Sri Lankan government seeks IMF bailout

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Confronting a worsening foreign exchange crisis, the Sri Lankan government is seeking a $US1.9 billion loan from the International Monetary Fund (IMF) to bail out the country. The island's foreign reserves fell from $3.5 billion last July to just $1.7 billion in December as export earnings fell, foreign investors pulled out and the Central Bank spent millions of dollars to stem the depreciation of the rupee.

The December figure is enough to cover just 1.5 months of imports—one of the worst positions of any emerging economy. Last month, Fitch Ratings downgraded its outlook for Sri Lanka to negative, warning that it could run out of cash to cover the current account deficit without a drop in imports or a devaluation of the rupee.

The government and Central Bank officials have desperately downplayed the country's precarious financial position. Central Bank governor Ajith Cabraal claimed that the IMF had approached the Sri Lankan government with a loan offer, rather than the other way around, and suggested that it came without significant strings attached.

In an interview with the state-owned *Sunday Observer* yesterday, Cabraal lashed out at critics, saying: "Many of these economic horror stories are created by a group of people who wish to see an unstable country and an unbalanced economy and are trying their best to destabilise our country." Such a threat is not an idle one in a country where journalists are jailed and murdered for criticising the government.

President Mahinda Rajapakse is particularly sensitive to any suggestion that he is going cap in hand to the IMF and will have to agree to tough new austerity measures. The government is already facing growing popular anger over deteriorating living standards produced by its huge military expenditures and the impact of the global economic crisis.

The size of the IMF loan request is unprecedented—three times Sri Lanka's quota at the IMF. An IMF team held a meeting with Central Bank officials in early March and are due back in Colombo at the end of the month with a decision.

There is no doubt that the government desperately needs the loan. Dushini Weerakoon, senior economist at the government-funded Institute of Policy Studies, told the media there was a large outflow of $US600 million in the second half of 2008 as foreign investors pulled out of Central Bank bonds. To prevent the currency from collapsing, the Central Bank pumped $200 million a month (between September and November) to defend an "unsustainable exchange rate policy". Despite these efforts, the rupee has depreciated by more than 6 percent since last October.

The country's current account deficit widened to $3.6 billion or 8.8 percent of GDP in 2008 from $1.5 billion in 2007. The main reason for the rise was a huge import bill of $14 billion, coupled with declining export earnings. Although hidden in the figures, a significant element of the import bill was the government's large purchases of arms from Pakistan, Israel, China and Russia. After Rajapakse restarted the war in July 2006, defence spending jumped from 96 billion rupees ($US840 million) in 2006 to 200 billion in 2008.

Oil prices fell sharply in 2008, easing the cost of oil imports. However, Fitch Ratings commented in February: "International oil prices have declined in recent months, and so too has Sri Lanka's trade deficit, but this has not prevented a steady drawdown in official reserves" as a result of high external debt repayments and other net capital outflows. The rating agency predicted a growth rate of just 3.2 percent in 2009, substantially less than the official estimate of 5.5 percent.

Previously the government borrowed on the international money markets to finance the war. In February, Rajapakse announced two measures to raise money—the sale of up to $500 million in war bonds to Sinhalese expatriates and currency swaps with other central banks—but neither was sufficient. As Dushini Weerakoon told the *Asia Times*: "We have exhausted access to domestic borrowing and international markets."

Commentators have dismissed government claims that the IMF loan would come without strings attached. The *Sunday Times*, for instance, wrote yesterday: "[T]he IMF would lay down certain conditions that would have to be fulfilled. These could relate to the exchange rate, expenditure on certain items, overall government expenditure and the fiscal deficit. The conditions could extend further to issues of good governance, the implementation of reforms and the privatisation of certain public enterprises."

Pakistan received an IMF emergency loan at the end of last year. The conditions included: eliminating all subsidies on energy, petroleum products and fertiliser; slashing government spending with the retrenchment of hundreds of thousands of employees; and raising taxes. Previously, the IMF and World Bank have called on the Sri Lankan government to cut its fiscal deficit, slash the public sector workforce, reduce price subsidies and implement privatisation.

Already there are signs that the government is bowing to IMF pressure. Treasury issued a directive last Thursday to provincial councils not to recruit any new employees because the government cannot pay their salaries. The agriculture minister announced that future fertiliser subsidies would be tied to sales to the government paddy marketing board. Many poor farmers have no choice but to sell their rice crop to private traders. Earlier this month, the government pushed through legislation that opens the door for the privatisation of electricity generation, transmission and distribution.

Exporters are pushing for a range of measures designed to increase their competitiveness, including the devaluation of the rupee. Export growth slowed from 11 percent in 2007 to 6.5 percent in 2008, but was accelerating toward the end of last year. Two of the country's major exports—garments and tea—fell by 6.3 percent and 22.5 percent respectively in December compared to the same month in 2007. One survey found that 24 garment factories have shut in the past six months.

The Employers Federation of Ceylon (EFC) has already begun to lobby the government for "greater flexibility of labour laws" to allow the "short-term lay-off of workers" and the reduction of the working week from 5.5 to 5 days. The EFC also wants an increase in the working day to 9 hours with no overtime bonuses.

Having imposed the economic burden of the war on working people, the Rajapakse government will have no hesitation in propping up big business and the island's financial system, by accepting an IMF loan that will lead to deepening poverty and unemployment.