

LANKAN CAPITALISM: OPTIONS FOR REFORM AND RESTRUCTURING

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The benefits of a relatively open economy at present are probably so enormous in terms of getting a certain amount of foreign investment, access to foreign markets and technology etc., that it will be very unwise for Sri Lanka to close her economy. Sri Lanka is a kind of country that can benefit from integration with the world economy. It doesn't have the kind of raw materials or industrial products which will automatically find a market. Particularly in the current international environment where the open economy is being practised on a wide scale it will be impossible for Sri Lanka not to participate, to isolate herself. The problem is that given what is happening at the level of foreign exchange, the country might be forced into a situation where closure will seem inevitable because the country can't pay for imports. But one of Sri Lanka's greatest hopes is that the international financial institutions, the World Bank and the IMF are still sufficiently heavily committed to the success of the open economic policy

in Sri Lanka. Therefore, they will ultimately be willing to support Sri Lanka's balance of payment if the situation gets extremely difficult. If for some reason they fail to do that, then clearly there will be major problems.

One of the problems of closing the economy again, of going back to a closed economic policy, is the possibility of capital expatriation, of capital flight. It will be very very difficult to prevent this. This is a very real danger. If there is any suggestion of return to a closed economy this will precipitate capital flight on a large scale. This will worsen the situation and the country will get into a vicious circle.

Similarly the mechanisms for running and controlling a closed economy – like Corporations and exchange controls – are much more weaker now than they were before. It will be very difficult to build these up again because when they were being strengthened in the 60's and the 70's there were lots of people who be-

lieved that these mechanisms will open up the way for a viable path of development and there was a certain amount of personal commitment. But that has changed today. Very few people in Sri Lanka now seem to have any commitment to a closed economy. For that reason it becomes much more difficult to implement it.

My impression in talking to people is that everyone supports the open economy in principle, but every one has problems about the way it's being put into practice. They are against what you might call 'the ugly face of the open economy' – for example, things like foreign casinos, excess and conspicuous consumption, the undesirable sides of tourism etc. But the basics of an open economy are encouraging foreign investment, trying to promote exports and maintaining a steady supply of imports of consumer goods from abroad. There is general support from a wide range of parties for these measures. It is interesting as to how many ideologues of the Left and Marxist parties now make statements of this nature.

One of the main problems at present is that the administrative mechanisms of Sri Lanka are not in a very strong position to implement any of the desirable reforms that one would wish to see. For example, there would be no doubt that the open economy would be more effective if there was more effective control of smuggling and therefore fewer abuses. Some action has been taken recently but one cannot be sure whether this will be very effective or long lasting. Similarly one would like to see a more effective appraisal of investment to make sure that they are consistent with Sri Lanka's interests in terms of employment, technology transfer etc.

But presently there is no mechanism to undertake this task. Another problem is that as a result of the open economy there is more incentive for people to work in the private sector. The public sector does not command the kind of respect of the kind of people that it used to command.

Privatisation is Inevitable

It seems to me that privatisation is inevitable for two reasons. First it is inevitable because the Government is facing a very acute revenue crisis and is very keen to obtain revenue from various sources. Therefore, the sales of assets will considerably alleviate that problem. The second point is that it is very important for the Government to maintain the links with the international financial institutions. It would

Basically I am a believer of the re-organising of the world once every thirty, forty years. The public sector in Sri Lanka has got into a situation of stagnation and decline. But this doesn't mean that in ten or twenty years we will not see the costs of this privatisation. Then we might come back to more public ownership, or rather, effective public regulation.

Credit is too cheap

I think much of what is being said and written about the banking sector in Sri Lanka has been widely misunderstood. Generally it's said that the main business of the banks is taking deposits and lending money to private or public sector persons and institutions for investment (and even for a profit). But in fact, the main interest of the banks is not taking deposits or lending money, but un-

term investments in Sri Lanka actually come from international financial institutions.

Another consequence of this is that banks are only interested in lending money to already established companies in the mercantile sector who have been very good customers and will pay back quickly. One of the side effects of this is that banks really have no interest in lending money to speculative ventures, to small scale businesses, to people they don't know. For this reason, there is a great deal of unacknowledged foot-dragging when it comes to giving credit to small scale businesses and farmers. So there is some justification in the complaints of small scale businessmen that they find it difficult to get credit. But the problem is not that the credit is too expensive. The problem is actually that the credit is too cheap! If the banks have more remunerative rates of profit in lending money, then they will be more interested in finding new investments and therefore will be more receptive to small scale businessmen. The problem is that the way things are, the banks' interests lie rather in discouraging people – specially small scale people – from coming for money, than in encouraging them!

A restricted private capitalism

One other very significant aspect of financing investment in Sri Lanka is that almost all the investments are financed either by the internally generated profits of the companies or loans – particularly long term loans – which come at subsidised rates from international financial institutions. Hardly any company here goes to the stock market and asks private investors to subscribe capital for the investments. In this sense the capitalist nature of the Sri Lankan private sector has become somewhat distorted. **The private sector is certainly very capitalist but it is a very restricted private capitalism which is not open to much of the public.**

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be difficult for the Government to actually cut welfare expenditure for political reasons. Therefore, a vigorous privatisation programme is very much on the agenda.

There are worries however, that the privatisation has not been well managed in the sense that it is taking a long time. It's not very clear as to who is responsible for privatisation and there is some fear that the assets will not be sold in a very clear manner in the open market. It is also very clear that some of the larger Corporations will have to be sold to foreigners because Sri Lankans don't have that kind of capital to invest – certainly not to invest in majority shares. This may cause some problems, more of a political nature than economic. This is particularly so because most of these industries are likely to be monopolies or quasi monopolies one way or the other. Therefore one would like to ensure that the national interests are being looked after.

dertaking what is known as commercial services for the private sector, particularly for imports and exports – for example, letters of credit. One of the results of this is that banks on the whole in Sri Lanka do not have any investment bias.

There is also a very wide perception that banks have been very tight on credit and that lack of credit is a major problem in Sri Lanka. If anything, the opposite is true. In essence, most credit in Sri Lanka has been given rather cheaply. The rates of interest have been controlled and in a situation of high inflation, the interest earned by banks on credit has often been very small. The real profit margin is actually very small, sometimes even negative. This explains why banks have not made a great deal of profit out of lending money and have not been very interested in lending money – particularly for long terms and for major investment projects. In fact most of the long

One of the reasons is that private sector much prefers loans rather than raising capital from the public, specially because from the companies point of view, loans are much cheaper than equity. In the first place this is so because you can deduct the cost of interest of the loans from the tax, whereas the cost of paying dividends is not normally tax deductible. In the second place loans – especially long term loans – normally come under subsidised rates under aid projects and therefore they are much cheaper. In the third place because banks find it very difficult to recover assets in the case of defaults, the risk of the companies actually losing their assets if they make a bad investment through loans is very small. However, that now is changing.

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Another aspect is that you see very much the same names investing in all kinds of activities – whether it is tourism or garments or diamonds – simply because they have the advantage of an established monopoly position. What you don't see very much in Sri Lanka is new small people coming up on the basis of particular experience or particular knowledge. To that degree the Sri Lankan private sector is a rather closed privileged private sector.

I think it was Dr. N. M. Perera when he was the Minister of Finance who made allegations about a small number of families controlling the private sector in Sri Lanka. I think these allegations are probably not true. And there is certainly no available evidence that a small number of families control the private sector in Sri Lanka. But there is an important core of truth in what he said – which is that the private sector in Sri Lanka does tend to be controlled by individual families, that is to say in most cases a particular company is associated to a particular family. And the reason for this, on the whole, is the reason I gave earlier about the

sources of financing. These family controlled companies can go to banks to find money for investment. That way they don't actually have the share control of their companies, whereas if they go to the stock market to raise capital they would be forced to share control with those people who buy the shares. They would also be under much more pressure to perform well and if they don't perform, to change their management.

One of the results of the present rather closed family based system is that families often prefer to bring the sons into the companies and even if these individuals are not very good at running companies, they still maintain control over the company and manage to stumble along in some

way. If there are a large number of share holders who are really concerned about the returns on their investment then they would vote inefficient people out of the Board of Directors of their companies and there would be much more incentive to find more efficient managers.

In the long term interests of the economy and the private sector itself, something should be done about this. A number of things could be done. These include –

- * cease making the interest on loans from banks tax deductible and forcing debt repayment (this is being done). There is also the need to,
- * change company laws and to make all companies, whether public or private, disclose much more information to the public and to their investors than they presently do.

No tax rebates

A major problem in the economy is that the original source of export earnings, i.e. the plantation sector, specially the tea sector, has simply declined and that there has really been no substitute for the tea sector as an export earner. There are a number of reasons for that. One of

this is that the exchange rate policy and protection policy on the whole has not encouraged exporters. Solutions lie in a large number of areas. But one area in which solution does not lie is giving more tax rebates to the private sector. It is unfortunately true that in most cases the private sector policy is to simply ask for more reduction in tax, more tax holidays etc. In fact the private sector in Sri Lanka pays very little tax and I believe that this policy of asking for more and more tax rebates is misconceived – because the private sector pays such little tax, a tax holiday or a tax reduction is not much of an incentive.

Closed economy is no answer

I don't think the alternative to these problems lies in the closed economic model. I think the alternative probably is, on the whole, to get the public sector to direct the private sector much more efficiently. One example is that, as I stated earlier, any change in legislation and enforcing legislation to force more disclosure will dynamise the private sector. A great deal could be done to improve the efficiency of the public sector organization and to regulate the private sector. For example, the garment industry is facing enormous problems because this industry depends on a great deal of imports and a great deal of exports and it actually requires a great deal of recurrent government action the whole time. But the information which is available to the Government is often of a rather antiquated nature. The garment industry has long been trying to persuade the government to basically computerise the activities of the garment sector so that government knows what is being done in terms of allocation of resources etc. There is a danger now that the private sector is becoming much better equipped in terms of thing like computer information systems and in fact its becoming increasingly difficult for the government to find out what the private sector is doing, let alone regulate it or control it. So there is the need to improve the efficiency of the government and encouraging the private

sector, and I would say, putting a little pressure on the private sector.

I don't think privatisation is the essential issue. It is important partly because the government is in a serious revenue problem and partly because it is symbolically important to the World Bank and the IMF. But I don't think privatisation in itself can solve the long run problems.

A case for Land Reform

The policy of distributing State land to poor and landless people is a policy that has a very long tradition in Sri Lanka. I am all in favour of it, but I don't think there is much land to be given. So it seems to me that it is increasingly peripheral to the problem of landlessness. This is so also in terms of the kind of land that is available – most of the State land are rather poor marginal land. So what we are doing is scraping the bottom of the barrel – but it might be better than nothing.

One thing that I find interesting and in many ways regrettable is that the whole idea of land reforms has completely disappeared from the political agenda of Sri Lanka. Nobody talks seriously about land reforms any more. I think this is very unfortunate because there is a case for land reform by which I mean the re-allocation of some medium sized holdings particularly in the paddy sector. I think there would be less political resistance to this than in the past because most families who own land also have alternative sources of income now. If they are compensated adequately many families will be willing or less reluctant to give their land for re-distribution among poor people. But unfortunately redistributing private land has completely disappeared from the political agenda. May be that the experience of the last Land Reform in the early 1970's has been interpreted as being so bad that people are embarrassed by this issue.

I think there is also a problem of credibility. We will have to look back as to what kind of land reform took place in 1970's. On the whole they were not programmes to redistribute lands to farmers. The programmes were in fact to nationalise the land and to form co-operatives or collectives in some places. That kind of land reform is not practical or desirable. I think that there is a case for re-privatising the management of the tea sector as well as a case for land reform in the other sectors of agriculture. I think it will be politically timely and it would attract a great deal of support. ■