Sri Lankan officials offer empty reassurances over the global financial crisis

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7 October 2008

Like their counterparts in other countries, Sri Lankan leaders and senior officials are desperately seeking to play down the potential impact of the US financial crisis. Government ministers, including President Mahinda Rajapakse, who also holds the key posts of finance and defence, have remained virtually silent on the turmoil, no doubt hoping that it will not affect the economy or their costly communal war against the Liberation Tigers of Tamil Eelam (LTTE), which has helped drive inflation to record highs.

It was left to Sri Lankan Central Bank governor Ajith Nivad Cabraal to offer reassurances. He told the media on September 30, the day after global stock markets plunged: "Sri Lanka is unlikely to be very badly affected by the global financial crisis." He said the Central Bank was taking measures to restrict loans by banks in order to help avert Sri Lanka being hit by the crisis.

Comparatively the immediate impact on share prices has been small. As Cabraal was speaking the All Share Price Index (ASPI) in Colombo dropped by 43 points or almost 2 percent--but still smaller than many of the falls that hit other markets in far larger economies in Asia and internationally after the US Congress first rejected the Bush administration's $US700 billion bailout plan.

As various economic commentators noted, the limited character of the Sri Lankan economy may be working in its favour, initially at least. Former economics professor N. Balakrishnan told a Pakistani web site that because the financial market in Sri Lanka was "relatively small, so is the impact [of the crisis]." Retired bank executive R. Nadarajah said the chances of Sri Lanka being badly affected were "very remote, because we do not depend largely on foreign investments to sustain our economy".

The size of the Sri Lankan economy, however, is hardly a guarantee against the global financial storms and an international economic slowdown. In fact, the very lack of foreign investment in Sri Lanka--a product of the island's political instability and protracted civil war--is a symptom of its economic weakness and fragility. The country's annual GDP of just $30 billion is smaller than some of the banks in the US and Europe that have collapsed and less than one twentieth of the bailout package enacted by the US Congress last week.

Even as Cabraal was offering public reassurances, the Central Bank was preparing to grant Sri Lankan banks access to an overnight reverse repurchase facility at a rate of 12 percent, six times a month starting from October 2. Previously, this option was available only three times a month. The Central Bank also announced that it was ready to add 7.5 billion rupees ($69 million) to the banking system by reverse repurchasing of government bonds at the rate of 12 percent.

Clearly these steps were taken to shore up the banking system under conditions of a global credit crunch and a severe restriction on inter-bank lending. Sanjeewa Dayarathna, chief manager at Ceylinco Shriram Securities Company in Colombo, told *Bloomberg.com* that the Central Bank decisions would ease the tight overnight money market and were "likely to reduce panic selling of government securities".

A scandal involving a financial operator Sakvithi Ranasinghe has served to highlight the stresses within the financial system. Sakvithi took nearly a billion rupees in investors' funds into his housing company promising very high rates of return. His company was not registered as a financial institution with the Central Bank. Police had reported on the company's financial irregularities two years ago but no action was taken.

Sakvithi, who has fled the country, is now being presented as an outright swindler. But the state of the Sri Lankan economy has encouraged highly speculative or outright illegal financial activities because investors are desperate for high rates of return. The country's inflation rate is now around 30 percent, well above the normal interest rate range of 18 to 20 percent. Central Bank governor Cabraal warned last week that there were other "spurious institutions" offering returns as high as 84 percent that were "completely untenable in the present context."

The impact of the credit crunch will not be restricted to shady financial companies. Over the past two years, the Rajapakse government has repeatedly boosted the defence budget--by 20 percent for 2008. To pay for the cost of its war, the government has increasingly had to turn to the international money markets for funds, borrowing 181,449 million rupees in defence loans. Increasingly that source of funds will dry up.

In a report last week, international rating agency Standard and Poor's warned that the prospects for emerging markets were on the wane and listed Sri Lanka as one of eight countries with a "negative outlook," along with the Dominican Republic, El Salvador, Hungary, Kazakhstan, Pakistan, Serbia and Vietnam. It pointed in particular to the vulnerability of countries like Sri Lanka to any downturn in export markets in the US and Europe.

In his comments last week, Cabraal optimistically claimed that Sri Lanka's apparel sector would be "less affected [than usual] even if the US goes into a recession". According to the *Central Bank Annual Report 2007*, however, nearly 50 percent of Sri Lanka's textile and garments exports went to the US in 2007 while another 45 percent went to the EU. The sector is the largest source of foreign exchange earnings, accounting for some 43 percent of the total.

The Sri Lankan press is offering empty assurances to its readers that the present international financial storm will not affect the island. An editorial last week in the *Daily Mirror*, for instance, echoed European criticisms that "the root cause [of the crisis] is American-style capitalism".Over the weekend, however, a string of major European banks and institutions had to be taken over or bailed out, making clear that European capitalism is just as vulnerable as its American counterpart.

The state-owned *Daily News*, which functions as the government's mouthpiece, published an editorial last Friday declaring that the "worst fears appear to have been doused at least for the moment by a temporary bailout" in the US. After adding that the crisis demonstrated "the vulnerability of the global economy to the vagaries of the world's financial super power," the writer offered the hope that "being further away from the centre of gravity a country like Sri Lanka may not feel the immediate pangs of financial upheaval".

The editorial left no doubt as to the measures that would be used to deal with any economic emergency, declaring: "The present crisis once again drives home the need for economic prudence". This call is a thinly-disguised demand for savage new measures to slash government spending that will inevitably mean further deep cutbacks to public sector wages, conditions and jobs, social services and subsidies to assist farmers.

Austerity measures will be accompanied by an intensification of pro-war jingoism and further inroads into basic democratic rights as the government brands any opposition from workers, students and the poor as aid to the enemy--the "Tiger terrorists". Far from being "unaffected" by the global financial upheavals, Sri Lanka is likely to plunge even more deeply into what is already a severe political, economic and social crisis.