World Bank and donor countries set the agenda for Sri Lankan government

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A two-day meeting of the Sri Lankan donor countries organised by the World Bank in Paris on December 18-19 has insisted that the Peoples Alliance (PA) government take steps to end the country's war, speed up the restructuring of the public sector, and cut back welfare and tertiary education if the country is to receive a new line of credit.

The government pinned great hopes on obtaining credit facilities at the meeting, known as the Sri Lanka Development Forum, in order to stem the country's economic troubles resulting from rising military expenditures and oil prices. The forum is the first to be convened in two and a half years due to Sri Lanka's political instability and the calling of early presidential and parliamentary elections.

Keen to impress potential donors, President Chandrika Kumaratunga herself presented the government case. Four other ministers were part of the delegation that was headed by Constitutional Affairs and Deputy Finance Minister G.L. Peiris.

Sri Lanka received $US860 million in 1997 and in $780 million in 1998 from donor countries. At the conclusion of the latest meeting, however, the delegation came away with little in the way of specific offers, other than $100 million promised earlier by the Asian Development Bank.

Vice Chairman of the World Bank South Asian Desk, Mieko Nishimizu, bluntly commented that there was a "sense of frustration among donors". After quoting Kumaratunga's recent policy statement, Nishimizu warned: "The nation is in deep crisis, public institutions are politicised, politicians are not accountable, people are not heard and they are isolated..."

She emphasised that the Sri Lankan government had to implement the World Bank's proposed framework before the "development partners" would support Sri Lanka "with knowledge and experience first, and if necessary and appropriate, with additional financial resources". Nishimizu's comments will have provided little comfort to the Sri Lankan government, which is desperate for money.

Nishimizu's comments were underscored by a European Union statement to the forum, stressing the necessity of a negotiated end to the war and further economic restructuring. "[T]he prospect of good economic performance in the long term requires the determined pursuit of indispensable structural reforms and of good governance as well as the introduction of simplified government procedures together with the restoration of peace. In this regard the European Union is concerned by the large proportion of the State budget devoted to military expenditure, which is compromising the country's development."

Sri Lanka's Central Bank recently underlined the deteriorating economic conditions in a report entitled "Sri Lanka State of Economy 2000". It noted that the government budget and balance of payments are expected to show "a considerable deterioration in 2000" as the result of a "shortfall of government revenue and expenditure overruns arising largely from unplanned defence expenditure".

Earlier in the year, the government had planned to limit the budget deficit to 7.5 percent of Gross Domestic Product (GDP) but the figure has expanded to 8.7 percent. The defence budget consumes about 36 percent of government income or 6 percent of GDP.

Defence expenditure rose from a planned 52.34 billion rupees ($US738 million) to 83 billion rupees ($1,037 million) after the government made huge arms purchases following a series of major military defeats at the hands of the separatist Liberation Tigers of Tamil Ealam (LTTE) in April and May. At the same time, total tax revenue has dropped by 2,043 million rupees and there is a shortfall of 28,500 million rupees in the expected receipts from the sale of public enterprises.

As a result, the government has been forced to increase its borrowing limit by 45 billion rupees. This has exhausted the liquidity of the banking sector and pushed up interest rates. Since June the Central Bank has increased interest rates three times. The inter-bank rate has risen to 28 percent as compared to around 14 percent a year ago. The government was also forced to buy $100 million on the international markets to pay for import bills.

The PA used to brag about its achievement in lowering interest rates; now it justifies higher rates, saying they are necessary to “stabilise the money markets”. The Central Bank report warns that “the high interest rate scenario is likely to continue, crowding out private investment, while there has been a lull in private investment in a period of uncertainty”.

Increased defence spending and the oil bill have widened the country's trade balance deficit this year to $1,749 million, up from $1,305 million in 1999. The balance of payments deficit is due to go up from $263 million last year to $514 million this year. On the other hand, Sri Lanka's foreign reserves are declining with a fall of 7.2 percent and 11.2 percent in 1998 and 1999. In the first 11 months of 2000, the figure has dropped by 29.1 percent from $US1,639 million to $US1,038 million with some analysts predicting it could go as low as $800 million by the end of the year.

The Central Bank has devalued the rupee three times since June, bringing its total depreciation to 12 percent for the year, increasing import prices and raising the volume of foreign debt in rupee terms. Top Central Bank officials justified the latest 2 percent devaluation on December 11, saying “we are closer to free float”—a hint that the government may abandon any intervention to determine the value of the rupee.

The increased military spending has resulted in a decline in public investment, which has dropped from a projected 8.1 percent of the budget to just 6.7 percent. In May, as part of her emergency measures to put the country on a war footing, Kumaratunga put “non-priority projects” on hold. The government's capital expenditure has been cut by 17,854 million rupees.

Although the government has boasted about avoiding the effects of East Asian crisis, the local textile sector, which is oriented to domestic market, is in a severe crisis as a result of competition from cheap imports. The government has been forced to extend its textile bail-out scheme. Now there are fears that high oil prices could drastically affect other industries.

The local stock market reflects the uncertainty prevailing among local and foreign investors. In November, the All Share Price Index of the Colombo stock market declined by 12 percent, while the Milanka index for blue chip companies fell by 15 percent. During the first 11 months, the net foreign capital outflow was 3.23 billion rupees compared to the 392 million rupees for the same period last year.

In the second week of December shares rose by 15.5 points. But as one analyst pointed out, the main reason was a rise in confidence by local investors over the prospect of negotiations between the government and the LTTE. There was no enthusiasm among foreign investors.

Following the Sri Lanka Development Forum, the burden of the economic problems will be placed even more squarely onto the working class and the poor who have already been hard hit by inflation. Proposals from the Forum included further restructuring of the public sector, and therefore more job cuts, and a greater “participation” of the private sector in tertiary education. The government is already planning to put a new tax on water used by poor peasants—a measure that has already provoked protests.

A World Bank report entitled “Sri Lanka: Recapturing Missed Opportunities” published in June was also discussed at the forum. Ominously it put a question mark over the government's Samurdhi program that is meant to provide some limited assistance to the poor. It pointed out 44 percent of the benefits go to the wealthiest 60 percent of the population. While it is undoubtedly true that Samurdhi program is abused for economic and political gain, the World Bank recommendation was simply to end benefits for higher income groups, not to boost spending for the large number of poverty-stricken families in the country.