# Sri Lankan government deeply mired in financial difficulties

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Just two months after April 2 general election, Sri Lanka's new minority government is confronting serious financial difficulties. To defeat the previous United National Front (UNF) government, the United Peoples Freedom Alliance (UPFA) made a series of populist promises to provide jobs, lift wages and reinstate subsidies for farmers. Now in office, the UPFA ministers are coming under pressure from big business and foreign investors to abide by the austerity demands of the IMF and World Bank.

The state of the government's finances was highlighted in an article in the *Sunday Times* of May 16. "There is no money even for state corporations and statutory bodies to pay salaries. This week, the Ceylon Electricity Board was going around sounding out state banks to raise funds; as did the Ceylon Petroleum Corporation, which has been refused Treasury allocations."

The UPFA is desperate to keep down the prices of essential items but in doing so faces mounting problems in making subsidy payments. With crude oil prices soaring over $US40 a barrel, the government is paying out billions of rupees in subsidies to the state-owned Petroleum Corporation (Ceypetco) and Lanka-India Oil Company (LIOC). In the first four months of the year, accumulated government dues to Ceypetco amounted to 2.5 billion rupees ($US25 million) while LIOC is owed 650 million rupees.

The government is also under pressure from the Singapore-based multi-national Prima Ceylon, which has a monopoly on the sale of flour. The company is owed 1.2 billion rupees in subsidies and recently threatened to raise the price of flour by 20 percent unless the arrears were paid immediately. Fearing an angry reaction to any price rise, Consumer Affairs Minister Jeyaraj Fernandopulle last week declared flour to be an essential item under the Consumer Protection Act and opened the market to competition.

At the same time, the government faces declining revenues. The collection for the first two months of the year dropped by 11.41 percent to 45.8 billion rupees, while spending increased by 3.1 percent to 78.6 billion rupees.

The only election promise honoured so far has been the restoration of fertiliser subsidies slashed by the UNF. The issue is particularly sensitive as the two major UPFA coalition partners—President Chandrika Kumaratunga's Sri Lanka Freedom Party (SLFP) and the Janatha Vimukthi Peramuna (JVP)—are facing elections for four provincial councils in which rural votes will be crucial. But the restoration of the subsidy, which has cost the government 3 billion rupees, only goes a small way to addressing the difficulties facing small farmers.

The UPFA promised to immediately create jobs for 60,000 unemployed high school and university graduates. The government has called for applications from an estimated 27,000 unemployed graduates for positions, as government trainees, on a monthly pay of just 6,000 rupees (about $US60). Even this limited program has yet to materialise and plans for other job schemes have been shelved. The annual cost of 60,000 government jobs is 6 billion rupees.

The UPFA promised to raise the salaries of government workers by some 75 percent—at an estimated cost of 90 billion rupees a year. In a recent interview, Treasury Secretary P.B. Jayasundara hinted that any salary rise will only be considered in the next budget, which is due in November.

IMF and World Bank officials have warned against any increase in the budget deficit. The budget deficit is already forecast to reach 7.3 percent of GDP this year. The World Bank's resident representative in Sri Lanka, Peter Harrold, recently declared that his institution would not oppose higher social spending but added: "[W]hat would be difficult is if the fiscal deficit rises 2-3 percentage points to accommodate it.... Additional spending requires generation of additional revenue if it is to keep the fiscal framework.... But revenue collection has been getting worse and is well below the forecast this year."

Business representatives have warned that high spending will increase inflationary pressures and lead to higher interest rates. One of the country's major banks, the Hatton National Bank, stated last week: "The lack of clarity as to how the government hopes to raise funds for a possible spending spree was putting pressure on market liquidity, possibly leading to a rise in interest rates."

An IMF team which visited the country last week insisted that the government end uncertainty over further economic restructuring reforms. IMF delegation chief Jehangir Aziz told Reuters last Thursday that the Kumaratunga government would announce plans to reform the financial and electricity sectors within the month. The IMF is threatening to withhold funds if its demands are not met.

Last November, the second installment of $US80 million in a three-year $567 million loan program was suspended after Kumaratunga precipitated a political crisis by unilaterally seizing three key ministries from the UNF government. After the latest visit, Aziz told the media: "We will wait and see what comes out before the next tranche is released."

The government is already having to raise extra loans. The Central Bank has decided to borrow $250 million on the foreign exchange markets in installments to cover government finances for the remainder of the year. Finance Minister Sarath Amunugama also floated a proposal in mid-May to sell the government's remaining stakes in Sri Lanka Telecom (SLT), Sri Lankan Airlines and other companies.

Kumaratunga's abrupt decision to restart the peace process is at least partly bound up with her government's financial difficulties. An aid package of $4.5 billion pledged by donor countries, including the US, Japan and several European countries, is contingent on resuming peace talks with the Liberation Tigers of Tamil Eelam (LTTE) as well as the continued program of ruthless restructuring and privatisation.

A conference of donor countries is currently underway in Brussels. On Tuesday, just prior to the conference, European Union spokeswoman Emma Udwin bluntly explained: "The way to unlock the bulk of the money is for Sri Lanka to make progress in peace talks." She noted that the current ceasefire was holding but added: "Sri Lanka needs to show that it's determined to move the peace process forward." The same message was delivered by Japanese special envoy Yasushi Akashi when he visited Sri Lanka two weeks ago.

A few days after the new government came to power, the influential Joint Business Forum (Jbiz)—a grouping of business organisations—issued a document. At the top of its agenda was an end to the civil war. Similarly the Central Bank in its Monetary Program for 2004 declared: "In order to achieve the projected macroeconomic and monetary developments, continuation of the peace process and the political stability in the country are essential."

However, any attempts to restart peace negotiations are certain to further destabilise the UPFA, which relied on two major planks during its campaign: opposition to privatisation and economic reform, and the whipping up of communal sentiment by denouncing the peace process. The JVP, which vehemently denounced the UNF for betraying the country to the LTTE, has already objected to the planned basis for talks with the LTTE.

The government's real fear is the hostility of masses of ordinary working people whose living standards have declined sharply under the UNF and who are expecting improvements under the UPFA. The recently published Central Bank annual report for 2004 pointed to the social impact of the economic reforms carried out by the UNF at the behest of the IMF and World Bank:

* Public sector employment was frozen, cutting the government's wage bill from 5.6 billion rupees in 2002 to 5.2 billion in 2003. Under a newly introduced state pension scheme, employees were compelled to pay 8 percent of their salaries towards pensions; a further effective wage cut.

* Education expenditure was slashed from 2.4 percent of GDP in 2002 to 2.2 percent of GDP in 2003. Health spending fell from 1.57 percent of GDP in 2002 to 1.56 percent of GDP in 2003. The limited welfare program, known as Samurdhi, was slashed by 12 percent to 8.7 billion rupees in the 2003 budget on top of a 3 billion rupee cut in 2002.

* Funds for state-owned enterprises, such as railways, bus companies, the postal service and the CWE retail chain, were cut by 29 percent in 2003 resulting in a significant deterioration in services.

* The corporate tax rate for large companies was reduced from 35 to 30 percent—one of the factors in boosting foreign direct investment from $197 million in 2002 to $229 million in 2003.

Under the UNF government, the budget deficit was reduced from 10.8 percent of GDP in 2001 to 8.0 percent in 2003. The IMF and World Bank are insisting that the figure be reduced even further. Finance Minister Amunugama told the media last month: "We have a problem in balancing the budget. The country has been living beyond its means."

Far from alleviating the social crisis confronting the masses, the UPFA government is preparing to make further inroads into the social position of the majority of the population—a move that can only heighten the political instability.