Sri Lanka faces economic holocaust

Sri Lanka demonstrates the grave danger of accepting incompetent IMF formulas, writes Susan Maitra from New Delhi.

Sri Lankan President Junius Richard Jayawardene was in Washington for meetings with President Reagan and other U.S. officials during the week of June 18. The head of state was seeking increased economic aid for his IMF-beleaguered island nation.

Periodic violent riots and a continued state of tension between Tamil and Sinhalese ethnic groups for almost a year have pushed Sri Lanka's economy closer to the edge of collapse. After enjoying relative calm and a superficial prosperity in the late 1970s, Sri Lanka has once again become economically stagnant—a fact which is adding fuel to the discontent among a large section of the population.

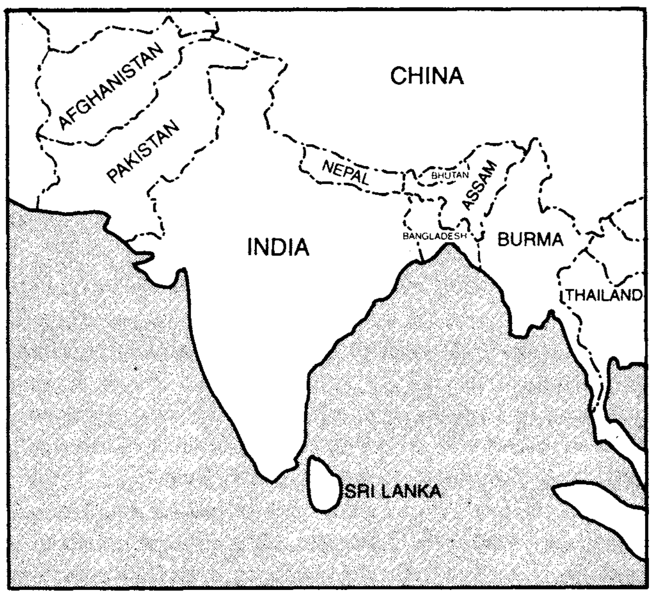
Sri Lanka, a nation of 15 million people located in the Indian Ocean 21 miles south of the subcontinent, has the distinction of having the highest literacy level—82%—of any south Asian nation. The population consists of two major ethnic groups, the Tamil Hindus who mostly live in the northern part of the island, and make up 20% of the population, and the Sinhala Buddhists. These two groups are mixed with less than a million Christians and Muslims. Like all British colonies, the island's economy was built on land-based raw commodity produce such as tea, rubber, and coconut. Referred to as the "emerald island" because of its lush, green hills and valleys, Sri Lanka was known in the Raj days for its large plantations and picturesque vacation spots. In fact, the word serendipity was derived from one of Sri Lanka's ancient names, Sri Deep, or beautiful island.

Stagnation and socialist rhetoric

Independence came to Sri Lanka, then called Ceylon, in 1948 without the usual mass movements which were the hallmark in the Indian subcontinent, with the result that the British legacy was hard to erase from the social and financial structures. The island's post-independence economic structure remained the same as before; even the British holdings were left untouched. The new nation's economic policy followed the same pattern woven by the British Raj. Industrialization and land reform, the two most important political decisions, were discussed but not implemented. Meanwhile, a group of Sri Lankans emerged in the tradition of the British feudalists atop a pile of wealth amassed by selling traditional plantation products.

The first significant change in this pastoral scene came in the 1960s when a new class of Sri Lankans came to power uttering "socialist" rhetoric. This was the government of the Sri Lankan Freedom Party (SLFP), led by Mrs. Sirimavo Bandaranaike. From the outset the SLFP was chauvinist Sinhalese, as their slogan of "Sinhalese Only" indicated. The SLFP called for extensive social welfare programs. Production and distribution were put under tight state control and the backward manufacturing sector was made even more inefficient when severe governmental restrictions were implemented on import of raw materials, capital-intensive equipment, and spare parts. As a result, industries became further incapable of absorbing new employment, and investment prospects became gloomier than ever.

In 1977, President Jayawardene's United Nationalist Party (UNP) swept into power following a landslide majority. A



new economic policy began to emerge. The UNP introduced a 10-year economic restructuring program designed to reduce state control, encourage private investment and enterprise, and push for an open-market economy. Initial measures included tax concessions to foreign investors, a currency devaluation of 46% against the U.S. dollar, a reform of interest rates involving a substantial rise in deposit and loan rates, relaxation of import and exchange controls, and the abolition or reduction of consumer subsidies.

The economic bubble bursts

Initially the economy responded favorably to these measures. Over 1978-82, real GNP grew at an annual average rate of 6.2%, which resulted in an increase in real per-capita income of 4.4%. The level of investment, which was only 14% of GNP in 1977, the last year of Mrs. Bandaranaike's SLFP rule, stood at 30% by 1982. The unemployment rate, helped by a large-scale migration of Sri Lankan workers to oil-rich Middle Eastern states, declined sharply from 24% to 13%.

The increased growth rate was the result of better performances in the traditional sectors as well as in the manufacturing sector, the latter constituting only a tiny fraction of the small economy. Agricultural production rose by 4% annually between 1978-82, compared with the 2% rise over 1971-77, manufacturing production by 5.3% compared with 1% in the earlier period. Similar encouraging results were also noted in the construction and services sectors.

Among the agricultural products, paddy (threshed, unmilled rice), a traditional import item, did better than the tree-crop (tea, coconut, and rubber). Hopes were raised in 1979 that Sri Lanka would soon be able to attain self-sufficiency in rice production.

Over the four-year period 1978-82, the heyday of Sri Lanka's economic growth, the economy flourished by virtue of exploitation of the traditional products for export. In 1982, tin, rubber, and coconut covered more than 40% of the entire cultivable land, and accounted for 47% of total export earnings.

But in the 1981-82 fiscal year, two things happened that jolted the Sri Lankan government and dashed the newly puffed hopes. First, a steep fall in agricultural product prices occurred in the world market under conditions of worldwide recession. Second, for the first time in four years, a drop in output of the traditional products was recorded. In 1982, production of tea fell by 11%; it was the lowest amount produced in 10 years. The rubber crop showed a marginal increase over 1981. Although coconut production showed a rise, it was not enough to cover the other losses.

The collapse of Sri Lanka's export income and a subsequent rise in the trade imbalance put a massive inflationary pressure on the economy. Jayawardene, who had committed himself to developing a "quick buck" economy in the style of Singapore and Hong Kong, was left with no choice but to borrow more money at a high interest rate to cover the trade imbalance. But along with the expensive money came the IMF *diktat*.

Enter the IMF

On the one hand, the IMF pressured Jayawardene to liberalize imports further and mobilize Sri Lanka's labor force for a cheap manual-labor-based production-for-export drive. On the other, the IMF demanded a reduction in the annual budget deficit, a cut in development outlays to slow capital-intensive infrastructure projects, and a rise in the bank interest rate to curb inflation. This policy was adopted *in toto*, and the Sri Lankan economy headed immediately toward a crisis.

No doubt, Jayawardene's earlier "Hong Kong" model policy pushed Sri Lanka firmly into the IMF grip. In 1977, the country's foreign debt was U.S.$780 million. Today, it stands close to $2 billion. Excluding the IMF transactions, the debt service ratio in 1982 was 9.5%; by 1983, it had risen to 15.2%, and is officially forecast to rise to 17.7% by 1985. On present indications, the projection may be conservative.

Meanwhile, the IMF, citing these figures as danger signals, has pressed the Sri Lankan government to intensify

Tamil-Sinhalese conflict: a legacy of British rule

The legacy of years of conflict between the two major ethnic groups of Sri Lanka, the Tamils and the Sinhalese, is tearing the island-state apart. Along with communal hatred and violence came more recently the Tamil demand for a separate state—*Eelam*. Terrorist actions directed by the separatists against the Army were countered by the authorities, almost all of whom are Sinhalese, with equal or even greater brutality, propelling the conflict into newer, more intractable directions.

Behind the clash lies a history distorted by British colonial policy. As in many other nations in Asia and elsewhere, the British rulers created ethnic problems in Sri Lanka to prolong their rule. Sri Lanka has perhaps the longest colonial history of any Asian nation, being conquered first by the seafaring Portuguese, then the Dutch, and finally the British in 1815. It was not until 133 years later, in 1948, that the British implementation of its austerity policy *diktat*. The IMF also urged the government to devalue the Sri Lankan rupee once again to enhance competitiveness of Sri Lankan products on the world market.

In this process, the economy has become increasingly dependent on consumer and other product imports, thus further widening the balance of payments gap.

It is not as if the government did not try to buck the IMF. The authorities believe further imposition of austerity prescribed by the IMF will provoke mass unrest and nationwide industrial strikes, and have said so out loud. At the 1980 Paris meeting of the Aid to Sri Lanka Consortium, Finance Minister Ronnie de Mel exploded in anger at the scale of cuts demanded in Sri Lanka's five-year investment program. Sri Lanka tried vainly to resist the IMF pressure to devalue. Last July, the rupee was allowed to depreciate by 5% against the U.S. dollar. In mid-September, the IMF approved a standby credit of SDR 100 million over the period through July 1984.

What went wrong?

From the outset, it was clear that Jayawardene's plan to implement the IMF prescription was based more on the desire to give the Sri Lankan economy a face-lift than on sound economics. The basic problem with the economy, the reason it cannot sustain a prolonged growth, was never properly understood. Therefore, the crucial infrastructural development on which every sound economy is based was virtually ignored. The only exception was a short-term effort on the government's behalf to expedite the Mahaveli irrigation and power scheme, which was in any case abandoned when it ran into criticism from the IMF and World Bank.

The areas where the Sri Lankan economy is most handicapped are electrical power, development of basic industry, and training of skilled manpower to adopt advanced technology for increasing the productive capacity of labor. The 1982 figures show that the total installed electricity generation capacity of Sri Lanka was 561 MW—even less than the generating capacity of one medium-size power plant. Of total energy consumed on the island, about 55% is provided by firewood—a policy bound to lead to large-scale deforestation. Petroleum accounts for 32% of energy consumed, and the balance is met with the help of hydropower. Petroleum, all of it imported, is burnt to generate 70% of all commercial energy.

By 1982, higher world oil prices were taking up 20% of total import expenditures. The four hydropower stations, which would have been long since completed had it not been for IMF interference, would add another 466 MW peak power to the system by 1986.

At the present time, the Sri Lankan government is far

finally departed from the Asian island.

Sri Lanka's history can best be traced to the fifth or sixth century B.C., the period of the final migration to the island, whose ancient name was *Sinhadipa* (Island of the Lion). According to early chronicles, the Sinhalese who came from Sinhapura in Bengal were Aryan. In all probability the Dravidians, who hail from southern India, were already on the island. While the Sinhalese brought along with them Buddha's teachings and began calling the island *Dhammadipa* (Island of the Buddhist teachings), the Tamils were Saivite Hindus. In spite of religious differences, the Sinhalese maintained close connections with the neighboring Dravidians and the Sinhala elite took wives and skilled artisans from the Tamil kingdoms in India.

Sri Lanka's earlier history does not show any conflict between the two ethnic groups. The seeds of discontent were planted only in the British days, fostered by the plantation economy itself. Those among the local peasants—most of whom were Sinhalese—who had any lands of their own from which to make a living refused to work under the oppressive conditions of the plantations. In response, the British brought in debt-ridden laborers from nearby Tamil Nadu to work on the plantations where conditions were so bad that at least one-fourth of the laborers died within a few years. At the same time, the British moved to dispossess the Sinhala peasants from their lands in a steady expansion of the hated plantation system.

By the early 20th century, the British began to openly exacerbate communal tensions to prevent the Sinhalese and Tamils from combining to start a liberation struggle. The tactic involved demonstrative pampering of the Tamil minority. The Tamils became the favored recipients of British missionary zeal; they were helped to advance in education and came to virtually monopolize administrative posts. They also controlled a majority of the professions—medicine, accounting, academia, engineering, and law. It was during this period that the Sinhalese began emphasizing their Sinhalese Buddhist identity, with a heavy anti-Tamil bias.

Since 1948, the Sinhalese have reasserted themselves strongly. The Tamils have steadily lost civil, statutory, and linguistic rights—including adult franchise—through measures such as the Sinhala Citizenship Act of 1948 and the Sinhala Enfranchisement Act of 1949. In 1956, the "Sinhala Only" Act was passed, declaring Sinhala the only official language of the nation and prompting the closing of Tamil schools in Sinhala-dominated areas.

from adopting an energy development program based on exploitation of commercial nuclear power, although Sri Lanka does possess thorium, the fissile material India is pioneering as a fuel for commercial nuclear reactors.

If Jayawardene's energy planning looks bad, there is general unanimity that his industrial policy is even worse. Until 1977, Sri Lanka's manufacturing sector consisted largely of import-substitution industries protected by high tariffs and subject to strict import and foreign exchange controls. Jayawardene quickly removed the controls and opened the economy up, but he had no programmatic concept of what type of investment was needed for sound economic development. The basic engineering and manufacturing sector, the key to increased agricultural output, was virtually ignored. Petroleum and chemical products, which account for 50% of total output, and food and beverages, which account for 20% of total output, continue to dominate the industrial sector. In addition, goaded by the export-promoting IMF, Jayawardene has introduced a gimmick to make foreign exchange by exploiting cheap labor.

Jayawardene's gimmick, a trick tried unsuccessfully by many developing nations in recent years, is to create so-called Investment Promotion Zones under the authority of the Greater Colombo Economic Commission. The purpose was to attract foreign investments by making cheap labor available. This would provide employment to 25,000 Sri Lankans at a meager wage, on the one hand, and generate foreign exchange by selling the assembled products on the other. But devaluation of the rupee, which increased import costs, and a glut of similar products from other developing nations on the world market, turned Jayawardene's plan into a cruel fantasy. The nation's workforce, meanwhile, remains as unskilled as before.

The real danger signals

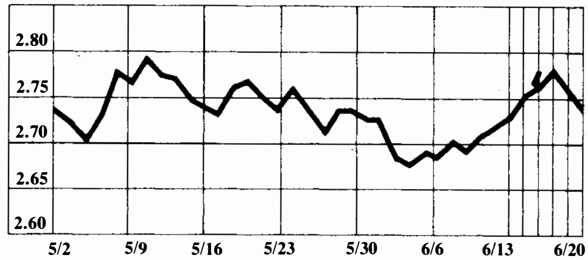
The increasing trade imbalance and decreasing development financing have already created a large cadre of unemployed and discontented workers. Among the elite, there is a fear that if the government continues failing to meet expectations of better living standards and more jobs, the country will be torn apart. Their fear is well founded upon the experience of the 1971 riots, when the trade union militants joined hands with the extreme left and forced the former regime to call in foreign troops to suppress the armed insurgency.

The 1983 July riots between the Tamil secessionists and chauvinist Sinhalese have already had a direct effect on the economy. The "quick buck" tourism is not, however, the only victim. The greater problem arose with the uncertainty that foreign investors have faced since then. The 1983 riots have put at least 100,000 workers out on the streets as 17 factories around the Colombo region ground to a halt. There are indications, further, that some private Indian capital will be withdrawn from Sri Lanka in light of the increasing financial risk.

Currency Rates

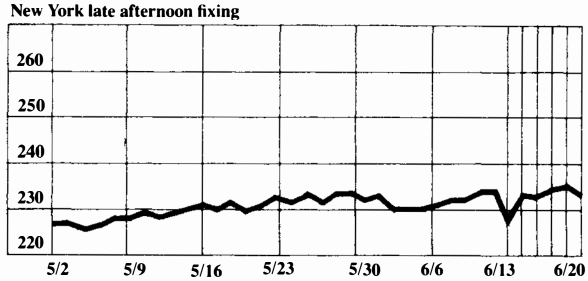
The dollar in deutschemarks

New York late afternoon fixing



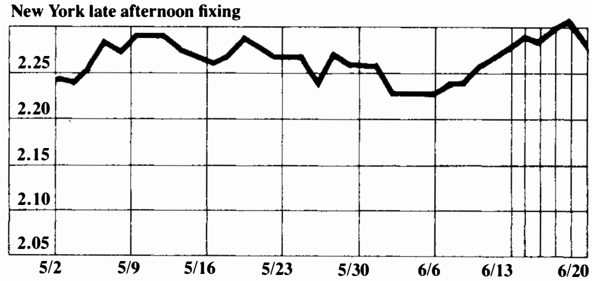
The dollar in yen

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing