NOTES ON THE OPEN ECONOMY: SRI LANKA, 1978-92

W.D. Lakshman

Economic strategy in Sri Lanka today, to be properly understood,must be placed in its historical context. The strategy currently implemented was adopted in the latter part of the 1980s, after experimentation with a series of economic strategies since political independence. In 1977 there was a significant about turn in policy, which has lasted up to now, primarily due to clever manipulation of the political process. All these experiments were guided by different goals, different objective conditions and different ideologies. Each of them had recorded successes within their own parameters; however, they had all, as necessary in a democratic system, failed to deliver the results expected by the masses, even during the period from 1977 to 1988. The period since 1988 is marked by, on the one hand, a continuation of the open economy experiment introduced in 1977 and on the other, the incorporation of certain items presented to the people as capable of eliminating or at least reducing some of the iniquitous effects of a market oriented economic strategy.

I may describe these two elements - a combination not new to Sri Lankan policy making - for the sake of brevity, as (a) the modernisation (or economic growth) element and (b) the poverty alleviation (or social justice) element.

The first element aims at an advancement of production forces or more simply growth of production or GNP and the generation of a suitable economic structure for self-sustained growth through export oriented industrialisation. To use a currently over-used expression, the primary policy objective is to make Sri Lanka a NIC in the year 2000 or to double GNP per capita (real) by that year, at the same time maintaining stable price levels and relatively full employment.

The second element is a result of the perception that the pursuance of this strategy since 1977 had, in spite of the safety net provided by food stamps, left a very large proportion of the population (the poor and those living in underprivileged regions) unaffected; there was no trickle down resulting in growing poverty and malnutrition among vulnerable groups. Since 1988, therefore, there has been the recognition of the objective of poverty alleviation and deliberate action to ensure a trickle down of growth benefits to the masses. As an objective this is laudable;

Professor W.D. Lakshman teaches Economics at the University of Colombo.

I fully approve of it. However, there are two questions I wish to raise here: to what extent is this element of policy political and populist rhetoric and to what extent is it symbiotically integrated with the objective of growth?

To the extent that the second element is dictated by political expediency and short term compulsions of regime popularity, the long term objective embodied in the first element is disrupted. This policy conflict/contradiction is anyway not an unknowm phenomenon to Sri Lanka.

The strategies adopted to achieve these ends may be summarised as follows:

The Modernisation element:

(a) **integration of the economy** into the global economy (into the on-going process of globalisation of capital).

(b) the adoption of a capitalist path: private enterprise and markets and prices

(c) the provision by the state of (physical and institutional) infrastructure and the restriction of the state to the tasks of maintaining an "even playing field" and of being the "referee" where necessary.

Poverty Alleviation Element

Here the strategy demands an expansion of the state's presence in the system. Even after 1978, the state was massively involved not only in the provision of infrastructure but also in the manipulation of market systems and price mechanisms. These would, in theory, be considered unacceptable in growth terms. (Note that I am *not* presenting an argument against selective intervention by the state in the market mechanism on a planned basis. My interest here is merely to highlight the contradictions in the postures adopted in respect of the two broad elements of policy noted above).

After 1988, the state has taken on an even more extensive role evident in various measures: →

strengthening of and additions to the "safety net", bringing poor and vulnerable groups so far unaffected by the development process into the production system through self-employment; the more or less "forced" creation of modern sector jobs in rural areas (e.g. the 200 garments factories); the enforcement of "non-market" wages on these private industrialists and on the estate sector; the creation of new "welfare" measures as, for example, free school uniforms. All these measures increase the intensity of the contradictions with the modernisation strategies.

The policy instruments adopted in the interests of modernisation and growth can be summarised as follows:

* fiscal policy measures
* monetary policy measures
* exchange rate
* liberalisation from controls
* privatisation (the populist expression being peoplisation)
* state's infrastructure and institution building activities (irrigation, roads, telecommunications; BOI & FTZs; development financial institutions)

For purposes of poverty alleviation and and for creating a regional balance in developmental impulses, a different set of instruments are recognised as necessary. They are:

* creation of safety nets
* janasaviya type income transfer schemes
* promotion of self-employment, small industry/small enterprise/self employment schemes with financial and marketing incentives
* unequal (uneven) use of fiscal incentives in favour of individual enterprises, not of sectors, (as for example the 200 garment factories) and monetary policy measures (selective use of interest rates, refinancing) that go against the principle of an "even playing field"
* the use of administrative fiat (along with fiscal, financial incentives) in determining industry location
* raising funds from the business community outside the normal tax system; maintaining non-budgetary funds
* the direct intrusion of centralised authority to the lowest levels of administration.

Let us now consider the results achieved by these strategies.

The growth rates achieved and the attendant circumstances can be briefly periodised :

* 1978-82: a period of historically rapid GNP or GDP growth, usually credited to 'beginners' luck;
* 1983-89: problems in economic management (balance of payments, public finance) and social unrest arising from the ethnic conflict and other political factors stregthened by unequal distribution; the result is a slowing down of growth;
* 1989-92: some recovery in the growth process due to several factors: political stability in areas other than the Northern and Eastern Provinces: government **implicitly** making a distinction between the two elements of the strategy — let what is needed to achieve modernisation be done as long as the advisers and administrators of these modernisation instruments do not try to meddle with and adversely affect the political program of poverty alleviation: as a visible element, compare the role of Finance and Industries Ministries in the modernisation package and their low key role in the **janasaviya** and 200 garment-factory programs; one gets the feeling that these two areas of responsibility, though not neatly, are divided between two parts of the government); the government's support of the modernisation programme results in the greater availability of foreign finance, ironically for both elements of the strategy; infrastructural projects undertaken earlier begin to function; a fairly consistent management of the industrialisation package; increasing interest shown by direct foreign investments. DFI (result of previous developments - higher level of development - and various institutional changes introduced as part of SAFE and ESAF). But the North East war makes only part of the country contributing to this growth.

A major objective of the policy package was the introduction of certain structural changes in the economy that would provide the basis for self-sustaining economic growth. Unfortunately evidence of such structural change is not visible. The production and employment structures remain very much the same with continuing sectoral productivity differences. The service sector continues to dominate the economy. The share of manufacturing in the GDP is still very small. There are also problems in the structure of exports; there is a high concentration of labour intensive products, which some would argue is a necessary first step in the process of industrialisation. The import intensity of industrial production for export is also a matter of concern.

Inflation is another problem. After 1978, inflation rose to a higher level (eg. on the basis of average of annual rates of increase in CCPI: 1974-78: 5.3%; 1978-82: 18.4%; 1982-86: 10.1%; 1986-91: 13.4%; for the same periods, the implied GDP deflator was 10%, 16.2% and 12%). The causal factors were: (a) deterioration in the terms of trade leading to continuing balance of payments weaknesses and to to consistent currency depreciation - an undesirable egg-chicken problem; (b) deficit financing leading to increases in money supply. Inflation has enormous implications for real incomes and income distribution patterns as well as for the competitiveness of export industries. It affects very adversely fixed income earners as against variable income earning business classes. One is impelled to question whether the structural adjustment policy package, in the political environment in which it is being implemented, is able to provide some solution to the basic inflationary problem.

(d) *Balance of Payments*

Developments here are obviously related to developments on the inflation front. Major causal factors have been the consistent deterioration in terms of trade [1978=100; to 1991=38] and high inflation.

A problem here is that different measures giveng different signals about performance. The trade balance, current account balance, basic balance and external resources gap as a percentage of GDP rose to their highest levels in 1980/1981. There has been a decline since then but even in 1991 these ratios were at quite high levels: 12%, 6%, 1%, and 17% respectively.

The import capacity of external assets drops from 11 months in 1977 to 2 in 1980, remaining around 3 till 1989; by the end of 1991 it goes up to 4.7 months.

The ratio of external debt to G.N.P was 44% in 1978; it rose to its highest point of 92% in 1989 and then dropped to 83% in 1991.

What should be noted are: the continuing heavy dependence on foreign aid with no sign of any dimunition of its role and the growing debt burden, even though there has been an increase in the concessionary nature of foreign funds. We need to raise in this context a few important questions: To what extent is foreign aid absolutely necessary and in what areas? Are we using foreign assistance effectively? Have we not become victims of an almost narcotic addiction to foreign aid?

Let us now take a look at the results of the poverty alleviation project , even though this is an area in which reliable data is difficult to obtain, with conflicting views coming from the government media and involved administrative agencies and from independent observers. I am yet to come across any independent intensive research on the subject. Impressionistic evidence suggests that people in the small-farm agricultural sector, particularly paddy, are doing very badly due to a kind of a scissors crisis in operation, with costs after the elimination of the fertiliser subsidy catching up with prices. Hidden tenancies and de facto loss of land holdings to rich *mudalalis* or rich farmers are other factors which contribute to the pauperisation of people in these sectors. This process is, however, ocurring without any significant capitalisation of agriculture or the development of large-holding agriculture in their hands; in effect, pauperisation without proletarianisation of farm labour.

There are also conflicting views on the impact of the limited spread of agri-business, multinational or otherwise, on the poor landless rural population. There is very little evidence, either, of the sustainability or financial viability of the numerous self employment projects in the rural areas sponsored by the government and by NGOs. What is happening to the poor in the informal urban sectors is not fully known. There is also a gradual but serious erosion of real incomes in the case of fixed wage/salary earners in the public sector; certain groups among them at the low end of the income scale may be getting pushed into the poverty category.

There are many distinct and important problems in this area. Let me mention a few. The available data base is totally inadequate to answer any of these questions satisfactorily:

(i) What is happening to the proportion of the population in absolute poverty?

(ii) Are the families in poverty constantly changing over time or do the same families largely remain in poverty over time?

(iii) How far away from the poverty line are the different families considered to be below that line?

(iv) How relatively poor are those remaining in poverty?

I would now like to draw attention, without discussion, to the important problem areas:

(a) the balance between investment and savings - currently we are investing twice the domestic savings, the balance coming from foreign grants and investments

(b) the large budget deficits that are a prime cause of inflation

(c) balance of payments position (large trade and current account deficits); growing external debt

(d) unemployment and under-employment

(e) distribution of the gains of growth and poverty

In the light of these problems, one must ask seriously what is meant by declarations of achieving NIC status by year 2000. What is exactly meant by the statement that

→

a certain country is a NIC is not at all clear. It does not imply any qualitatively different social system. What is referred to are mostly quantitative criteria. Let me take two such criteria: (a) per capita income level and (b) structure of the production system.

In respect of per capita income, the following are some of the comparative data today: Sri Lanka's present per capita income (subject to all weaknesses in international comparative data on per capital incomes) is about $500. Even in would-be NICs like Malaysia (about $2500) or Thailand (about $1500) per capita income is about 5 times and 3 times that of Sri Lanka. In S.Korea it is over $5500, in Singapore and Hong Kong about $11500.

The second criterion is generally based on the strength of industry, particularly manufacturing, in the production system. The manufacturing sector in some of the existing so-called NICs and some would-be-NICs is as follows:

Hong Kong 18%;	Singapore 29%;
S.Korea 31%;	Brazil 26%;
Thailand 26%	

Compare these figures with Sri Lanka's 15%. Leaving out Hong Kong because of its special circumstances, how long will it take, at what rate of manufacturing sector growth, to achieve the level of industrial development, which such high manufacturing sector proportions imply ? Our GDP (real) growth rate in the 1980s averaged 4 per cent and that of the manufacturing sector 6 per cent.

Thus the achievement of some of these characteristics of the so-called NICs, even in fifteen years let alone the seven years that are left of the 20th century, is a formidable task. Pessimistically perceiving that this is an unachievable target, there is an alternative representation of this objective, that of doubling our per capita income by year 2000. This is in 7 years from today. To achieve this target, the rate of growth of per capita income has to be at an annual average rate of about 10 per cent over this period; If population grows at about 1 per cent, the GNP growth has to be adjusted to 11 per cent. The implications of this for required capital formation, the financing (domestic and foreign) of that capital formation and the growth of productivity of capital (ICOR) are formidable, given the actual growth rate of the 1980s, actual ICOR, the actual low level of domestic savings and the weak prospects for any substantial increase in foreign capital flows.

Also consider the structural conditions of the economy: the presence of a very large sector in the economy which remains unaffected by the modernisation wave; under-capitalised small holding agriculture; inadequate development of commercial farming, emphasised by the weak impact of large, multinational or otherwise, agri-business on the sector; archaic institutional framework affecting this sector (in spite of changes over time); lack of any effective land reform; unproductive small industry, small enterprise and self-employment sectors; There is also the traditional plantation sector and its low productivity; whether the combination of public ownership and private management can overcome its inefficiencies is a moot point. Unless these sectors are modernised and their productivity grows substantially, they will be a drag on the fast modernising industrial and service sectors.

An attempt to raise the growth rate of the economy beyond what the economy can sustain with its own efforts in a global environment which militates against a consistent expansion of concessional foreign assistance flows will either lead to sharp increases in the rate of inflation or to unsustainably heavy external debt burdens. Both will be counterproductive and will undercut growth efforts.

Finally consider the degree of congruence between the political imperatives of the 'second leg' (i.e. poverty alleviation) and the economic policy adjustments required for the promotion of the 'first leg' (i.e. modernisation).

As a vision and a guiding light, it is good to be thinking of a doubling of income by the turn of the century; considering the economic position enjoyed by Sri Lanka in the late 1940s when it compared favourably with most Asian societies which have since then overtaken us in the economic race, we Sri Lankans clearly deserve it. This is a particularly desirable objective if it is combined with poverty alleviation, equal opportunities for all and full employment. If we *genuinely and committedly work* hard (it is after all hard work on the part of all, which alone can produce this kind of result: there are no short cuts) towards that goal, we might at least be able to go some distance along that path. But have we so far developed that necessary hard working national ethos? Is the socio-economic system we live in today and being promoted by various elements of the current policy, the kind which is likely to promote hard work?