanka.

Before I conclude, allow me to once again thank Mrs. Suganthie Kadirgamar for inviting me here and giving me the privilege of sharing some thoughts on Sri Lanka and India-Sri Lanka relations. She has grand plans to expand the activities of The Lakshman Kadirgamar Institute for International Relations and Strategic Studies into a range of areas. I would like to take this opportunity to wish her and the Institute continued success in their endeavours.

Thank You