

## **Ajith Nivard Cabraal: Practical, not conventional, wisdom has driven Sri Lanka's rebuilding and reconciliation**

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About five years ago, Sri Lanka faced three daunting economic challenges. To deal with those challenges, the Sri Lankan authorities implemented certain pragmatic strategies that challenged conventional wisdom.

At the time of defeating terrorism in May 2009, a massive investment was required to restore normalcy in the terror-torn Northern Province. Conventional wisdom suggested that the rebuilding, rehabilitation and restoration should be carried out at a moderate pace, without burdening the economy unduly, and without placing government expenditure under stress.

However, even at the risk of experiencing a spike in the fiscal deficit in the years 2009 and 2010, Sri Lanka executed a rapid action plan to de-mine land, re-settle IDPs, and upgrade infrastructure in the war-affected areas. That investment brought quick relief to the hundreds of thousands of people who had suffered during the 30 year war.

The cost? A staggering US\$ 3.2 billion over 4 years, or nearly 6% of GDP! The direct benefit? Rapid clearance of over a million landmines from the Northern Province: speedy resettlement of nearly 300,000 IDPs; early restoration of the infrastructure: considerable progress in agriculture, fisheries and SME activity: significant increase in industrial production and domestic tourism: major transformation in the financial sector; and creation of new entrepreneurs and job opportunities;

The overall outcome? A peaceful country without a single terrorist incident; significant country-wide economic growth; and sharp reduction in poverty levels. These incredible outcomes vividly reflected the extraordinary benefits that had been reaped via practical wisdom!

Around 2008, the country was trapped in a "vicious cycle" that had hampered growth since independence: high fiscal deficits leading to high inflation; high inflation leading to high interest rates; high interest rates leading to low investor confidence; low investor confidence leading to sluggish investment; sluggish investment leading to lower growth than potential; lower growth and high fiscal deficits leading to unfavorable debt dynamics which in turn, impacted fiscal deficits adversely. This vicious cycle was deep rooted, and many Sri Lanka's economists who subscribed to conventional wisdom used to lament that this cycle was the country's "karma" (fate), and that it would be impossible to break free from that grip!

To escape, a radical change in policies and perspectives was needed, and Sri Lanka responded by introducing several bold policy initiatives across several fronts: excessive monetary expansion was contained through unconventional monetary policies such as tight quantitative tightening; recurrent fiscal expenditure was curtailed while preserving public investment for infrastructure development; monetary and fiscal policies were-coordinated to bring about overall macroeconomic stability; new foreign investment was targeted through a steady pipeline of major projects and investments in government bonds. These new measures led to an average annual growth of 7.5% over the four years, 2010 to 2013 and thus, the vicious cycle was converted into a new virtuous cycle, with inflation in single digits, shrinking debt to GDP ratios, and low interest rates.

In 2009, Sri Lanka also faced another major challenge: the threat to its external account. The effect of Global Financial Crisis had impacted Sri Lanka, and large scale overseas bond redemptions had resulted.

It was soon clear that some external support was required to stave off this challenge, and Sri Lanka decided to avail itself of the IMF facilities via a stand-by arrangement (SBA). The key

objective of the SBA was for Sri Lanka to build up its foreign reserves to more comfortable levels to meet the uncertain global environment.

The issue however was that the IMF, in its conventional wisdom, was insisting that Sri Lanka sharply depreciates its currency in order to curb its trade and current account deficits which, in their view, would help the country to build up reserves. The IMF also held the view that Sri Lanka must significantly increase government revenue by raising taxes.

In theory and normal circumstances, IMF's suggestions may have had merit. However, the Sri Lankan authorities who had a deep practical understanding of the socio-economic challenges facing Sri Lanka, held a different view.

The authorities' view was that since the conflict had ended, there was an urgent need to reconstruct the terror-affected areas, which covered almost one third of the country's land mass, and two thirds of its coastal belt. New economic activities had to be promoted for the peace dividend to be realized. Such new activities would necessitate a high import expenditure, which in turn, would create new capacity for economic growth.

In such circumstances, if the Sri Lankan Rupee were to depreciate sharply, it would lead to a significant reduction in the imports necessary for reconstruction and a slow-down of new economic activities. Those outcomes, together with the resulting higher levels of inflation would have kept Sri Lanka trapped in the vicious cycle.

Accordingly, through negotiations, the Sri Lankan authorities were able to convince the IMF that Sri Lanka would commit itself to building its reserves, but would do so, while allowing the exchange rate to adjust according to economic fundamentals and market conditions, instead of forcing an artificial, sharp depreciation of the currency. The Sri Lankan authorities also took the view that lower tax rates would spur growth and ultimately increase revenues, and based on such view, they were able to convince the IMF that it would be better to lower tax rates and encourage economic activity. Subsequent economic outcomes have since confirmed the wisdom of both these moves by the Sri Lankan authorities!

Although this trio of major challenges have now been effectively addressed through the application of unconventional wisdom, Sri Lankan authorities realize that they must continue to practice innovation in order to reach their long term goals. At the same time, Sri Lanka must also preserve the country's peaceful environment and political stability, in order to make these outcomes sustainable.

In this regard, Sri Lanka is now facing a fresh challenge, where human rights advocates of the US and the West, are focusing on the last phases of the 30 year war on terror, and raising certain human rights issues and prescribing various "foreign" solutions to those perceived issues. In this situation too, just as conventional economists did not appreciate the practical benefits of the innovative economic strategies, theoretical human rights activists also do not seem to appreciate Sri Lanka's strategy of ushering long lasting peace to its communities in a practical and effective manner, without inflicting further anxiety, pain and anguish on the people.

Sri Lanka is a vibrant, practising democracy and a country with a 2500 year history, emerging out of a long and bloody conflict. It has the maturity and the ability to deal with issues confronting the country, in accordance with its own systems, culture and democratic traditions.

So far, all Sri Lankans have been able to enjoy peace, by practising a hybrid system of restorative justice and rapid economic and political development. In that background, it is vital that the country is not pushed into "foreign-grown" solutions of international agencies and others, who unfortunately, sometimes appear to be influenced by certain human rights crusaders, who have been well-known terror activists in the past.

It is also worthy to recall that, in its commitment to the principle of restorative justice following the conflict, the Sri Lankan government has already granted amnesty to more than 11,000

former Tamil Tiger terrorists, some of whom have even committed grave crimes. In such circumstances, if the government were to open new investigations as proposed by some, it could turn the clock back and cause great anxiety to those offenders who have been forgiven, and may even lead to some of them reverting back to violence. At the same time, some of the proposed “foreign” interventions that seem to be narrowly focused on the conduct of the Sri Lankan armed forces only, could also be construed as unfair and/or selective treatment towards the Sri Lankan armed forces who defeated terrorism, and could lead to a consequent de-stabilization of the country.

Practical wisdom would therefore suggest that reconciliation between communities must be allowed to follow a “home-grown” path in keeping with the time and space as set out by those who suffered the agony of terror, and those who are today responsible for maintaining the peace in the country. Needless to say, such reconciliation cannot and must not be “imposed” by foreigners who do not carry the burden of being responsible to the Sri Lankan people.

As every Sri Lankan living in the country would readily acknowledge, Sri Lanka’s overall objective in defeating terrorism was not only to win the military battle, but also to place the country firmly on a sustainable path of peace, prosperity and growth for all of its people. For that objective to be achieved, Sri Lanka must follow its own time frames and priorities, and if need be, challenge conventional wisdom as proposed by outside parties, however well-meaning their intentions may appear to be.