Sri Lankan Central Bank attempts to cover up deepening economic contradictions

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The *Central Bank of Sri Lanka Annual Report 2005* issued on May 1 painted a rosy picture of the country's economy and government policies. It emphasised that the growth rate of 6 percent last year had "exceeded expectations" and backed government forecasts of even higher growth rates for 2006 and beyond. Inflation was down and the balance of payments was in surplus.

This optimistic view does not stand up to critical examination. Not only are the figures themselves questionable, but the economy is beset by rising oil prices, huge debts and the danger of renewed civil war. The outlook is bleak, particularly for ordinary people whose living standards are continuing to deteriorate.

The "growth" figures included the reconstruction activities following the devastation caused by the December 2004 tsunami, which destroyed homes, schools and infrastructure in much of the island's coastal strip. While fishing and tourism was damaged, limited post-tsunami rebuilding provided a boost to the economy. Moreover, the inflow of international aid was a significant factor in the balance of payments surplus.

A *Sunday Times* commentator noted: "If one reads between the lines and examines the detailed data contained in the Annual Report of the Central Bank, it is clear that the economy performed well or as well as it did owing to the tsunami. Paradoxically and ironically the economy would have faced several crises had the tsunami not come to the country's rescue. These are especially with respect to external finances and fiscal imbalances."

While international tsunami aid may have helped government finances and increased business activity, it did little to assist the hundreds of thousands of impoverished victims who lost their homes, possessions, livelihoods and loved ones. Many are still subsisting in temporary accommodation with little in the way of government assistance and no prospects of employment.

According to the Central Bank report, more than half the economic growth was in the services sector, rather than agriculture or industry. Rather absurdly, the authors declared that this was a sign that the country needed to spend "smaller amounts on food, shelter and other goods with physical manifestation" and was devoting more to "services to make life more enjoyable".

Most people spend all their income surviving from day to day. The average monthly salary is 6,000 rupees or about $US60, all of which is spent on food, accommodation, clothing, transport and other essentials. The report itself points out that over a fifth of the population, or 22.7 percent, live below the poverty line of 1,423 rupees a month. Two million families are dependent on Samurdhi—limited welfare payments—just to survive.

The growth in services has not made "life more enjoyable" for working people. Rather it reflects increasing activity in the commercial service areas, such as finance and banking, and in government services. A component of this growth will have been the provision of services to the tsunami victims. Another was the government's decision last year to recruit 42,000 graduates in a desperate effort to lower unemployment rates.

More ominously, the expansion of services also includes spending on the military, which has increased under successive governments, particularly following the election of President Mahinda Rajapakse last November. In his special "pro-poor" budget announced in December, spending on the police and military was increased by a massive 26 percent from 76 billion rupees to 96 billion rupees. Rajapakse is preparing to use these "services" to plunge the country back into a disastrous civil war.

The report has little to say about the danger of open conflict and its possible impact on the economy. In financial circles, however, there are real fears that war will lead to a collapse of foreign investment, huge government spending increases and a balance of payments crisis. In late April, following a suicide bomb attack on army headquarters in Colombo, Standard & Poor's downgraded its credit outlook for Sri Lanka from stable to negative, citing concerns about "the recent sharp escalation in hostilities".

The *Sunday Times* economic analysis on April 30 warned:

"Now that open war is closer than ever, even irrespective of whether it would happen or not, the preparedness for it means huge military expenditure with high import content.... If these additional expenditures amount to around $US1,000 million, a likely prospect, it would be almost an unbearable burden on the balance of payments and would no doubt have to be financed by borrowings and deferred payment agreements. This means that the foreign debt would rise to horrendous proportions making future development expenditure well nigh impossible. The additional fiscal deficit would destabilise the economy through the inflationary pressures that it would generate."

Despite the Central Bank report's upbeat picture, last year's economic indices are anything but healthy. The balance of payments may have been in surplus but the country's trade deficit jumped by $US274 million to $2,516 million this year, mainly due to the surging price of oil. The cost of oil imports increased from $1.2 billion in 2004 to $1.7 billion last year. On Wednesday, the finance ministry announced an estimated oil bill for 2006 of $2.2 billion.

The overall balance of payments surplus is the product of two factors—firstly remittances from the country's export of cheap labour and secondly, the inflow of tsunami aid. Remittances grew by 22.7 percent last year to $1.92 billion, over half from contract workers in the Middle East. According to the report, "net inflows to the government increased by 51 percent in 2005 with large tsunami related inflows, and lower debt service payments resulting from the debt moratoria following the tsunami, contributing to an overall BOP surplus of $501 million".

The country is heavily in debt. The Central Bank reported that debts are equivalent to 95 percent of GDP, slightly down from last year's figure of 105 percent of GDP. Desperate for finance to cover its budget deficit, the government is seeking further borrowings on the international capital market. In February, a plan was announced to raise between $500 million to $1 billion by selling bonds on the global money market.

However, the main thrust of the Central Bank report is to push the government into another round of economic restructuring—privatisations, public spending cutbacks and financial incentives—designed to woo foreign investment. The report noted that Sri Lanka confronts intensifying competition from the huge cheap labour platforms of India and China. It called for "critical structural reforms", pointing to poor physical and service infrastructure as impediments to higher economic growth.

The report called for a "comprehensive public awareness program on the role and limitations of the public sector, the benefits of the liberalisation and reforms and the role of the private sector". In particular, it singled out fuel and fertiliser subsidies and welfare programs for cutbacks.

The director of the Central Bank's economic research department, Thenuwara told a seminar on the report: "Poorly targeted and undue subsidies drive budgetary resources away from productive investment.... If the full effect of price rises were passed on to the people, people might come to know how to live with higher fuel prices. If the prices were correct (without subsidies) consumption would be adjusted accordingly."

This is nothing but a recipe for imposing the full burden of the country's economic crisis onto the backs of the most vulnerable sections of the working class and rural poor. The Rajapakse government is already slashing subsidies. In March, it announced an increase in fuel prices of more than 10 percent. To justify the rise, Rajapakse's Sri Lanka Freedom Party issued a statement declaring that the oil subsidy had become "unbearable for the government coffers, hence excess was passed on to the people".

Even though the inflation rate is 11.6 percent, the Central Bank urged the government not to pressure the private sector for wage increases, declaring "this would not be compatible with developing a productivity based wage adjustment policy in the economy". The report noted that real wage rates in the private sector fell by 2.3 to 7.6 percent during 2005. At the same time, average profits for domestic industry increased by 2.1 percent to 14.4 percent.

Indirectly, the report points to the irresolvable contradictions facing the Sri Lankan ruling class. To boost foreign investment and profits, the government is implementing IMF and World Bank "reforms" that are eroding living standards, leading to higher levels of poverty and unemployment, and producing a deepening divide between rich and poor. At the same time, the government is responding to the growing popular discontent and anger by stirring up communal hatreds to divide working people and, in doing so, is pushing the country back towards a war that will only intensify the economic crisis.