



Pathfinder Economic Flash

Adverse Economic Impact of Ethno-Religious Violence Unite to Counter the Ugly Head of Extremism

Political stability and social harmony are crucial for creating a conducive enabling environment for sustained development and upliftment of the lives of all Sri Lankans. Any instability on these fronts has serious adverse implications for development. The recent violent disturbances in the country should, therefore, be a matter of the utmost concern to all Sri Lankans.

Domestic Economy and Local Producers

Domestically the following negative impacts are likely to materialize:

- The confidence of domestic investors from all social backgrounds is likely to be eroded. This has implications for employment opportunities and incomes of all communities.
- If social and/or political instability leads to the destruction of productive capacity, it has an impact not only on the employees of the affected businesses but it also leads to dislocation of the supply chains of the enterprises concerned. This has implications for a range of suppliers, many of whom are likely to be small producers or providers of services. One may conclude that the destruction of businesses owned by any one community inevitably has an adverse impact on people from all communities.
- In a context of instability, insurance premia increase exerting upward pressure on cost structures thereby reducing the competitiveness both of local producers vis a vis imports as well as exporters in foreign markets.

There are also a number of international ramifications which seriously undermine the development prospects of the country and the livelihoods of the people.

International Repercussions

- The risk premium attached to the Sri Lankan economy will be increased. This will have a negative impact on capital flows in various ways.
 - FDI flows will be discouraged. Sri Lanka needs to move to a growth model based on FDI - driven exports to have a realistic chance of meeting the

government's growth targets. Failure to do this will fundamentally undermine efforts to move to upper middle-income-country status.

- Capital flows into the stock market and Rupee denominated Treasury bills and bonds are likely to be adversely affected. These flows can be volatile and flow out if the instability leads to a change in risk appetites of foreign institutional investors.
- Trade, particularly exports, can be affected if the perception emerges that supplies from Sri Lanka are unreliable due to disruptions in production. Buyers could well shift to suppliers from other countries with negative implications for the country's export performance.
- Tourism can also suffer a serious setback. Travel advisories are likely to be issued discouraging visitors from the traditional European markets which have recorded an upward trend in recent months as these economies recover from recession. Even tourists from new markets, such as China, India, Middle East and Eastern Europe can also be diverted to other tourism destinations because there are so many countries competing for the tourist dollar. For instance, the tourism sectors in Thailand and Egypt have experienced major setbacks due to the instability in those countries.
- If relations with Middle Eastern countries are affected by domestic developments, the remittance flow that is crucial for both balance of payments and domestic consumption support could well decline with negative consequences for the viability of the external finances of the country and the living standards of all communities.

Unity of All Against Disunity of a Few

It is a fundamental responsibility of all stakeholders, including all political parties, business, civil society, religious leaders and the government to maintain political stability and social harmony. It is futile to expect economic advancement in a context of instability. It is also important to remember that it is the poor and vulnerable of all communities that have no buffer or hedge to withstand any disruption to their lives, who will invariably be most affected by the consequences of instability, particularly violence.

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