

enced in this century. The ethnic troubles of the past six years were compounded by political and social turmoil. Most serious of all, there was an alarming breakdown of law and order, and for the first time in our experience there were prolonged periods when the writ of the Government did not seem to apply even in the city of Colombo. I need hardly elaborate on the near impossibility of satisfactory economic development in such conditions. The growth figures from 1987 sounded an unmistakable warning. The 1987 growth rate was 1.5 percent, the lowest since 1971. The 1988 figure was 2.7 percent. One shudders to even hazard a guess at the 1989 figure."

This quote, from the paper in this issue on pages 7-9, by Professor of Economics of Sri Jayawardenapura University Dr S. Tilakaratne adds a further perspective to the impact of the dislocations: "The crisis that Sri Lanka is passing through is one of the most complex in its recent history, both politically and economically. The country's economic problems have grown to serious proportions. The rate of increase in the country's overall production (Gross Domestic Product) had sharply deteriorated to an average of a mere two percent during 1987-88, the lowest level recorded in the past 15 years. The economic performance in 1989 is unlikely to do any better; probably it could deteriorate further in the wake of the political turbulences and uncertainties. Three successive years of virtual economic stagnation has no parallel in the post-independence history of the country. The economic crisis has manifested in many forms such as growing macro-economic imbalances, increasing unemployment and under-employment and worsening poverty."

Business Sector

Opinions on why the business sector finds it extremely difficult to operate in this climate were expressed to the 'Economic Review' by Ajit Jayaratne the

SRI LANKA'S ECONOMY IN CRISIS

The current crisis in the Sri Lankan economy reached its gravest point by the first week of September 1989. Following months of dislocation of essential services in the country came a month long total public transport strike in August, followed by a week long hold up of economic life from August to September.

The extent of today's dramatic crisis is clearly manifest in the virtual collapse, fully or partial, of many production and service sectors. The disruption of economic activity during the previous twelve months had contributed to a weakening of the general economic environment; while aggravating rising levels of inflation, cost of living, unemployment and consequently malnutrition and overall poverty.

The economy is reported, according to preliminary figures, to have recorded a growth rate close to zero during the third quarter of this year; the first two quarters being only slightly better.

Many depressing views have been expressed recently on Sri Lanka's social and political crisis, and how seriously it affects the economy. Of significance are the vocal and helpless cries of the business sector, typical being the following extract from an address (carried more fully on pages 10 - 11) by A. S. Chator, till recently, the Chairman of the Ceylon Chamber of Commerce:

"The past twelve months have surely been the most traumatic period which Sri Lanka has experi-

Deputy Chairman of the Colombo Securities Exchange and also the new Chairman of the Ceylon Chamber of Commerce in the following informed comment:

"The business sector in the country today, both public and private, is operating under extremely difficult and trying conditions. The essential pre-requisites for a conducive business environment are law and order and political stability. Without these basic factors the business community cannot indulge in any forward planning and without forward planning it is obvious that there could be no development. There has been a total breakdown of law and order and an apparent absence of political stability in the country now for a long period and under these circumstances no forward planning has been possible. In fact most business establishments in the recent past have put their existing forward plans into abeyance, at least for the time being, and spend most of their time in merely ensuring day to day operations. Some of the factors that have led to this situation are sudden work stoppages, absence of public transport for carriage of goods and people, early closure of government offices and slow cargo handling at the Port. Needless, to say, under these conditions, productivity is seriously affected resulting in loss of exports, increase in unemployment, further inflation due to decrease in production and loss of tax revenue to government. In the meantime under these conditions prospective foreign investors naturally are having second thoughts and are awaiting more stable conditions before they make any significant investment.

In addition to the problems mentioned above, certain fiscal disadvantages have also arisen recently so far as the business community is concerned. Perhaps with a view to curbing inflation and a drain on foreign exchange resources, the Central Bank has insisted on a 100 percent cash margin on most imports. Overdraft facilities have

also been restricted, except in certain key areas, to what they were at a previous date. Also, there were reports that banks abroad were not happy in confirming L/C's opened in Sri Lanka. In addition, the high rates of interest offered by banks and government securities are also driving investment funds away from development oriented ventures into the safety of fixed interest bearing deposits and securities.

All these factors are being significantly shown up by the drop in activity in the Colombo share market and the poor response by the public to new share issues."

Growth Rate

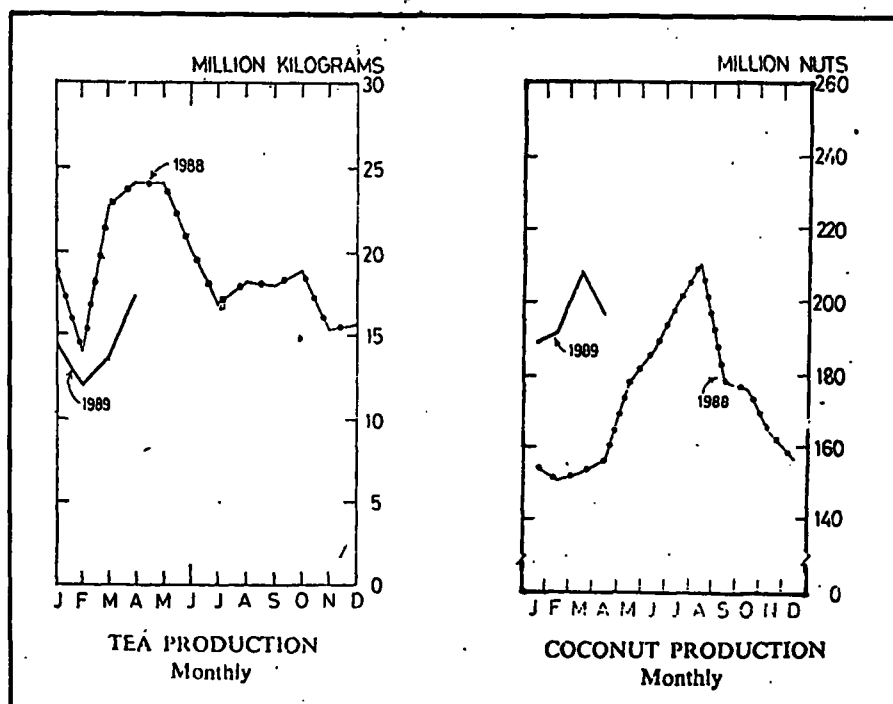
The Governor of the Central Bank has expressed the view, in a foreign news despatch, that the GNP would rise by about 3.5 percent this year from the 2.7 percent growth in 1988; although others reflecting the mood of the times expect growth to be below 2 percent. The growth rate in 1987 was 1.5 percent; which means that even with the Central Bank's optimistic estimate of 3.5 percent for this year, the average growth rate for the three years 1987-1989 would

be at a low of 2.5 percent as compared with an average growth rate of about 6.6 percent over the three years 1978-1980. The "growth" momentum gained with the introduction of the Open Economy could not be maintained in the 1980's and the crisis of recent years contributed towards bringing down the economy to unprecedentedly low levels of growth.

Plantation Agriculture

The commanding heights of the economy appeared to be in disarray. For instance, the agricultural sector which accounts for approximately 25 percent of the GNP recorded a drop in production at all levels, in both the plantation and domestic agricultural sub-sectors. In the plantation sub-sector tea production was heading for one of the lowest levels of annual production on record and was expected to be over 30 mn kgs below the 222 mn kgs produced in 1988. Tea exports were also falling far behind and in value terms were expected to be at least Rs. 1 bn below the Rs 12.3 bn earned in 1988.

Making the situation more critical was the fact that the two State Corporations which account for nearly two-thirds the country's tea



production and one-third of total rubber production today face severe crisis conditions. A 16 member official core committee which recently reported on this crisis indicated that the two leading estate agencies, the State Plantations Corporations (SPC) and the Janatha Estate Development Board (JEDB) were "heading for virtual bankruptcy. Both the SPC and JEDB were in desperate financial straits last year having recorded losses of over Rs 300 million each. These losses and other expenditure were financed with borrowings from a leading state bank, the Bank of Ceylon, which has given overdrafts of Rs 725 million to the JEDB and Rs 543 million to the SPC; and the position deteriorated further in the first four months of this year with the overdraft limits rising to Rs 900 million and Rs 850 million, respectively".

The disruptions to cropping, transport of manufactured teas, tea sales and exports from ports have intensified in recent months. Also it is inevitable that with the average cost of tea production being pushed to levels much higher than the nett sales average obtained for tea that is sold, large trading losses will result and the liquidity position of

the two estate agencies is bound to worsen. Furthermore, their borrowings from the Bank of Ceylon have exceeded Rs 1,000 million and it is feared by some observers that this debt could become irrecoverable, thereby jeopardising this banks own financial stability. Extracts of the core groups report, published in the 'Sunday Times', support this view.

Domestic Agriculture

Another area of concern was that of the domestic agricultural sector. Paddy production for the current year is reported to have totalled 99 mn bushels, the lowest recorded in the past 12 years. In 1984 paddy production reached a record of 127 mn bushels, but with the ethnic violence in the Northern and Eastern provinces cultivation was affected and production continued to decline. Since then the disturbances have spread to all paddy growing provinces in the country and this year's estimated production of 99 mn bushels is lower than even that of 1978, which yielded 101 mn bushels, when the new agricultural drive began to "take-off". Apart from the civil unrest, both drought and floods have contributed towards the drop in production and to the lower

acreages under cultivation. This fall in paddy production has also necessitated higher rice and flour imports.

How serious the situation is may be observed from the fact that in 1984 Sri Lanka was only 8 percent below self sufficiency in paddy production, but in 1989 the country is expected to be about 25 percent short of self sufficiency, according to a 'Daily News' report quoting a Ministry of Agriculture and Food document.

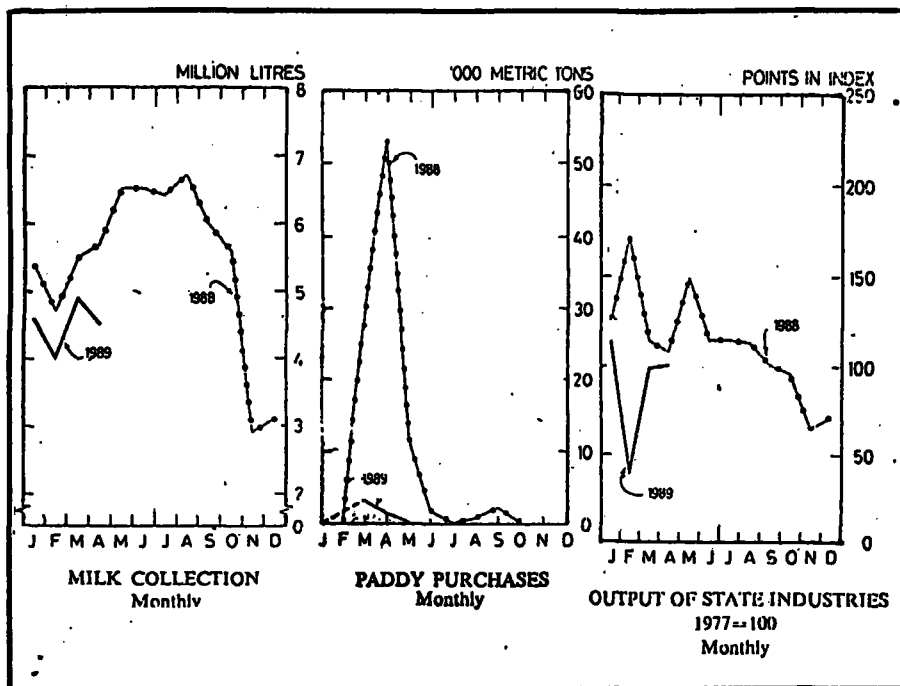
Other domestic food crops have similarly been affected. Due to frequent tension prevailing in the agricultural producing areas and uncertainty of purchase from producers the output of crops such as potatoes, onions, chillies and vegetables is reported to have decreased in some cases upto nearly 50 percent.

Consumer Prices

There were three basic factors precipitating the upward push in prices. Firstly, official agreement on some IMF conditions that subsidies on essential consumer items such as flour, bread, sugar and milk be lifted in order to keep the Government's budget deficit within control.

Over the past three months basic food items have experienced more than one price increase. The price of a kg. of flour has been increased by nearly Rs 1/50 over this period, while bread has increased by 55 cts per kg loaf; and sugar has increased from around Rs 16/- per kg to Rs 25/- per kg. and is expected to move up further. Milk foods have experienced a 25 percent price increase in recent months. The second factor is the break down in production and transport of most agricultural crops which has also contributed to the rise in consumer prices of many of these items.

The month long transport strike in August and the subsequent total week long strike upto September 1 paralysed transport, bank and



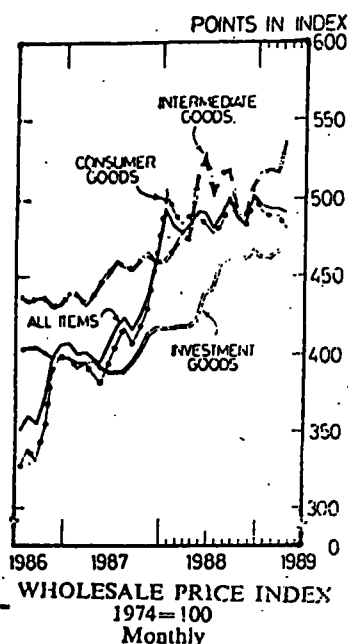
port services. The third factor is a rapid depreciation of the Rupee against most other currencies which had also pushed up local prices of all imported items, as a large part of the country's flour and sugar requirements are imported.

There has also been pressure on fuel prices and shortages of petroleum due to disruptions in supplies. As a consequence the prices of many essential commodities have increased significantly and the majority of traders who belong to the large and medium scale categories suffered heavy reductions in their margins.

Government Budget

The Government Budget, particularly its revenue measures are in jeopardy as a result of the regular disruptions in normal business activity. The monopoly cigarette manufacturer, which provides over Rs 10 mn of revenue per day to the government budget (estimated Tobacco Tax in 1989 Rs 4,802 mn,) has experienced regular work stoppages. Business Turnover Taxes expected from most traders, small, medium and large may not materialise as business gets more constricted and the entire trading sector has continued to experience difficulties.

In most areas of the Government Budget the revenue shortfall is



expected to be considerable. For instance a tax amnesty was offered, to holders of 'black money, who made official declarations, and this amnesty was expected to contribute Rs 100 million in revenue to the Government budget. Upto September 1989 (after 7 months) it was reported that less than Rs 1 million has come in. Such shortfalls in revenue are unfortunate in the context of the conditions laid down by the IMF for the release of a further US \$ 87 mn structural adjustment facility which required containing of expenditure and realising of revenues expected in the government budget. The IMF required that the budget deficit be contained to 10-12 percent of GDP as against the 16 percent of the Government estimates. In 1988 too Sri Lanka's overall budget deficit was 16 percent, which was the second highest among the 19 ADB Asia member countries, second only to Laos.

Together with this budgetary policy the IMF had also required a slowing down of monetary expansion (MI) to 18 percent this year though it was running at over 20 percent. But according to ADB statistics, Sri Lanka's Money Supply (M1) was 29 percent in 1988 which was again the highest for 19 Asian member countries, with again the exception of Laos. The inability to contain the money supply was also manifest in the rate of inflation which was closer to an official rate of nearly 20 percent. Interest rates have been rising, with Treasury bills of one year maturity offering a rate of 19 percent, reflecting the attempts at a tight monetary policy.

Poverty Alleviation

The Government was committed in its Poverty Alleviation Program to assisting nearly 1.5 million families (approx 6 million people) with a monthly allowance of Rs 2,500 per month. This Program was to extend over the next two years commencing with the Government Budget, presented in March this year. An initial sum of Rs 10 billion was voted for this purpose in the current budget. According

to published reports the program could not get off the ground, due to (a) a lack of funds; (b) the demand from those employed in the lower wage groups for a minimum wage of Rs 2,500/- a month; (c) administrative unpreparedness, and (d) the very insecure law and order situation in the country which posed a threat to field personnel involved in this program. There are several other factors that have caused a stalling of this programme, while the foreign aid agencies are more interested in the investment component of the programme.

However, the concluding part of the first phase of the programme saw the distribution of printed Janasaviya Entitlements to all food stamp receiving families throughout the island, on June 29 this year. A total of 2.3 million Entitlement Certificates were distributed in all districts of the island.

According to a note from the Janasaviya Commission "the first round was due to start in July 1989, but could not due to civil and economic unrest. Now, it is rescheduled to start in September 1989. This phase will go on till the year-end. It will form an invaluable pilot and learning phase. Phase III will begin in January 1990 with the second round of Janasaviya distribution. The largest possible number will be covered in 1990 depending on the actual first hand experience of the first round, the availability of Budgetary resources and the impact on inflation."

In October this year, of the 1.5 million families eligible for Janasaviya assistance, only about 12 percent are due to be the first recipients of the consumption component of this Program. It will cost a little over Rs 3 billion, of the Rs 10 billion voted in the Budget this year, to start off the 181,740 selected families on the Janasaviya over a 12 month period. The first round will include exactly 181,740 families in 28 AGA Divisions in 25 Districts. The distribution of goods will be carried out by 30 Multi Purpose Co-operative

Stores in these areas. The balance 88 percent of the families are expected to be covered over 10 more rounds.

Once the eleven rounds are completed, the Janasaviya Programme would embrace all the AGA Divisions in all 25 Districts in the island. At the end of the 24 months the consumption component of Rs 1,458 per family per month is expected to cease when the investment component of Rs 25,000 will be made available to generate employment. When the last round in the Program is due to end, however, is not certain.

Foreign Reserves

In the area of international payments, private remittances from the Middle East and other countries employing Sri Lankans had declined from SDR 270 million in 1984 to SDR 234 million in 1988. Exports too have continued to lag far behind imports and in the first 4 months of this year the deficit in Sri Lanka's merchandise balance of trade was Rs 8.6 billion, as against Rs 6.9 billion in the same period last year; in the 1989 period while export earnings were Rs 14.9 billion the value of imports reached Rs 23.5 billion.

The Current Accounts Deficit of the Balance of Payments was widening and it appeared that the government would find it increasingly difficult to finance much needed imports of rice, flour, sugar, fuel and cement unless agreement was reached with the IMF for balance of payments support:

Foreign exchange reserves were low and had come down from sufficient to finance 3 1/2 months of imports to sufficient for (according to reports) a much lesser figure. With this depletion of foreign exchange reserves foreign banks had also become reluctant to provide needed guarantees on credit lines for Sri Lanka. It had at times become necessary to finance essential imports on 180-day letters of credit, while a few suppliers were demanding that off-shore foreign banks independently confirm that payments will be made. Meanwhile, importers of 'non-essential' goods

have been asked to put up a 100 percent cash margin. One interpretation of these pressures is that it could compell the government to come to terms with the IMF. Most of the IMF's conditions are being complied with since the consequences of having to obtain commercial credits to finance imports would mean a more painful round of shortages and higher inflation.

Other aspects of the plight relative to larger perspectives of the Sri Lankan economy are summed up by the ADB in this concluding comment on the economy, in its recent annual report:

"Sri Lanka currently faces a very difficult economic situation. The macro-economic constraints to economic growth are a high debt-service ratio high unemployment, large interest payments on government debt, a large current account deficit, and low domestic savings. The inflow of external assistance, which was at very high levels during the last decade, is not likely to increase further. In addition, the productivity of the massive investment program undertaken in the past has fallen far below expectations"

Prospects

Overall prospects of the economy for 1989 are one of gloom and all forecasts indicate that if political

and social conditions continue to remain as unsettled as at present the economy would deteriorate further. In all major sectors there were signs of downward trend. As noted at the outset prospects for agriculture are uncertain. An overall growth rate of 2.1 percent was recorded for this sector in 1988, but the same level of performance could not be expected this year.

Industry and industrial exports, particularly rapidly growing product groups such as garments and new lines such as jewellery and gems (especially diamonds), are not expected to achieve their original targets. Other key sectors affected are Mining, Construction and Economic and Social Overheads. Cement manufacture, for instance, had come to a standstill at the two major factories for some weeks and both the mining and construction sectors which normally make a substantial contribution to the GNP are expected to turn in a poor performance in 1989.

Under Economic Overheads are sub-sectors such as banking and financial services, internal trade, tourism, roads and transport, communications and other infrastructure facilities.

The Social Overheads cover sub-sectors such as education, health and housing but every one of the Economic and Social Overheads have felt the damaging impact of the social and political upheavals over the eight months of this year.

The unrest has been at its highest in Aug-Sept. and in recent weeks the targets of anti government activities have turned out to be economic / administrative targets such as Government installations, tea factories and other public buildings and property.

The Crisis facing the business sector is but a reflection of the economic crisis. The economic crisis is but an epiphenomenon in the breakdown of the fabric of the socio-economic system that we are witnessing today with the legitimacy of the very social order being questioned.

