Sri Lanka's budget: hoping for peace and planning for war

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In presenting the Sri Lankan budget on March 8, Deputy Finance Minister G.L. Peiris managed to highlight a central contradiction that runs through government policy as a whole. Since coming to power in 1994, the Peoples Alliance (PA) government has promised to end the country's protracted civil war, which has had such a devastating impact on all aspects of social and economic life, but instead has continued and intensified the conflict.

Peiris demonstrated with facts and figures the tremendous economic cost of the vicious war, which has been pursued for 18 years by the present PA and previous United National Party (UNP) governments in order to suppress the democratic rights of the Tamil minority. He stated that a peace settlement was needed “to boost the economic activities throughout the country” and therefore should be “the national priority”.

At the same time, however, the minister outlined a budget that provides for the massive military spending to continue. Within the financial restrictions insisted upon by the International Monetary Fund (IMF), the huge defence budget inevitably means higher taxes, further privatisation, cutbacks to social services and other austerity measures. Public servants will have to wait until next year's budget for proposals from a salaries commission and a committee on pensions to be implemented.

Peiris told the parliament: “The government appeals to the people to refrain from demanding concessions at least for six months and fully cooperate with us to re-strengthen our economic fundamentals.” Those who will inevitably pay for “strengthening the fundamentals” through lower wages and higher prices will be the vast majority of workers, small farmers and the poor, who have already born the brunt of the war.

The government has allocated 75 billion rupees ($US862 million) or 22 percent of the total state expenditure to the defence budget—a figure which is nearly double the combined allocation of 43 billion rupees for public health and education. The defence budget is substantially higher than the allocation in last year's budget of 52 billion rupees but less than actual military spending last year of 83 billion rupees. The increase resulted from the government's huge arms spending following a series of military defeats in April and May at the hands of the separatist Liberation Tigers of Tamil Eelam (LTTE).

The government is still paying the cost of new fighter aircraft, naval patrol boats, artillery, multi-barrel rocket launchers and other military hardware bought last year. In the pre-budget estimates released last month the defence allocation was 63 billion rupees but when the budget were presented to parliament, the figure was increased by another 12 billion rupees, in part to cover deferred payments for the arms procurements.

The increased defence spending is to be paid through higher taxes. The government has put up the National Security Levy (NSL)—an indirect tax on many goods—by another 1 percent to 7.5 percent and extended it to cover previously exempt items in order to raise 6.1 billion rupees. It has also increased the corporate surcharge by 20 percent, raised the export tax on garments and doubled the international departure tax.

Business groups have complained about the corporate surcharge increase, saying that it will affect savings and investment. But like the other tax rises, it will translate into higher prices in goods and services, which have already been rising sharply. Following the floating of the rupee in January, the Colombo consumer price index shot up by 104.5 points from 2,693 to 2797.5 in January and by another 45.3 points in February. Prices for essential goods such as rice, dhal and sugar rose by nearly 30 percent in January and February.

The Ceylon Chamber of Commerce wrote to the government stating bluntly that “we doubt that this budget as a whole can deliver the vision of the private sector or the vision 2010 of the government...We also doubt whether the long term targets committed to by the government will be achieved.” Other business leaders have criticised the budget for failing to “kick start the economy.”

Government indebtedness

The government's precarious financial position is highlighted by the fact that the largest single item in the budget is debt repayment: 91 billion rupees or 9.4 percent of the GDP, which is a jump of 20 billion rupees from last year. Taken together, debt repayment and the defence budget are equivalent to nearly half of the government's total planned expenditure.

The government plans to raise 69 billion rupees from the domestic financial markets and another 21 billion from overseas sources. Local businessmen have expressed fears that this government borrowing, which has already forced interest rates to 26 percent, will drive them even higher.

The government is desperate to obtain foreign loans of between $400 to $450 million to shore up the country's foreign reserves, which fell to a dangerous level by the end of last year due to the heavy arms spending and high oil prices. In order to obtain the loans, the budget is framed to meet the IMF's stringent requirements and has set a target of 8.5 percent of GDP for the deficit.

The IMF's resident representative, Nadeem ul Haque, welcomed the budget, saying he was “glad to note that Prof. Peiris in his budget speech mentioned reforms in the labour market, financial sector, civil service and the education system”. Spending will be cut on electricity, water, telephone, travel and overtime expenses of state departments which will inevitably lead to a reduction in the level and quality of services provided.

Peiris announced the restructuring of “economically viable” public entities and the closure of others not considered viable. He said that “35 entities have been identified and are in the process of being liquidated”. The government is planning to sell its remaining shares in Sri Lanka Telecom and to “restructure” the Electricity Board, the Petroleum Corporation, and the Ports Authority, all of which are highly profitable ventures, as well as state-owned commercial banks and the Central Bank. Thousands of jobs will be destroyed in the process.

Fulfilling a longstanding demand of foreign and local capital to cut the number of public holidays enjoyed by workers, the government announced it will amend the laws relating to the public sector and private sector with a view to “the rationalisation of existing holidays”.

The impact of the war

A more fundamental concern of significant sections of big business is the government's failure to end the war. Nihal Abesekara, vice president of the Sri Lanka Federation of Chambers of Commerce and Industries, commented at a seminar on March 12 that the budget reflected a country geared to “a war economy” rather than to economic development. “If we continue like this, the country's economic growth will face more problems,” he said.

In his budget speech, Peiris outlined the devastating impact of the war: “It is foolish to deny or ignore the cost of war. The increase in defence expenditure from around 1.5 percent in early 1980s to 6 percent of GDP in 2000 has a huge cost on our economy. According to Central Bank estimates, the economy could have achieved over 8 percent growth and reached a per capita income of $2,500 (Rs.212,500) by now instead of a 5 percent growth with $900 (Rs.76,500) per capita income—a loss of income of $1,600 (Rs.136,000) per person.

“Average household consumption would have increased by 42 percent. Two thirds of 800,000 households, which are earning below Rs.4,920, would have moved above that level of income. The current level of unemployment of 650,000 could have declined to 250,000 by the creation of around 380,000 additional employment, through development expenditure. The tourist arrivals could have passed 1 million benchmark generating a large inflow of foreign exchange, increased activities in ancillary services and 300,000 direct and indirect employment as opposed to about 70,000 employment at present.”

Moreover, as Peiris explained, the high level of arms spending over the past year has compounded the financial problems facing the government and the economy as a whole. The budget deficit, which had fallen to 7.5 percent of GDP in 1999, rose to 9.8 percent in 2000; interest rates rose from 16 percent to over 20 percent; and the inflation rate doubled from 5 to 10 percent.

As if to try to answer the government's critics, Peiris painted a rosy picture for the economy if the government were to settle the war. “Peace will trigger off a massive rehabilitation program for the North and East. This will boost economic activities throughout the country. The reduction of military expenditure below 3 percent of GDP and corresponding rise in public investment as well as rapid inflow of foreign direct investment will boost economic development.”

However, all of this begs the question—why has the PA government and previous UNP government proven incapable of ending the war? Not only powerful sections of big business but also the major powers, concerned at the impact of the continuing war on the stability of the Indian subcontinent, are pressuring the PA government to negotiate a peace deal with the LTTE.

Peiris knows the answer better than most. As well as functioning as deputy finance minister, he holds the post of Constitutional Affairs Minister and was responsible for drawing up the package of constitutional changes presented to parliament last August. The so-called devolution package, which provided for limited autonomy for the provinces through a power-sharing arrangement between Sinhalese, Tamil and Muslim elites, was envisaged as a means to end the war.

But amid a ferocious protest campaign by Sinhalese extremist organisations and the Buddhist hierarchy, the opposition UNP ended its support for the package and, lacking the necessary two-thirds majority, the government was forced to withdraw it. Having pursued the reactionary war for nearly two decades, both the PA and UNP are beholden to these chauvinist layers and fear that even the most minimal concessions to the LTTE, or more broadly to the Tamil minority, will trigger demonstrations and rifts within their own ranks.

Needless to say, Peiris offered no estimation in his budget speech as to when the preparations for peace talks, which have been dragging on for months, might come to fruition.