# SRI LANKAN ECONOMIC SOVEREIGNTY: INSIGHTS OF POTENTIALLY ALARMING TRENDS

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***Abstract***

*This study attempts to examine Sri Lanka's macroeconomic evolutions which could be potentially harmful to national economic sovereignty. The study was based on time series secondary data for the time period spanning from 1970 to 2016. The operational methodology adopted is a descriptive statistical trend analysis on macroeconomic variables such as Gross Domestic Product (GDP), Gross National Income (GNI), Net Factor Income from Abroad (NFIFA), Exports, Imports, Current Account Balance and Foreign Debt. The findings of the study revealed that the adverse Trade Balance ever since the liberalisation of the Sri Lankan economy in 1978 has been behind much of the ill-effects resulting in heavy foreign indebtedness. Growing factor payments abroad as a ratio of GDP provides suggestive evidence of gradual weakening of national ownership of the Sri Lankan economy. The findings of the study indicate that the solution for such malaise possibly exists in policies anchored outside the hitherto adopted mainstream economic doctrine.*

***Keywords:*** *Economic sovereignty, External debt, GDP, GNI, NFIFA, Sri Lanka.*

***JEL Codes: E60, E61, F52, F54, F62***

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## BACKGROUND

The relative magnitude of the citizen's ownership of an economy could be a reflection of the economic sovereignty of a nation. Hence, greater the sovereignty of a nation, the greater the ascendancy to conjoin the political reign and cultural roots to establish a country's identity in the world (Pick, 2011). It is in this paradigm that comparative economic development of low and middle-income nations may be analysed, where most such countries appear losing national ownership of their economy with the dawning of neoliberalism empowered by its prime agenda, namely the economic openness. It is generally asserted that globalization perforates national boundaries, or that it renders borders obsolete. In an economically integrated world, governments have no alternative but to adopt neoliberal economic policies of privatisation, deregulation and reductions in public expenditure (Quiggin, 2001). Thus, amidst expanding economic openness, upholding national economic sovereignty, a multiplex terminology itself, becomes a pertinent question.

In assessing claims about economic openness and national economic sovereignty, it is prudent to observe that sovereignty itself is a multiplex terminology. According to Krasner (1999), sovereignty could be discerned based on four notions: (a) *International legal sovereignty*, which is the ratification of a given nation as a member of the international community; (b) *Westphalian sovereignty*[1], pedestalled on the postulate that one sovereign State should not interfere in the domestic arrangements of another; (c) *Interdependence sovereignty*, representing the scope and desire to control flows of people, goods and capital into and out of a State; and (d) *Domestic sovereignty*, being the potential of a State to designate and impose policies within its territorial boundaries. However, in this study, the authors would like to perceive sovereignty through an economic sense as well. Hence, a fifth dimension, namely "*economic sovereignty*" would be a nation's ability to superintend its economic system, safeguarding not only the State's economy but also its political reign and cultural, and traditional identity as a nation-State in the world.

Neoliberalism, on the other hand, could be viewed as the architect of the so called "openness". Harvey (2007), for instance, conceded neoliberalism as a manifestation of "creative destruction". The term 'Washington Consensus' was brought to the lime light in 1989 by John Williamson. It emerged as the fashion after the crisis of mid-1970s when Keynesianism failed to solve it. Neo-liberalism thereby become the new orthodoxy. According to Mavroudeas and Papadatos (2007), neo-liberalism and Washington Consensus are two sides of the same coin; which, together, ensured that most of the countries in the world opted for opening their economies in the 1980s.

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[1] The origins of Westphalian sovereignty have been traced in the scholarly literature to the Peace of Westphalia (1648).

Sri Lanka stepped into this system by liberalising her economy in 1978. It became the first South Asian country to open up its economy to the rest of the world. While the balance score card pertaining to this strategic shift could be viewed and perceived at different angles, this study attempts to look at its impact on Sri Lankan nation's economic independence, a stated objective when the country gained political independence in 1948, and when it became a Republic in 1972.

## MATERIALS AND METHODS

### A Reflection on Literature

In spite of the prodigious vacuum of literature on the relationship between openness and national economic sovereignty in both local and international arena of research, a number of important works on assessing the impact of globalisation on national sovereignty, could be found in literature.

Quiggin (2001)'s study on the relationship between globalisation and economic sovereignty, is an example. The general objective of it has been to assess globalisation as an exogenous force that undermines domestic economic sovereignty. Having adopted a qualitative approach supported by a review of literature in this domain, the study could bestow little support to the view of globalisation as an exogenous force that has undermined domestic economic sovereignty of nations. Yet, Quiggin (2000) contended that financial globalisation could be best interpreted as the international counterpart of domestic neoliberalism.

Jotia (2011) analysed globalisation and the nation-State granting more emphasis on national welfare. According to him, globalization, though could not be pushed back by nation-States, is generally challenged by miscellaneous responses from all over the world. He further proposed that globalisation process had its impacts on the nation-State under political, economic and cultural spheres. It concluded that globalisation would thence impact on the internal education system and policies, and ultimately on the identity of citizens and on the very autonomy of the nation-State.

Monk (2011) researched sovereignty in the era of global capitalism. The globalisation and financialisation processes have pushed the institutional logics of the capital market and the bureaucratic State in to association at a rapidly increasing rate. Moreover, the capitalist power of financial markets threatens the governments in the world, from communist to the most conservative, causing them lose their grip on national economy.[2]

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[2] However, the author argued that, in order to counter aforementioned threat, nations have placed trust in sovereign wealth funds. This, in turn, is an attempt by States to leverage finance and filter global

Grinin (2012) evinced that globalisation undoubtedly contributes to the change and reduction of the scope of State's sovereign powers. It attempted to identify how and why the scope of State sovereignty has lost through the process of globalisation. More importantly, the study identified transformation factors of State sovereignty under two spheres: First, States lose their sovereignty due to global threats such as global financial flows, multinational companies and global media corporations. Second, States sometimes voluntarily reduce their sovereign power in order to join supranational alliances, international organisations and to gain extra prestige and benefit.

Ku and Yoo (2013) analysed globalisation in the notion of expeditious movements of goods and services, people, capital and information which erode a nation's capacity to regulate its territorial activities. Accordingly, a country's efforts to solve adverse impacts of globalisation by being opposed to neoliberal organisations, is premature and inconsistent with persistent power. Rather than rejecting such organisations, Ku and Yoo (2013) proposed middle path to safeguard sovereignty of a nation.

According to Savanovic (2014), economic sovereignty would be synonymous to "absence" of budget deficit and subsequent freedom from indebtedness to foreign creditors (commercial or institutional), financial stability of the State, regular servicing of the budget and ability of the State to independently decide on its own policies. Thus, sovereignty of a nation-State would be compromised through proliferation of capital, and also due to inability to resist the power of multinational corporations, in relation to taking over of resources and imposition of political decisions.

Marsonet (2017,) anatomised national sovereignty and globalisation, and viewed globalisation as a phenomenon which entails the rising magnitude, impetus and momentousness of flows within and across borders of people, ideas, goods, money, and much else, challenging the very principle of national sovereignty. Accordingly, globalisation has crumbled national sovereignty in to pieces or it has caused the borders outworn. Hence, current governments have no alternatives, but to embrace the neoliberal economic policies of privatisation, deregulation and limiting public expenditure, he argued.

## Justification and Focus

Almost all these studies recognise that globalisation as a phenomenon imposes an impact, often adversely, on the sovereignty of nation-States. However, none of these have empirically examined the economic impacts of liberalist economic policies on the evolution of macroeconomic parameters reflecting national sovereignty of any given

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capitalism's adverse forces. Thus, sovereign wealth funds are expected to safeguard the local autonomy and State sovereignty by enhancing nation's control on its finances.

nation. On this backdrop, the present study attempted to fill this research gap by comparatively examining the Sri Lankan economic evolution through analysis of secondary data, in view of tracing the influence of neoliberal political economic ideological trends on the country's economic sovereignty. The study also perused to discuss feasible alternative economic policies to safeguard the sovereignty of the nation through its future economic evolution.

### Methodology Adopted

The study analysed time series secondary data for the period spanning from 1970 to 2016, sourced from the Annual Reports of the Central Bank of Sri Lanka and World Development Indicators, published by the World Bank. Descriptive statistical trend analysis on macroeconomic variables such as Gross Domestic Product (GDP), Gross National Income (GNI), Net Factor Income from Abroad (NFIFA), Exports, Imports, Current Account Balance and Foreign Debt, were adopted as research methodology to derive inferences.

## RESULTS AND ANALYSIS

United Nations' General Assembly gathered on 2nd March 1995, clearly stated that national sovereignty is undeniable and incontestable by any external force. It also enumerated that "the principles of national sovereignty and non-interference in the internal affairs of any State should be respected in the holding of elections", and also that there is no single political system or single model for electoral processes equally suited to all nations and their peoples, and that political systems and electoral processes are subject to historical, political, cultural and religious factors" (United Nation, 1995). Further, the World Trade Organisation, in its report[3] titled "The Future of the WTO", succinctly defined the concept of sovereignty: "First, a sovereign State is one that enjoys supreme political authority and monopoly over the legitimate use of force within its territory (Sutherland et al, 2004). Second, it is capable of regulating movements across its borders. Third, it can make its foreign policy choice freely. Finally, it is recognised by other governments as an independent entity entitled to freedom from external intervention" (Sutherland et al., 2004).

Aforementioned quotes clearly elucidate the supreme importance of national sovereignty. Since economic sovereignty is closely tied to national sovereignty, a depletion of economic sovereignty leads to nation losing its national sovereignty, and vice-versa. Hence, an examination of a country's economic sovereignty becomes important in view of understanding the status of the country's national sovereignty. It is for this reason that

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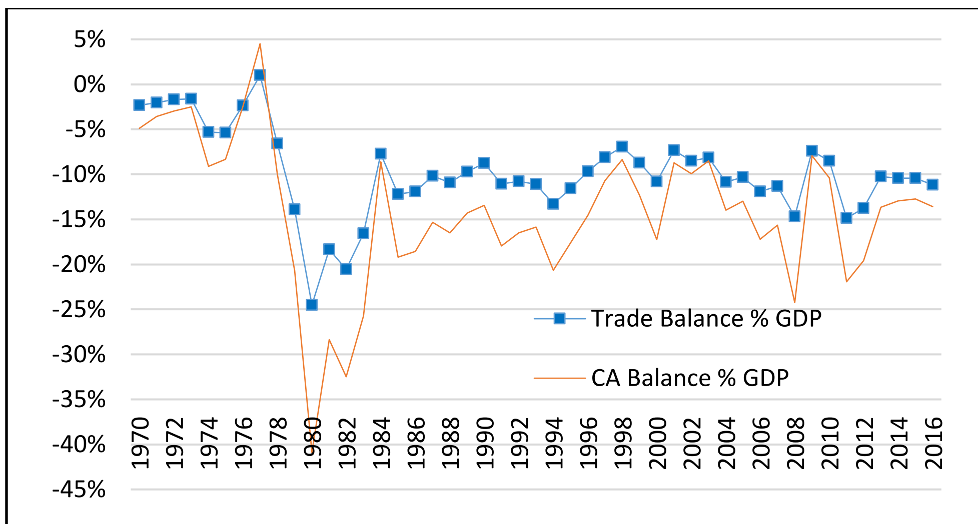
[3] A Report by the Consultative Board to the former Director-General Supachai Panitchpakdi (WTO, 2005)

the present study used macroeconomic variables such as Gross National Product (GDP), Gross National Income (GNI), Net Factor Income from Abroad (NFIFA), Exports (X), Imports (M), Current Account Balance (CAB) and Foreign Debt (FD), also deployed by John Maynard Keynes (1936) in examining national economies, in view of assessing the level of national economic sovereignty of Sri Lanka, and its evolution over the years.

The first to focus was external trade and its evolution. Strong and positive trade balance would reduce the necessity of foreign borrowings, and thus, would help reduce relative foreign debt, strengthening the international standing of the national economy and thereby, the national economic sovereignty. The opposite will be the result if an economy experiences persistent trade deficits. As trade liberalisation, within neoliberal ideology, was believed to facilitate and promote exports, one would logically expect to observe improved trade balance, associated with more accentuated trade liberalisation.

To examine this, Sri Lanka's trade balance as a share of GDP was worked out for the 46 year period from 1970 to 2016, and graphically depicted (Figure 1).

**Figure 1: Sri Lanka's Trade Balance and Current Account Balance as a share of GDP [1970 – 2016]**



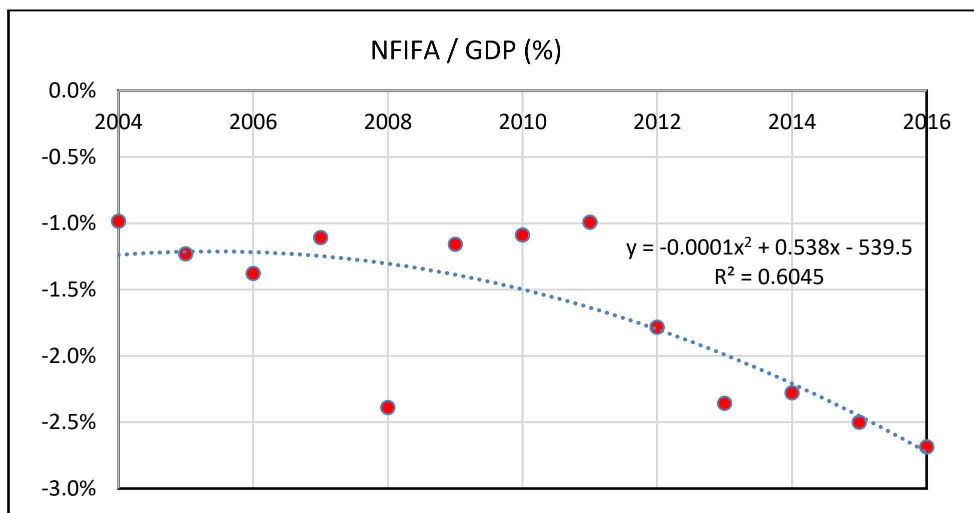

Source: Based on World Bank Data (World Development Indicators)

It is clear from the patterns that the trade balance had been seeing improving from 1974 (after the international oil shock in 1973) until 1977, and yielded a positive trade balance of 1% in the singular year of 1977, an apparent result of intensive adoption of import substitution policies during that period. Sri Lanka's trade balance nose-dived immediately after 1978, the very first year of statistical data availability after the newly elected right-wing Government of President J R Jayawardena introduced liberal economic policies

after his party's electoral victory in 1977. The trade balance remained heavily negative throughout, and until to date, could be direct results of this myopic decision to liberalise trade (Gunaruwan, 2017). The deterioration during pre-1981 period is noteworthy, because no internal insurgency that could be advanced as an excuse during this period. Thus, it is clear that the Sri Lankan experience brings no empirical evidence to support the hypothesis, that liberalisation policies would bear positive influence over the evolution of trade balance in developing countries.

The Current Account balance as a percentage of GDP also indicated a similar trend pattern (Figure 1), which has seemingly provoked the subsequently observed worsening of the external accounts of the nation, aggravating the country's exchange and debt crises. Hence, the evidence from Sri Lanka does not support the hypothesis that liberalisation facilitates trade balance or national sovereignty improvement; but, appears to help infer the contrary.

**Figure 2: Net Factor Income from Abroad as a share of GDP [2004-2016]**




Source: Author developed, using World Bank Data (World Development Indicators)

Net Factor Income from Abroad (NFIFA) is yet another momentous macroeconomic variable which mirrors a country's national economic sovereignty.[4] This is because, factor payments represent to what extent the returns on factors of production, earned in Sri Lanka, are expatriated, and factor incomes represent the inverse. The former is a proxy for "foreign ownership" of factors operating within the domestic economy, while the latter could be perceived as an indicator as to "Sri Lankan ownership" of off-shore factors of production. Thus, the evolution of NFIFA, generated by subtracting factor (or,

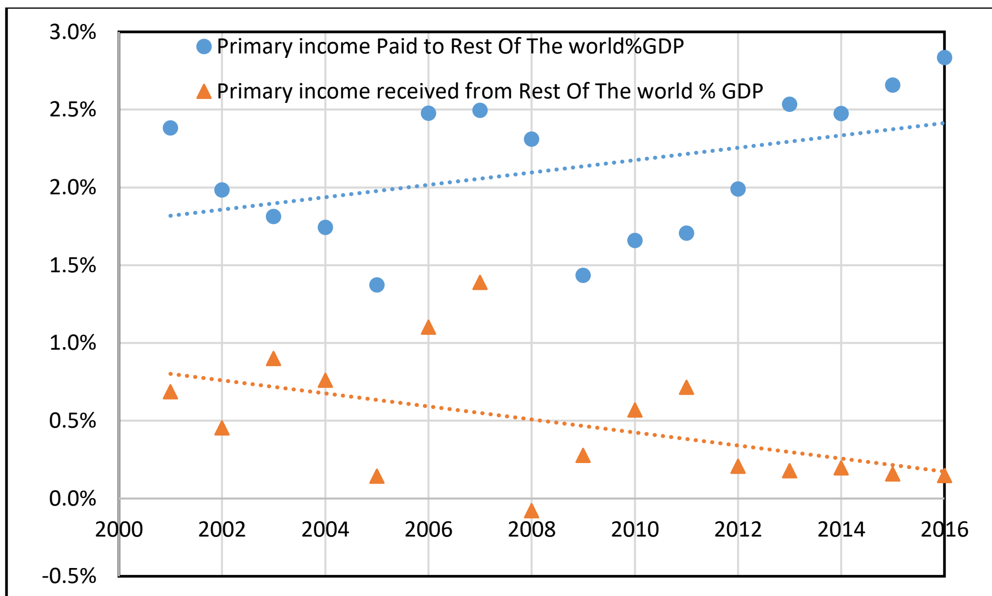
[4] NFIFA=Factor earnings from abroad – Returns earned by foreign-owned factors

"primary") income paid to the rest of the world from factor (primary) income received from abroad; a negative trend in NFIFA indicating increasing net outflows, reflecting loss of national footing of domestic economy much faster than Sri Lanka gaining ownership of factors in foreign territories.

NFIFA pertaining to the Sri Lankan economy were therefore appraised for the period between 2004 and 2009, expressing the net factor incomes as a percentage of GDP (Figure 2, above). It could be observed that NFIFA showed a negative trend throughout the period under the study; the ratio hovered below zero percent up to 2009, and experienced a greater decline in the negatives thereafter (Figure 2).

Factor (or "primary") income received from, and paid to, the rest of the world as a percentage of GDP were analysed in segregation to identify their relative contribution towards the drop of NFIFA (Figure 3).

**Figure 3: Factor Incomes Received and Paid as a share of GDP [2009 – 2016]**




Source: Author developed based on CBSL Various Annual Reports

The study reveals that, as a percentage of GDP, primary income received from abroad recorded a downward trend while primary income paid to the rest of the world has taken a significant upward trend during the post-conflict period.

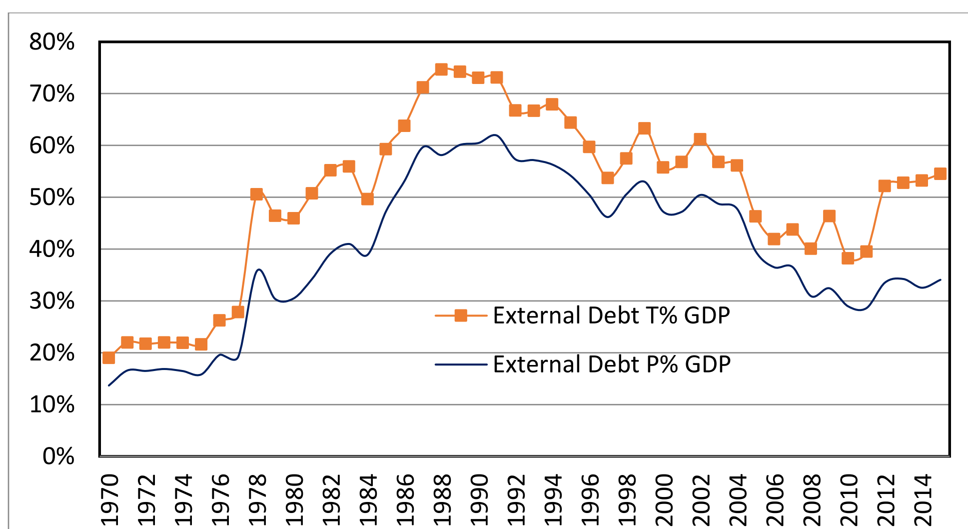
The factor payments abroad include wage (returns on labour), interest (returns on capital) and profit (returns on entrepreneurship) outflows from the economy. Therefore, the factor payments as a ratio of GDP could reflect the share of domestic value added "expatriated", and thus, the level of the national economy "owned" by foreign economic forces. This

trend, therefore, is a clear indication that, day by day, Sri Lankans lose ownership of their country's national economy, a reflection of weakening economic sovereignty.

The inevitable outcome of a persistent deterioration of trade balance, combined with deteriorating net factor incomes as a share of GDP, would be foreign exchange starvation of the national economy. It is only natural that such an economy would have to resort to foreign borrowings to meet foreign exchange deficits; a further deepened dependence on foreign support, thus, exposing the national political economy to foreign dictates undermining the scope for national sovereignty.

To empirically verify this postulation vis-à-vis Sri Lanka, the evolution of External Debt (both "public" and "total") as a percentage of GDP was examined (Figure 4).

**Figure 4: External Debt (Total and Public) as a share of GDP [1970 – 2016]**



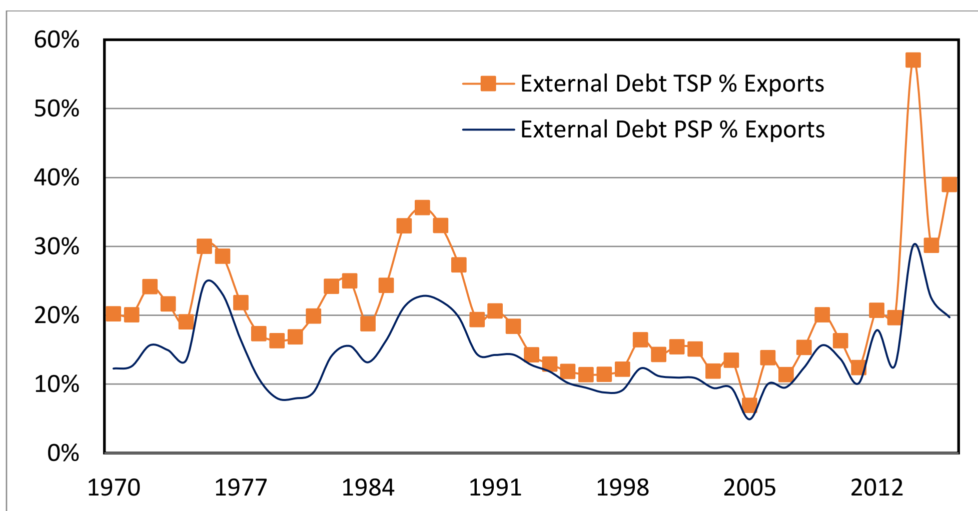

Source: Author developed based on World Bank Data

The analysis revealed that the External Debt ratio averaged around 25% prior to 1978, had a significant structural break to the upward direction in 1978, and increased gradually ever since to peak at 75% in 1988. This significant rise in external debt ratio is a manifestation of the augmentation of external debt of the economy at a faster rate than the GDP growth rate up to 1988. The two decades between 1988 and 2008 indicated a gradual improvement of the external debt ratio of the economy, indicating that the GDP growth rate has stood higher than the growth rate of Debts, possibly because of (a) the relative slowing-down after 1980s of borrowings, which were high during the immediate aftermath of liberalisation largely owing to public investment on large-scale development projects such as Mahaweli, (b) the growth impetus of such investments, particularly in irrigation and power generation, starting to yield in subsequent years, and (c) relatively

smaller Current Account deficit as a share of GDP experienced during this period, as could be observed in Figure 2. However, statistics indicate that this relative improvement has not been sustainable, and has once again taken an upward turn since the end of the internal conflict in 2009.

It is curious to note that the external debt burden as a share of GDP, a key determinant of foreign dependence of the national economy, which had undergone a favourable downward trend through the period of internal conflict, has started worsening ever since the defeat of terrorism. The natural expectation would have been the inverse, as an end of resource-eating internal conflict should theoretically have saved a significant amount of financial and economic resources. While the causes for this unusual pattern needs further investigation in a different research, it could be preliminarily hypothesised that the positive economic outlook secured by the country internationally would have upgraded the "creditworthiness" of the economy, enabling the economic management to borrow at ease from international sources, leading to indiscriminate spending, without adequate feasibility appraisal, on large-scale infrastructure development projects with long gestation periods.[5] This would possibly have prevented the economy from achieving a higher level of investment productivity (in other words, a lower level of Incremental Capital-Output Ratio) during the post-conflict period, and would have led to aggravating Foreign Debt to GDP ratio in the aftermath of 2009 (Gunaruwan & Jayasekera, 2012).

**Figure 5: External Debt Service Payments as a share of Exports [1970-2016]**



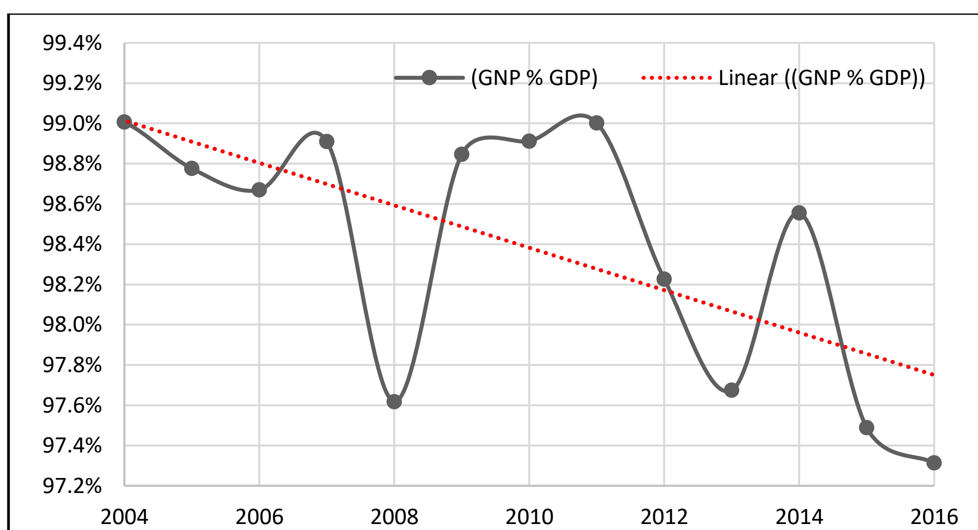

Source: Author developed based on World Bank Data

[5] Bilateral loans, in particular, which usually are tied to donor-execution of projects, and do not allow for granting contracts for local enterprises, nor that those permit competitive bidding for contracts. Thus, this mode of public project financing is heavily and unnecessarily capital intensive, and least investment productive. Many Port, Road and Railway infrastructure development projects implemented during post 2009 period fall into this category (Gunaruwan & Jayasekera, 2012).

There is no doubt that high external debt burden is a clear reflector of the external dependence of the national economy of any country, which puts the economic sovereignty of a nation at risk. Thus, as revealed above, having over 50% Foreign Debt ratio as a percentage of GDP, could not be considered as an indicator of Sri Lanka being in a comfortable zone vis-à-vis national sovereignty. For this reason, the study went into examining the foreign debt burden of Sri Lanka, particularly the capacity of the economy to service its external debts. This is because, the Foreign Debt ratio, computed by dividing the total foreign debt (payable in foreign currency) by the country's GDP (earned within the economy, and in rupees), is unable to describe the country's capability of servicing debts.

The above analysis indicates several fundamental ailments in the Sri Lankan economy when it is perceived at a national economic view-point: First, the trade deficit appears to continue unabated, which could be recognised as the most fundamental and long-term weakness of the economy. Inadequate export growth and lack of policy focus to develop local industries to substitute for imports appear to be the crux of the matter (Gunaruwan, 2016). Next, over-dependence on external debt appears to have made the national economy vulnerable to external shocks and influences. Rising debt service payments, together with falling exports and increasing imports, have made the country's ability of servicing foreign debt rather weak. Third, the rising factor payments abroad appear to prompt at augmenting foreign ownership of the country's economy, leading to gradually weakened Gross National Product (GNP) in comparison to Gross Domestic Product (GDP). Figure 6 depicts this negative trend of GNP/GDP Ratio over the years.

**Figure 6: Gross National Product / Gross Domestic Product [2004-2016]**




Source: Author developed based on data published in the CBSL Annual Reports (Various Issues)

This mirrors that the domestic means of production becoming increasingly “foreign-owned” and increasing amounts of factor returns being expatriated, while no parallel gains abroad are made by Sri Lankan factors of production. This is a clear indication of Sri Lankan nation being “impoverished” of “ownership” of economic production means; not only in terms of failing to expand into economic activities abroad, but also in losing control of those within her own economy.

## CONCLUSION AND POLICY RECOMMENDATIONS

Sri Lanka has been following the path of liberal and neoliberal economic policies since 1977, and this main economic policy stream did not change ever since, even though a number of decelerations that could be observed intermittently. Hence, the economic balance sheet, particularly vis-à-vis nation’s economic sovereignty, is undoubtedly attributable to this economic policy adopted. Meticulous analysis in this study of selected macroeconomic variables undeniably manifests that this purblind adoption of liberal and neoliberal policies, either under the dictates of international financial organisations and their *Structural Adjustment Programmes* or blindly and dogmatically following the *Washington Consensus* policy guidelines (Williamson, 2003), has triggered an adverse economic process, which has gradually driven the Sri Lankan economy towards losing its ownership; thus, significantly eroding its national economic sovereignty.

It is pertinent, however, to observe that economists and policy makers attempt to find solutions to the present economic crisis within the same economic policy paradigm of neoliberalism. For them, the causes of the crisis appear found in “shortfalls” or “lapses” of strict adherence to neoliberal policy prescriptions by the successive Governments (Mirowski, 2013), and not in the policy prescriptions themselves. This may be why they recommend further broadening and deepening economic liberalisation as remedy to the problem (Kanaan, 2000). It is on this premise that further privatisation of public assets, facilitation of foreign investment, pruning of the State budget implying reduction of public investment and welfare expenditure, and further liberalisation of trade through bilateral and multilateral trade agreements, inter-alia, are contemplated as way out of the economic malaise.

While it might not be irrational to hypothesise that what was “not done” in the list of standard neoliberal prescription as the crux of the problem, it is inconceivable to ignore the possibility that the neoliberal policy prescription itself could be the problem. Not only that these liberal prescriptions have failed to produce the intended growth and development impetus, but also that those are clearly counter-productive towards economic decision making authority of the nation-State, and thereby towards national sovereignty of developing countries such as Sri Lanka.

Therefore, it is high time that Sri Lanka scrutinise beyond the hitherto resorted mainstream economic dogma. An innovative economic policy paradigm, empowered by national economic orientation, overcoming the unpropitious cage of the neoliberalism, appears to be necessary in order to prevent the economy dripping into incurably grave malaise, while safeguarding the sovereignty of the nation-State, and to search for sustainable and appropriate strategies for economic development.

Such alternative policy search may not ignore, among others, the lessons that could be learnt from implementing pre-1977 economic policies, which evidently managed to build a domestic production base, granted national preference in public procurement stimulating local investment and entrepreneurship, and achieved the last ever recorded positive trade balance in the latter half of the 20th Century. It might also be worth that the Sri Lankan policy makers look for home-grown solutions, including those strategies to strengthen grass-root economic forces seeking a greater degree of self-sufficiency, to promote domestic multiplier effects through creation of forward and backward economic linkages, and to explore possibilities of import substitution to combat the dreadful deterioration of trade balance. With regard to the latter strategic axis, an attitudinal change may be contrived amongst Sri Lankan citizens to get rid of their apparent fancy for foreign products, and to prefer and fashion locally produced goods and services against those imported, stimulating a consumer preference drive to import substation, which might even be more effective and sustainable than tariff interventions in that favour.

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