# Sri Lankan budget: a sign of political crisis

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The first budget of Sri Lanka's United Peoples Freedom Alliance (UPFA) government, delivered by Finance Minister Sarath Amunugama last Thursday, was a desperate attempt to stem the anger of working people over rising prices and declining living standards.

Amunugama took nearly six hours to deliver the budget speech, which was as much a piece of political theatre, full of nationalist rhetoric, as a financial plan for the next year. Having defeated the United National Front (UNF) at the election this April by exploiting the widespread hostility to the previous government's economic restructuring policies, the UPFA had to walk a delicate line: giving limited handouts to ordinary workers while implementing policies designed to appeal to big business and foreign investors.

In the lead up to the parliamentary session, UPFA spokesmen declared the government would present a "people-friendly budget" that would be "pro-poor" as well as "pro-growth". Well aware of the popular resentment over the role of the IMF and World Bank in imposing austerity measures on the country, Amunugama ostentatiously declared that there would be no pre-budget meetings with the international agencies. This would be, he declared, a "home grown" budget.

The same theme was taken up in the budget preamble, which emphasised "sustainable economic and social development, based on local values and national priorities". This nationalist orientation—promoted in particular by the Janatha Vimukthi Peramuna (JVP), the second largest UPFA partner—is aimed at shoring up support for the government among layers of small businessmen and farmers hard hit by international competition.

However, Amunugama's claim that his home-grown budget is going to stem the country's economic crisis is a sham. The government's policies have been shaped by factors outside its control—rising world oil prices; sharpening competition for foreign investment; an end to the international textile and garment quota system; and the insistence of major donors that aid will be withheld until talks to end the country's 20-year civil war restart.

The UPFA government may not have engaged in formal pre-budget talks with the IMF and World Bank, but these institutions nevertheless shaped the document. Nationalist demagogy aside, Amunugama was well aware that the government could not afford to alienate foreign investors and donors. Like the UNF, his Sri Lanka Freedom Party (SLFP)—the main UPFA component—implemented free market restructuring during its period in office from 1994 to 2001.

In the speech, Amunugama admitted that 70 percent of the rural population saw no trickle-down benefits from the economic growth of the past two decades. "In fact the share of the poorest 40 percent in the national income, which was 21 percent in the 1980, has steadily declined to 14 percent in 2002—a distressing 1/3 decline in the share of income of the poor. For the richest 20 percent the share increased to 54 percent," he said.

While the UPFA narrowly won the April election, Amunugama and the cabinet ministers are conscious that they are living on borrowed time. Rising prices, as well as planned privatisations and further attacks on social services, have fuelled strikes and protests by workers in the railways, plantations and the health and education sectors. The budget was therefore crucial to the ruling coalition, particularly the JVP, to stem a collapse of popular support.

In the course of the election campaign, the UPFA made a series of promises that have not been kept—including a pledge to increase public sector workers' pay by 70 percent within three months. Concerned to defuse this potentially explosive issue, Amunugama proposed a 40 percent pay increase for state employees ranging from 3,250 rupees [$US32] to 9,000 rupees a month. Even then, the wage rise will be paid only in stages—20 percent or a minimum of 2,500 rupees from December and the remainder in January 2006.

The wage rise is premised on a major assault on working conditions—the undermining of the eight-hour day that until now has been sacrosanct in the public sector. The budget proposed that the working day be extended by one hour—from eight to nine hours—with no additional pay. The move will not only save on overtime payments but lay the basis for more demands for "greater productivity" and further undermine public sector jobs.

The majority of Sri Lankan workers will not get the pay increase. Out of the total labour force, only about 13 percent of workers are employed in the state sector, while 44 percent are employed in the private sector. Although the finance minister made a face-saving appeal to extend the rise to the private sector, employers are under no obligation to comply with the "request". In the tea and rubber plantations, the biggest single private sector, the government recently sanctioned a wage deal that guaranteed a rise of just 14 rupees or 11 percent in the daily wage.

Wages have already been seriously eroded by inflation. In the short period that the UPFA has been in power, the official cost of living index has jumped from 3,426 in March to 3,699 in October. The price of essential items has risen even more sharply, including for rice—which has increased by 66 percent from 30 to 50 rupees a kilogram—and wheat flour, which has gone from 22 to 32 rupees. Higher oil prices have added to the cost of petrol, diesel, kerosene and gas as well as transport.

In an effort to placate public anger over prices, the government introduced a complicated three-tier system for the imposition of Value Added Tax (VAT)—dropping the tax from 15 to 5 percent for basic items such as sugar, vegetables and dry fish, while increasing the rate on selected "luxury" items to 18 percent. But the changes will do little to alleviate the suffering of the very poor while hitting sections of wage workers who will find it even more difficult to afford "luxury" items.

Other "pro-poor" measures in the budget included limited improvements to housing loan schemes, increased health insurance and more extensive maternity leave for state sector workers, but on half pay or no pay. The budget allocations for health and education were increased by 23 percent and 25 percent respectively, yet both these sectors have been undermined by years of cost cutting under previous governments. Amunugama also promised to provide jobs next year for 42,000 unemployed graduates who are now in a low-wage training scheme and for 30,000 high school graduates who have completed their A levels. Other unemployed will have to wait until "economic development" provides them with a job.

Virtually nothing was provided to farmers and small businessmen, beyond limited tax concessions and loan facilities for small and medium entrepreneurs. Farmers, who have been hard hit by rising production costs and growing debts, were told that the government's grandiose plans to renovate 10,000 small tanks [lakes] and initiate rural development schemes would enable them to prosper.

Like its election promises, the government's "pro-poor" budget measures could rapidly prove to be illusory. Even before the projected increased spending, government finances were in a crisis. The projected budget deficit is 171 billion rupees, which amounts to nearly one third of total expenditure. The government plans to raise 58 billion rupees from foreign lenders but that will be contingent on the IMF and World Bank giving the budget the seal of approval.

While declaring that there would be no talks with the international institutions before the budget, Amunugama quickly reassured the media that he would be meeting with the IMF and World Bank after its presentation. The government will of course immediately come under pressure to implement further economic restructuring. In order to appease these agencies, Amunugama pledged to rein in government expenditure as a percentage of GDP to 7.5 percent next year after it ballooned to 8.5 percent this year.

As a number of economic commentators have noted, the government confronts severe difficulties in raising the taxes required to pay for its programs and meet the projected financial targets. A decade of cutting taxes for businesses and foreign investors has seen government revenue as a percentage of GDP decline precipitously from 20.4 percent in 1995 to 13.2 percent in 2003. The latest budget projects an increase in revenue to 17.2 percent of GDP next year and to 19.5 percent by 2008 but provides little explanation as to how this substantial rise is going to be achieved.

The budget did not foreshadow any significant increase in tax collections from big business. In fact, it contained a major concession to investors by removing the existing 15 percent capital gains tax and introducing instead a 0.2 percent tax on transactions in the share market. But if no burden is to be placed on big business then small businesses, traders, farmers, workers and the poor will inevitably be the ones to suffer—either through increased taxes, or on the government reneging on its promises.

The main role in imposing the budget on the working class will fall to the JVP, whose MPs in the course of the parliamentary session repeatedly thumped their desks in approval at the measures. Opening of the budget debate for the government side, JVP demagogue Wimal Weerawansa heaped praise on the budget, declaring it a "new economic tactic" and denouncing its opponents as "pigs". His comments are a warning that the JVP will stop at nothing in dealing with any critics.

The country's deteriorating economy will compound the government's difficulties. The annual cost of importing oil has jumped from $US837 million in 2003 to $1,600 million this year. The country's trade gap has widened by 67 percent to $1.57 billion in the first nine months of this year alone and economic growth has fallen from 5.9 percent in 2003 to 5 percent this year. The Sri Lankan rupee is continuing to fall against the US dollar even though the American currency is declining against the euro and yen.

Conscious of the political and financial difficulties facing the government, big business has cautiously welcomed the budget and the all share price index on the Colombo stock market rose by 22 points to 1,485 points. Nawaz Rajabdeen, Federation of Chamber of Commerce senior vice president, blandly praised the emphasis on small and medium-business and said it was "an overall very favourable budget". The Ceylon Chamber of Commerce and National Chamber of Commerce (NCC) made similar comments.

Senior IMF Residential Representative Jeremy Carter, while "welcoming" the budget proposals, emphasised that capital expenditure should not be cut to pay for the deficit in current spending. In what can only be interpreted as a guarded criticism of the financial plan, he commented: "Budgets are always ambitious but the challenging task is the implementation and delivery." He hinted that the IMF's credit facility of $657 million, which was suspended in April, would be reconsidered, but only if IMF demands were met.

The overriding concern of big business is the danger of a return to civil war. While promising to restart peace talks with the Liberation Tigers of Tamil Eelam (LTTE), the government has increased defence expenditure from 43 to 56 billion rupees to keep the military on a war footing. As far as corporate chiefs are concerned, the present situation is untenable—the lack of negotiations is holding up foreign aid and defence spending is holding back expenditure on much needed infrastructure—while renewed fighting would be an economic disaster.

Speaking on behalf of foreign investors, Adrian Lim, a manager at Aberdeen Asset Management Asia Ltd in Singapore, bluntly declared: "Peace may be a more powerful tool than taxes.... The budget is important but I am more keen to see progress on the peace process." Lim is a partner in several major blue chip companies in Sri Lanka, including John Keells Holdings Ltd. and Aitken Spence Company.

Working people will rapidly come into conflict with the UPFA government over the budget. Already sections of workers have widely condemned the increase in working hours and are agitating against it. Most working people, already angry over deteriorating living standards, are deeply sceptical of the government's promises.