Sri Lanka’s crisis budget: government imposes new war burdens

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18 November 2008

The Sri Lankan budget handed down last week by President Mahinda Rajapakse was dominated by two major crises: the country’s protracted civil war and the economic impact of the international financial turmoil and rapid slide towards global recession. Having restarted the war in mid-2006, the government is struggling to borrow the money to pay the ballooning military costs.

The defence allocation for 2009 is a record 200 billion rupees ($US1.8 billion) or nearly 17 percent of the government’s total expenditure of 1,191 billion rupees. Total government revenue is expected to be just 855 billion rupees leaving a huge deficit of 336 billion rupees. In the current year, defence spending has already shot up from 166 billion rupees to 194 billion rupees as fighting for the northern strongholds of the separatist Liberation Tigers of Tamil Eelam (LTTE) has intensified.

Rajapakse, who holds both finance and defence portfolios, devoted the major part of his budget speech on November 6 to boasting that the army’s offensives against the LTTE were in the “final phase.” Working people, he insisted, “should unite and dedicate” themselves to the war effort “as much as the soldiers [who] are fighting to liberate the country.”

Rajapakse’s comments underscore the reactionary character of the war, which for the past 25 years has been used to divide working people along communal lines and suppress opposition to the government’s anti-working class measures. As inflation has hit 30 percent, Rajapakse and his ministers have denounced strikes by workers and protests by farmers and students as undermining the war effort and playing into the hands of the LTTE.

Rajapakse’s concentration on the war in his speech was aimed at pre-empting any opposition to the rest of the budget measures. On the key issue of inflation, the budget only provided a very limited increase in the monthly cost of living allowance of 1,000 rupees for public sector workers and 560 rupees for pensioners—effective from next January.

Earlier this year, public sector employees campaigned for a 5,000 rupee increase in their monthly salary, which was rejected by Rajapakse as unaffordable. Yet as part of efforts to boost army recruitment, the budget included a significant increase in the monthly allowance for soldiers serving at the frontline from 2,000 rupees to 4,500 rupees.

In a bid to placate anger over inflation, the budget reduced petrol, diesel and kerosene prices respectively by 15, 30 and 20 rupees a litre. Far from being a concession to working people, the government is capitalising on falling world oil prices as one of the means for plugging the holes in its finances. Analysts have pointed out that petrol should be selling at 85 rupees a litre not 142 rupees meaning that the government is pocketting the difference.

Rajapakse also announced a reduction in the value added tax (VAT) from 15 percent to 12 percent except on motor vehicles, luxury goods and liquor. In the same breath, however, he imposed a raft of new taxes and tax increases that will only add to the burdens on ordinary working people.

These include a range of new taxes on imported products: 15 percent on wheat, 5 percent on wheat flour, 5 to 15 rupees per kilogram on milk powder, 25 percent on maze and animal feed, 5 and 15 percent on paper and furniture, 200 rupees per kilogram on imported leather items and 10 percent on mobile, cordless and fixed-line telephones.

The government also imposed another war levy—a 1 percent “nation building tax” for the next two years on industries and businesses to provide for the welfare for the security forces. While imposed on the private sector, the costs will inevitably be passed on to the population as a whole.

The budgets for education, health and welfare have been held to 48, 60 and 14 billion rupees respectively, totalling just over half of the defence allocation.

Despite the tax increases, the government still has a large budget deficit. Its ability to access low interest loans and other forms of financial assistance dried up after the so-called

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international peace process broke down. Last year the government raised 122 billion rupees in foreign loans and this year it is looking for 153 billion rupees.

However, amid the present international credit crunch, there is no guarantee that Colombo will be able to raise the necessary loans. As the International Monetary Fund (IMF) explained in a rather understated way, Sri Lanka's external borrowing will be a "challenge". And if it fails to do so, the island could rapidly face a financial crisis.

The international credit rating agency Standard & Poor's (S&P) last week named Sri Lanka as among the countries in Asia at the highest risk. "Pakistan is the weakest, followed by Sri Lanka, then Vietnam," spokeswoman Elena Okoro-tchenko said. S&P rates Sri Lanka's long-term currency debt at B+ with a negative outlook—that is, slated for possible further downgrading.

Foreign investors have already begun to pull out of Sri Lanka. Foreign holdings of Sri Lankan treasury bills and bonds amounted to around $670 million in early October, but plunged to $380 million at the beginning of November.

The country's foreign currency reserves have fallen from $3.4 billion in July to $2.6 billion in October. Over the last two months, the Central Bank sold around $600 million to maintain the exchange rate at 108 rupees to the US dollar. The bank has recently slowed its intervention in the money markets on the advice of the IMF and big business. As a result, the rupee quickly devalued to nearly 111 to the dollar.

According to IMF figures, Sri Lanka has $3.5 billion in short-term external debt that matures this year. Unable to cover this debt from foreign currency reserves, the government will be compelled to borrow again. Since last year it has already been forced to obtain $790 million in short-term loans at high interest rates on the global markets. On October 7, the government floated a proposal for another $300 million syndicated loan.

As a last resort, the government will simply run the printing presses, adding to soaring inflation. This year alone, it added around 87 billion rupees to circulation.

Big business has expressed serious concerns about the government's financial position. Referring to the accumulating problems of declining foreign reserves and high borrowings, Citigroup Global Markets Asia bluntly described the situation in Sri Lanka as "an accident waiting to happen."

The economy is also being undermined by sharp falls in world prices for two of its main exports—tea and rubber. The price of tea has dropped by 40 to 50 percent this year. Unsold tea is piling up in storage houses in Colombo. Rubber prices have fallen from 397 rupees a kilogram in June to 220 rupees. Textile exports have been affected by shrinking markets in the US and Europe.

Rohantha Athukorala, head of economic affairs at the Government Peace Secretariat, noted in a recent article that Sri Lanka's total exports are expected to shrink by $300 to $500 million in 2009.

All of the major opposition parties support the government's renewed war and therefore had limited criticisms of the budget. The conservative United National Party (UNP) declared its full support for the defence budget and proposed further pay increases for soldiers and policemen. In its "shadow budget", the UNP even called for a 7,500 rupee a month pay increase for public sector workers. It provided no indication, however, of how it was going to pay for the extra spending.

The Sinhala extremist Janatha Vimukthi Peramuna (JVP) also expressed opposition, denouncing the government's corruption, wastage and increased taxes. But the JVP had nothing to say about the huge defence budget, reflecting their support for the continuation of the war. Last year, after similar posturing, the JVP eventually voted in favour of the budget.

Rajapakse's budget was replete with empty promises to the "sustainable peace, development and welfare" of the country. However, the high cost of the communal war combined with impact of the global economic crisis are creating huge financial problems that could rapidly erupt in a major political crisis for the island's shaky coalition government.

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