Sri Lanka’s debt crisis worsens

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Despite the efforts of the Sri Lankan government and Central Bank to paint a picture of a vibrant economy on the brink of an historic expansion, the island confronts a worsening economic crisis. Like a number of European countries, Sri Lanka is burdened with heavy foreign debts and a ballooning budget deficit, in large part due to the huge military spending needed to wage war against the separatist Liberation Tigers of Tamil Eelam (LTTE).

The Sri Lankan army defeated the LTTE last May, but the island’s economic problems have only deepened. Last week Central Bank governor Ajit Nivard Cabraal visited London to tout for foreign investment, saying Sri Lanka was ready to take off. Foreign reserves, he declared, had risen to around $US6 billion, equal to six months imports, and economic growth would increase dramatically to around 6.5 percent in 2010, up from 3.5 percent last year.

The truth is that the rise in foreign reserves has rested substantially on large commercial borrowings by the government, and the release of the first two instalments of a $US2.6 billion International Monetary Fund standby loan, which is spread out over two years. The IMF approved the loan last July when the country faced a major foreign exchange crisis and, potentially, a default.

The *Sunday Times* economic columnist warned last weekend: “Most of the [foreign currency] reserves are loans that have to be repaid rather than funds that have been earned through exports. These contingent liabilities have also increased the country’s public debt that is a serious burden on the economy…”

The columnist also noted that another reason for the favourable foreign exchange figures was a rise in remittances sent by workers employed overseas, particularly in the Middle East. He pointed out that while remittances increased 14.2 percent in US dollar terms over the first 11 months of 2009, exports were sharply down in all areas by an overall 14.7 percent. These included a fall of 12.3 percent in agricultural exports, including 10.2 percent for tea, and 15.1 percent for industrial exports.

Textile and garment exports fell by only 5.3 percent, but the sector will be hard hit by the EU’s decision to end its GSP+ trade preferences over the Sri Lankan military’s war crimes and human rights abuses. Like the US, the EU is using the human rights issue to pressure the Sri Lankan government, and undermine the influence of rivals such as China. But the decision to end GSP+, which will take effect in six months, will have a damaging effect on garment exports and jobs. More than half of the sector’s exports go to Europe.

The latest debt figures show continuing rapid rises. The country’s outstanding debt increased by 83.2 billion rupees ($728 million) from September to October last year, with the total rising to 4.1 trillion rupees ($35.6 billion). Of that, foreign debt amounted to 1.77 trillion rupees—a 29.6 percent increase from the previous month. Since then, the Central Bank has not published figures—in part to obscure the real economic situation in the lead-up to the January 26 presidential election.

During the first 10 months of last year, the budget deficit expanded by more than 50 percent, compared to the previous year and hit 8.4 percent of GDP. The estimated deficit for 2009 as a whole is a staggering 11.3 percent of GDP, which far exceeds the limit set by the IMF as a condition of its loan.

The IMF releases quarterly instalments of $330 million following a review to ensure that the government is on track to meet its targets. Over three years starting with 2009, the budget deficit must be successively reduced to 7, 6 and 5 percent of GDP. If the estimated 2009 budget figure is correct, the government has exceeded its limit by a massive 4.2 percentage points.

Last week the IMF residential representative Koshy Mathai warned that the Fund was concerned about the high fiscal deficit. While his tone was measured so as not to spook the markets, Mathai declared: “The fiscal situation is challenging… We want to see whether the underlying deficit reduction path will be maintained.”

This warning has only one meaning. The government will be compelled to slash the budget deficit by more than half by the end of 2011, which can be achieved only through a savage assault on public spending and the living conditions of working people. An IMF delegation is expected to visit the country at the end of this month to conduct a quarterly review.

In the lead-up to the presidential election, President Mahinda Rajapakse, who is also the finance minister, postponed the budget with the tacit approval of the IMF. Now, amid a deepening political crisis in Colombo, Rajapakse has called a general parliamentary election for April 8. The budget will be presented only after the next government is formed.

The IMF, however, may well insist that Rajapakse start to spell out just what steps he will take to reduce the budget prior to April. The conditions of the loan require the government to make tax reforms and restructure key state-owned enterprises, including the Petroleum Corporation and Electricity Board. Any steps in that direction will compound the political crisis in the leadup to the general election.

A sovereign debt crisis is looming in Europe and elsewhere; it is a new stage in the global economic turmoil that erupted in 2008. Greece’s budget deficit is running at 13 percent. EU officials have put forward a plan to slash public service wages and jobs, increase the retirement age by two years, cut health care, and impose higher taxes, including a tax surcharge on fuel, with the aim of bringing the budget deficit down to 3 percent.

The impact will be no less in Sri Lanka. As soon as the general election is over, the Rajapakse government will be compelled to launch what he has termed an “economic war”. While the president uses the term to conjure up a glorious “victory” that will make Sri Lanka “the emerging miracle of Asia,” the reality is that working people will be forced to pay. Using the military analogy, Rajapakse has already made clear that workers will have to perform like soldiers and be prepared to make heavy sacrifices.