

Contents

NOTES AND COMMENTS 03

FOCUS ON THE ECONOMIC
CRISIS 6-31EMERGING ECONOMIES IN A SEA OF
GLOBAL FINANCE 6*Paul A. Volcker*THE CRISIS OF GLOBAL
CAPITALISM 11*George Soros*

THE NEW CHALLENGE: 13

*G. Chris Rodrigo*THE EXTRA-ECONOMY OF THE ASIAN
ECONOMIC CRISIS 19*Janaka Biyanwila*IS ALL SO WELL WITH THE ECONOMY
AND WITH THE RURAL POOR? 22*David Dunham and Sisira Jayasuriya*

"ASIAN VALUES" AND REACTION 30

*Kanishka Jayasuriya*MARKETS, MELTDOWN
AND MARX 33*Eric Hobsbawm*SRI LANKA'S CHILDREN:
THE A.I. REPORT 36NEWTON GUNASINGHE - TRIBUTE
TO A SCHOLAR 39*Jayadeva Uyangoda*NATIONALISM, COMMUNALISM
AND NATIONAL UNITY 43*S. Arasaratnam*BUSINESS COMMUNITY'S APPEAL
TO POLITICAL PARTIES 51

Pravada in contemporary usage has a range of meanings which includes theses, concepts and propositions.

EAST ASIAN CRISIS: SRI LANKA IN A GLOBAL CRISIS?

Our focus in this issue is on the East Asian economic crisis and its likely consequences on the global economy. While East Asia, Russia and Brazil have been reeling with very serious economic difficulties, Sri Lankan economists and policy makers do not seem to demonstrate much academic or policy interest in the possible consequences of the crisis on our own economy and politics. This relative apathy perhaps has good reasons. Our capital account is not made convertible. The share of hot money "short-term foreign investment capital" in the economy still remains insignificant. Ours is not a trade-based economy. Our export markets are not as volatile as those of East Asian economies. Yet, will our economy be insulated from a possible global economic crisis? What would be the likely economic and political consequences of a major crisis scenario?

While Sri Lankan analysts are cautious in predicting a spread into our own economy of the East Asian crisis, the more articulate voices of Western capital have recently been showing a sense of an impending catastrophe. The Washington Post carried an editorial in September entitled "Rethink Capitalism" which was re-produced in the International Herald Tribune. George Soros, the biggest global investor in the world capital markets who lost nearly one billion dollars due to the East Asian and Russian crisis, gave evidence before the US House Committee on Banking and Financial services, warning of an impending crisis of global capitalism.

In September Soros was in away much more forthright than any of the professional economists at the World Bank and the IMF.

"The global capitalist system" he warned, "that has been responsible for America's remarkable prosperity is coming apart at the seams". Characterizing the recent decline in the US stock market as a belated symptom of more profound problems afflicting the world economy, the great financier went onto tell the US congress: "There comes a point when distress at the periphery cannot be good for the center". Readers may note the semi-Marxist metaphors which Mr. George Soros has used in this formulation.

Some leading economists even in the US have come out publicly to say that the World Bank and the IMF are not in a position to control the spreading world economic crisis. The IMF's problem in East Asia is that it cannot admit its guilt about what has happened in East Asia, while at the World Bank a debate is going on to identify where things have gone wrong. It is highly unlikely that a new policy consensus will emerge within the World Bank about what to do in the short and long run to avert a major world economic crisis. The Bank and the Fund cannot adopt neo-Keynesian solutions, as advocated by critics like Jeffrey Sachs of the Harvard University. There does not seem to be a strong realistic school among leading economists in Washington, D. C.

Meanwhile, a section of the American ruling class is engaged in one of the most narcissistic political exercises that can ever be imagined in a situation of a likely global economic crisis. The Republicans are truly obsessed with the idea of stripping their emperor of his clothes on charges of sexual misdemeanour, thereby bringing the entire US, the economic and political leader of

Pravāda

Vol. 5 No. 10 & 11, 1998

Editors

Jayadeva Uyangoda
Kumari Jayawardena

Managing Editor
Janaka Biyanwila

Executive Editor and
Circulation Manager
Rasika Chandrasekera

Pravada is published monthly by:

Pravada Publications
425/15, Thimbirigasyaya Road
Colombo 5
Sri Lanka.
Telephone. 501339, Fax. 595563

Annual subscriptions:

Sri Lanka	Rs. 300
By Air mail:	
South Asia/Middle East	U.S. \$ 28
S. E. Asia/Far East	U.S. \$ 28
Europe/Africa	U.S. \$ 30
Americas/Pacific countries	U.S. \$ 40

world capitalism, into an unprecedented political crisis. Propelled by an amazing spirit of ruling-class parochialism, the Republicans are threatening to impeach President Clinton, proving the point that Americans are imperialists with no imperial spirit. Otherwise, who would want to create political paralysis in Washington — the capital of the global empire — when the world economy is in a state of a virtual vertigo?

The idiosyncrasy of the right wing of the Americas ruling class is matched by political uncertainty in Japan. With a weak government, and growing collapse of its banks, Japan has been seeking more and more individualistic solutions to its own crisis. Europe is more pre-occupied with its own economic unification project. These are not signs of an immediate breakdown of the world capitalist economy. They merely point to the fact that the three leading locations of world capitalism the US, Japan and Europe are presently handicapped, in political terms, to manage the world crisis. Averting a world-wide economic crisis is as much a political exercise, as it is an economic one.

There are two possible developments that may turn the present East Asian situation into an economic nightmare. The first is the continuing collapse of Japanese banks, forcing the Japanese government to resort to short-term measures aimed at saving the Japanese economy, with little or no concern for their consequences for the American economy. The second is another devaluation of the yuan, the Chinese currency. As some analysts argue, in the absence of an internationally coordinated plan to arrest the spreading financial crisis, Japan and China are likely to take steps to safeguard their own national economic interests.

In any case, even the most measured of the predictions for the next few years indicate a truly bad time for the developing countries. The UNCTAD is worried that during the next year economic growth in the developing world might fall by half, to 2.5 percent. UNCTAD's worst scenario is for East Asia. Indonesia's output is expected to decline by 12 per cent, while South Korea and Thailand will suffer 6 to 8 percent decline. China and Hong Kong may not be affected so severely, yet the projected decline in output there is 2 percent. UNCTAD study concludes that the recovery in the region may not be possible for several years to come.

Sri Lanka's economic future in the short-run is not likely to be as disastrous as it has been in Malaysia or Indonesia. But if the crisis begins to hit the global economy as a whole, Sri Lanka may find it extremely difficult to safeguard her economy from a tidal wave of such a crisis. A continuing fall in export prices, a decline of the rupee, a rise in the rate of inflation and a downward tendency in the stock market, these are not unlikely scenarios, even within the next six months. The combined effect of such developments will throw into disarray Sri Lanka's macro-economic targets that have been set under conditions of a favourable world economic atmosphere.

Sri Lanka's real challenge would be the political consequences of an economic downturn. An economic crisis will first be felt in the viability of continuing the present level of defence expenditure. Only

last month, the government obtained parliamentary approval for rupees 12 billion as additional defence expenditure, totalling the years defence budget at rupees 58 billion. The Northern war has also reached a phase of intensity, as indicated in the Paranthan-Killinochchi-Mankulam battle. Continuous funding of a highly intense war would compel the government to direct more resources to the defence budget, resulting in macro-economic distortions. A rising budget deficit, further inflation, continuing rise of the cost of living and a possible decline in the growth performance of the economy—these are consequences that cannot be ruled out, even in the short-run.

Already emerged against this likely backdrop is the PA government's electoral agenda. When caught up in an economic crisis, governments are less likely to win elections. In the face of a possible dual crisis — economic consequences of a global crisis and the challenge of funding a high-cost war in the context of an economic downturn — Sri Lanka's politics in the coming year would be quite interesting to watch.

All signs at the moment are that neither the government, nor the opposition, is conscious of a likely worse-case scenario as sketched above. They are playing the usual political game, blissfully oblivious to the impending crisis. For them, politicizing every issue for partisan gains, with election imperatives in sight. They, as the old folk wisdom goes, are like crabs in the pot on fire, dancing in joy not knowing that the pot would soon begin to boil.

Sri Lanka's real crisis, if one were to make a considered prediction, would be not the economic crisis *per se*, but its political consequences. In situations of internal civil war, economic crises usually tend to create conditions favourable for those who challenge state power. This has been the experience in a number of countries in the developing world. This logic, an objective one at that, has worked in such a way to compel governments to compromise with rebels under terms that had been spurned earlier. Will Sri Lanka prove itself to be an exception to this logic?

P