The Economic Consequences of Civil War in Asia: A comparison of Sri Lanka and Cambodia

Simon CAREY*

Abstract

This study looks into the nature of two prominent Asian civil wars and the impacts they had on their respective economies. Comparing the 1967-1979 Khmer Rouge genocides in Cambodia with the more recent 1983-2009 Sri Lankan war for Tamil independence, we look specifically at the impacts on infrastructure and land, the fiscal system, and the monetary and financial systems. Evidence suggests that the Cambodian civil war fits the standard mould for internally worn-torn countries, while the relatively more isolated nature of the Sri Lankan conflict led to significantly different outcomes. It is still too soon to compare the post-conflict impacts on the two nations, however.

*careysimo@myvuw.ac.nz Essay submitted towards FIN1234

1 Introduction and Brief Literature Review

For any country, engaging in conflict comes with significant cost. However, for countries engaged in domestic conflicts the costs are often particularly high (Collier, 1999). Violence and social upheaval drastically alter the lives of those living in afflicted areas and take their toll via a number of economic impacts. This study looks at these economic impacts in two Asian countries – Cambodia and Sri Lanka. These two countries make an interesting comparison because although they are in a similar part of the world they experienced distinctly different civil wars, as we shall discuss below. This study will compare the experiences of each country and the similarities and differences between them and other civil wars more generally. The structure is as follows: After a brief look at the existing literature on Cambodia and Sri Lanka the fundamental elements of the two conflicts are compared, and this is then set in a broader context with a discussion of the general consequences of civil war. Given that this is an extensive topic, the focus then turns to just three key economic impacts in Cambodia and Sri Lanka: infrastructure and land, the fiscal system, and the monetary and financial systems. The conclusion is that fundamental differences in the conflicts themselves seem to explain the different economic impacts of the respective wars.

The literature to date has taken a wide variety of approaches, from focussing on the timing and allocation of multilateral aid into these conflict zones (Ofstad, 2002) to looking at specific and varied impacts such as landmines (Harris, 2000) and tourist behaviour (Selvanathan, 2007). Amongst the varied literature, there has been some limited work specifically on the economic impacts of the Cambodian (Irvin, 1993) and Sri Lankan (Grobar & Gnanaselvam, 1993; Arunatilake, Jayasuriya, & Kelegama, 2001) conflicts. No studies have attempted to approximate the specific cost of the Cambodian war, but there have been four interesting attempts in the Sri Lankan case (the two papers above, as well as Marga, 1998; Richardson & Samarasinghe, 1991). The Cambodian experience has the benefit of hindsight – which is reflected in the number of post-conflict studies – while the Sri Lankan experience is still too recent to have a reasonable body of literature around post-conflict conditions. As with almost all conflict situations, reliable statistical information is somewhat difficult to come by (Collier, 1999), particularly for Cambodia.

2 A Comparison of the Conflicts

In order to understand the different *impacts* of the Cambodian and Sri Lankan conflicts, it is necessary to first compare the conflicts themselves. There are some similar elements. Both were fuelled by ethnic tensions, and large-scale repression and killing of ethnic groups led actions in both conflicts to be considered genocide – although in Cambodia this was on a much larger scale. Both conflicts were affected and (arguably) aggravated by international influence. Indian influence in Sri Lanka and American, Chinese and Vietnamese influence in Cambodia led to increased fighting and tension (despite the presence of Indian troops for peacekeeping purposes). In spite of these international influences, each war took place almost exclusively on domestic ground.

In many respects, however, the two conflicts were very different. Firstly, although starting a number of years earlier, the Cambodian civil war was shorter – it is generally considered to have lasted for the twelve years between 1967 and 1979 (Kiernan, 2002).[1] In contrast, the Sri Lankan civil war, which began with the ambush of a government convoy by Tamil separatists in early 1983, lasted for twenty-six years.[2] As Collier (1999) has argued, differences in the length of conflict can lead to very different experiences post-conflict. The fact that Sri Lanka's war was more than twice as long as Cambodia's and has only recently reached some form of closure is likely to

[1] Although civil unrest continued late into the 1990s (Beresford et al., 2004).

[2] It is officially considered to have ended May 2009, with the death of Velupillai Prabhakaran (Times of India, 2009).

result in considerable differences in the economic legacies of the two conflicts.

Secondly, the intensity of fighting was quite different. In Cambodia the conflict was predominantly intense for the entire twelve years, while in Sri Lanka, where much of the fighting was confined to the northern and eastern areas, bursts of fighting and terrorism took place more sporadically (Arunatilake et al., 2001).

A third notable difference is that the conflict in Cambodia led to total government upheaval, with a military coup in 1970 and the Khmer Rouge taking control of the government by force in 1975 before being overthrown by the Vietnamese in 1979. By contrast, the Sri Lankan conflict took place during a period of relatively stable democratic governance, although the control of the government in some areas of the country was limited and the governing party changed over the period.

3 General Economic Consequences of Civil Conflict

To put the experiences of Cambodia and Sri Lanka into context, a comparison can be made with civil war economies more generally. A number of authors have examined the general economic impacts of internal conflict across a large cross section of countries – Collier being perhaps the most widely published[3] – and there are a number of stylised facts that are apparent from these studies. Starting with perhaps the most

[3] Collier's has focused on a broad range of topics. For example, he also looks at the economic *causes* of civil war (Collier, 1998;2000)

obvious overarching phenomenon; GDP, GDP per capita, and the associated growth rates almost always fall, relative to both an alternative no-conflict scenario and to pre-conflict levels (Arunatilake et al., 2001). Some of the key general economic impacts that are not focussed on here include: sharp decreases in the overall health and education of the population; a large rise in human rights abuses; mass population displacement and demographic shifts; political instability and the onset or spread of corruption; and often a collapse of a country's institutional systems (including government, the legal system and property rights) and industrial sector. Trade typically declines, international relations fall apart, and around the end of the conflict aid flows increase.[4]

What typically happens with regards to the three economic impacts that are the focus of *this* study? Firstly, infrastructure tends to deteriorate in a number of ways, leaving a low level of infrastructure post conflict. Both domestic and international productive investment declines sharply, maintenance of existing infrastructure is neglected and it is often directly damaged during the fighting (Haughton, 1998). Productive land is generally left unproductive, riddled with landmines or other hazards (Harris, 2000). Secondly, a country's fiscal position usually declines as governments increase spending on war related endeavours (most notably the military), and as social upheaval and institutional breakdown make tax avoidance easier, narrowing the tax base (Haughton, 1998). And thirdly, the country's monetary and financial systems typically disintegrate. Because the tax base narrows, governments tend instead to print

[4] The ideal timing of aid is debated, but typically the bulk of aid flows are once conflict ends (Ofstad, 2002).

money to finance high military expenditure and this leads to high levels of inflation, sometimes at magnitudes in excess of 100%.[5] Combined with a decline in the fiscal position, this usually leaves a country financially crippled at the end of an extended period of conflict. As confidence in the monetary system declines, the financial system also falls apart. Banking one's assets becomes risky as the government's ability to monitor and regulate lending is undermined and banks become insolvent, so people tend instead to keep their assets in more liquid forms (Azariadis & Stachurski, 2005). This often means an increase in informal credit networks and holdings of foreign currency, which can be a difficult process to undo (Kiernan, 2002). These are the general observations, which we will now compare with the specific experiences of Cambodia and Sri Lanka.

4 The Economic Consequences of Civil War in Cambodia and Sri Lanka

4.1 Infrastructure and Land

How did conflict affect each country's infrastructure and land? Cambodia's experience was perhaps more dramatic than Sri Lanka's. Massive infrastructure losses occurred around the country, particularly in the urban centres where the Khmer Rouge evacuated and relocated entire populations and near the

[5] Haughton (1998), p.37. This effectively taxes those who are in possession of domestic currency.

Vietnamese border where the United States undertook a systematic aerial bombing campaign as part of the war in Vietnam (Kiernan, 2002). The infrastructure losses were exacerbated when the post-conflict government was isolated by the international community from significant aid and investment flows that would have helped in reconstruction, during a time when there was significant FDI flows into other developing Asian countries (Irvin, 1993). While modern industry was largely destroyed, basic agricultural production survived due to the regime's focus on relocating urban centres and the exclusion of certain agriculture-oriented primary schools from closure (De Walque, 2004). However, significant areas of productive land were lost in the widespread distribution of landmines[6] and property was neglected as private ownership was banned (Ear, 1995).

In Sri Lanka, the direct destruction of infrastructure such as roads and buildings was much less widespread. Although not entirely isolated, infrastructure was destroyed primarily in areas where the fighting was most intense – to the north and east of the country (Selvanathan, 2007). Infrastructure suffered largely as a result of a sharp decline in government investment, as well as a decline in both domestic and international private investment – with total investment falling from 30.8% of GDP in 1982 to 22.8% of GDP in 1988 (Grobar & Gnanaselvam, 1993). This is significant but probably far less than the decline in Cambodia, where at one stage even money itself was banned. However, as the conflict continued and the government introduced a number of economic reform programmes, FDI into

[6] Harris (2000), p.219. Estimates of landmines in Cambodia are around 4-6 million.

Sri Lanka recovered and by 2003 it had reached its highest level (Chandrakumara & Budhway, 2005). Approximately 45% of the (now significant) aid flows into Sri Lanka are invested into economic infrastructure (Goodhand & Klem, 2005). Nevertheless, much productive cultivatable land has been lost in the fighting, and there are large numbers of landmines, particularly in areas such as the Jaffna Peninsular (Arunatilake et al., 2001).

The destruction of production inputs from the Cambodian conflict seems to have been proportionally greater than that of the Sri Lankan conflict. One explanation for this may be found in the differences between the fundamental purposes of the insurgent factions. The Khmer Rouge made it their aim to destroy the old society – including its various forms of infrastructure – which they achieved to a large degree (Clayton, 1998). The Liberation Tigers of Tamil Eelam (LTTE), however, were fighting not for the *destruction* of Sri Lankan society, but for its *separation* into two sovereign states. Their warfare was therefore aimed at strategic government and civilian targets, and in areas under their control they often coexisted with the established infrastructure, albeit exploitatively.

Another explanation for this difference may be found in the nature of international involvement. While the presence of the Indian army in Sri Lanka was for the purposes of peacekeeping – even though it aggravated anti-Indian terrorist groups – the involvement of other nations in Cambodia largely promoted the destruction of infrastructure. Thailand provided refuge for the insurgents across their borders while the Chinese financed them, the Vietnamese forcefully invaded, and the United States bombing brought widespread destruction. Also, an improvement in international investment occurred in Sri Lanka during the conflict (Chandrakumara & Budhway, 2005), while it virtually ceased during Cambodia's. The Cambodian experience is more familiar to the general experience – whereby civil war leads to comprehensive damage to a country's infrastructure. The Sri Lankan experience demonstrates that the partial isolation of civil conflict to certain areas may allow a large portion of the country's infrastructure and land to avoid destruction and neglect.

4.2 The Fiscal system

What impact did the conflicts have on each country's fiscal system? The Cambodian conflict began in a context of financial difficulty – the Sihanouk regime had been bankrupted during the mid-1960s, when rice smuggling undermined the government's main source of revenue, export duties (Kiernan, 2002). The fiscal situation continued to decline, as the Khmer Rouge massacres targeted many of the trained urban workers – teachers, engineers, doctors – that constituted a large part of the country's tax base (Clayton, 1998). This took place on an incredibly large scale, with the death toll estimated at over 12% of the entire population (Haughton, 1998). At the end of the conflict the new government struggled with numerous fiscal problems including an estimated budget deficit of at least 5% of GDP, tax revenue down to below 15% of GDP, and foreign debt up to over 100% of GDP (Haughton, 1998). Conflicts of interest between the post-war government and the Khmer Rouge opposition controlling Cambodia's UN seat meant all international aid was cut off in 1982. More than fifteen years after the conflict ended, Cambodia still had a substantial government deficit (Irvin, 1993).

In Sri Lanka, the commencement of fighting prompted the government to increase military spending from just over 1% to over 6% of GDP (Arunatilake, 2001). This was partly offset by large decreases in spending on economic services, housing, and investment by the government, but was also funded by an increase in the country's foreign debt (Grobar & Gnanaselvam, 1993). Interestingly, spending on health, education and welfare has been much more stable – a vastly different experience to that of Cambodia. Ofstad (2002) argues that the Sri Lankan experience was different to that of most countries engaged in civil conflict as the government managed to fund the war somewhat successfully, although this stability began to decline in later years. A special defence levy, combined with other government revenues, provided almost all of the necessary finance. Increasing flows of financial aid also helped appease the government's deficit.

So the detrimental fiscal impacts of the conflict were significantly worse in the Cambodian case, and again this seems to reflect differences in the fundamental nature of the conflicts. The Sri Lankan government benefited from consistent revenues from a relatively large and stable tax base, while the Cambodian tax base shrank drastically. International aid flowed to a more stable Sri Lankan government, while international transfers of money into Cambodia primarily supported the unstable Khmer Rouge regime (although not in the form of official aid). Military spending increased sharply at the onset of the Sri Lankan civil war, yet at 6% of GDP (plus the significantly lower costs absorbed by the LTTE and other rebellious factions)[7] the total direct and indirect spending was never as high as the military spending in Cambodia. Although precise statistics are not available, it seems that by the time the Khmer Rouge had taken power a large part of the country's efforts had been shifted into some form of war-related endeavour. Again, the experience of Cambodia is more in line with the general experiences of internally warring countries while the fiscal stability of Sri Lanka in the earlier years of the conflict is unusual, and seems

[7] Arunatilake et al (2001), p.1489, provides an estimate of this amount.

to stem from the relatively stable and strong control that the central government maintained over much of the country.

4.3 The Monetary and Financial systems

How did each of the conflicts impact the countries' monetary and financial systems; particularly currency and the banking sector? In Cambodia, a consequence of the fighting was the fundamental destruction of the monetary system – based on the Cambodian *riel* – altogether. As the Khmer Rouge assumed control of the country they destroyed the central bank of Phnom Penn and abolished the use of money (Clayton, 1998). This didn't prevent the country from experiencing significant monetary problems after the conflict and, once the use of currency had been re-established, accelerating inflation occurred as the government printed money to finance the deficit caused by its reconstruction programme. This inflation was not successfully controlled for some time, and attempts to do so came at great economic cost as important government spending was cut back (Irvin, 1993). Obviously, with the deconstruction of the monetary system, the financial sector also collapsed. The Cambodian economy instead turned to unofficial channels of lending and borrowing, and this reliance on the informal credit market has been difficult to undo post-conflict, partly because it requires a confidence in the new financial sector that has taken a while to materialise (Beresford et al., 2004). With ongoing inflation undermining real interest rates and widespread dollarization, the monetary system, exchange rate policy, and banking sector in Cambodia have continued to struggle (Irvin, 1993).

Because Sri Lanka didn't initially finance the war by printing money, inflation was stable and low for the first few years of the conflict. However, as the war drew on and external debt began to rise, monetisation of deficits meant that after 1987 inflation started to rise. By 1990 it was over 20% per annum (Grobar & Gnanaselvam, 1993). With the end of the fighting such a recent event it is difficult to make accurate statements about inflation figures in Sri Lanka post-conflict, but the government has taken steps to address rising inflation. Despite the fighting, the government developed policies and introduced reforms to rein in the debt and reduce monetisation.[8] Because the country's infrastructure has largely remained intact there is still a functioning financial sector and strong central bank. A consequence of the retention of a relatively strong monetary system based around the rupee is that the Sri Lankan population has not transferred large parts of its assets into foreign currency.

Again, there are significant differences in the experiences of the monetary and financial systems in Cambodia and Sri Lanka. Cambodia's monetary system – including the central bank, financial sector, and means of exchange – was destroyed in the course of the fighting, while Sri Lanka's remained intact despite significant impediments generated by the conflict. Foreign currency was largely the preferred means of exchange in post-conflict Cambodia (primarily US dollars), while in Sri Lanka the rupee has remained the currency of choice. One

[8] The document containing these policies is *Regaining Sri Lanka* (2002), see Ghosh et al. (2008).

similarity is that a legacy of inflation was left to both economies after the cessation of fighting, as both governments monetised large budget deficits. However, this was far worse in Cambodia and while the legacy of inflation is common to civil conflicts more generally, the collapse of the monetary and financial system in Cambodia is more analogous to the general case than Sri Lanka's relative stability. Again, it would seem that the restricted scope of the Sri Lankan civil war led to a more positive economic outcome.

4.4 Impacts on GDP per capita

These destructive economic impacts translate into significant changes in living standards within the countries involved. One reasonable proxy for this change in living standards is GDP per capita, which almost always decreases as a result of prolonged civil war (Collier, 1999). The Cambodian experience certainly matches this stylised fact. From 1970 to 1975 Cambodian real GDP fell from $1086 to $693 (2005 US dollars) per capita. The decline in income levels wasn't reversed until 1987, by which time per capita real GDP had fallen to $347 – 32% of its 1970 level (*Penn World Tables*, 2009). This can be seen as a combined result of the impacts discussed here and the other consequences of the Cambodian civil war, since most similar countries were experiencing real GDP *growth* over this time. In contrast to this, the Sri Lankan civil war accompanied a continued period of domestic growth in real GDP per capita. Over the 20 years for which comparable data is available – from 1983 to 2003 – it increased at a consistent rate from $2081 to $4272 – a 105% increase (*Penn*

World Tables, 2009). So although civil war in Cambodia led to a drastic decrease in income levels through the impacts discussed above, this was not the case in Sri Lanka. This is not to say that the war in Sri Lanka had a positive, or even neutral, impact on income levels – in fact a number of studies such as Arunatilake et al (2001) have estimated that GDP would have been significantly higher had there been peace – but, despite the conflict, growth in incomes still occurred. The income distribution in Cambodia was significantly affected by the war and the urban-focussed reconstruction efforts (Beresford et al, 2004), but it is too soon to make a useful comparison with the Sri Lankan post-conflict income distribution.

5 Summary and Conclusions

Having discussed three of the major impacts of the civil wars in Cambodia and Sri Lanka and compared these to the experiences of civil war-torn countries more generally, what can we conclude? It seems that although there were some comparable aspects to these two conflicts, fundamental differences in the length and intensity of upheaval and governmental stability led to very different economic experiences. The Cambodian experience largely seems to conform to the general case, with the country undergoing massive and widespread infrastructure damage, pervasive fiscal problems, and a collapse of the monetary and financial systems. In fact, the Cambodian case seems to be an extreme example of the typical country engaged in civil war. In contrast, the Sri Lankan experience does not conform to the general case very well at all. Infrastructure damage was limited, fiscal problems were kept under control for much of the fighting, and the monetary system remained relatively stable for many years.

The explanation for these major differences seems to lie in the nature of the conflicts themselves. While both were ethnic, genocidal and internationally influenced, the Cambodian conflict was much more countrywide and consistently intense than the Sri Lankan conflict. Important to the impacts discussed here was that the government in Cambodia experienced massive upheaval and struggled to maintain stability post-conflict (Beresford et al 2004). In Sri Lanka, however, the government remained relatively stable and in control of most of the country. The "internal conflict … put a heavy burden on the government" (Ghosh et al, 2008, p.82) on Sri Lanka, but this burden did not lead to the same degree of economic change as in Cambodia. The different experiences of these two countries are an indication that the nature of civil conflict has important implications for the specific legacies that a post-conflict society will have to deal with. While this seems an obvious and straightforward conclusion, it highlights the notion that the experience of civil war does not necessarily lead to a standard outcome. The economic impacts of domestic conflict appear to be at least partly determined by the fundamental nature of the conflicts themselves.

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