Sri Lanka: IMF loan delay signals deep assault on living standards

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In a move that foreshadows a far-reaching assault on the working class, the International Monetary Fund mission to Sri Lanka announced on Thursday that the Fund would delay the release of the third installment of its $US2.6 billion loan agreed last July. IMF mission head Brian Aitkin nominated the government's failure to meet its budget deficit reduction target as the reason for the decision.

The IMF delegation expressed its disapproval that "the ceiling on domestic budget borrowing—consistent with the government's overall deficit target of 7 percent of GDP—was exceeded by a substantial amount". It identified the rapid implementation of infrastructure projects, higher interest payments and sluggish fourth-quarter revenue growth as factors.

The decision effectively puts President Mahinda Rajapakse on notice that major cutbacks in public spending, further privatisations and more taxes are required. If the IMF withdrew its loan facility, the government and economy could quickly confront financial turmoil. Rajapakse, who is also the country's finance minister, agreed to the loan last year when, amid the global credit crunch, the government failed to secure loans from other sources to avert a looming balance of payments crisis.

During the campaign for the January 26 election, Rajapakse falsely claimed that his government had doubled per capita gross domestic product (GDP) in four years and was turning Sri Lanka into "the emerging wonder of Asia". Having won a second term of office, the president has called a parliamentary election for April 8 and continues to paint a rosy and phoney picture of the island's economy.

Rajapakse was able to get away with this deception, in part because he postponed the 2010 budget due last December until after the parliamentary elections. Moreover, he was assisted by the Central Bank, which has downplayed the economic crisis facing the island, and the IMF, which raised no objections to the charade. Now the IMF is beginning to tighten the noose—allowing Rajapakse to have the election and bring down his budget, but making clear that he must meet the Fund's demands to slash the budget deficit.

The IMF's conditions for the loans included cutting the deficit progressively to 7 percent of GDP in 2009, 6 percent in 2010 and 5 percent by the end of 2011. The Fund specifically called for the broadening of the government's tax base and the restructuring of state-owned corporations into profit-making enterprises, naming the Electricity Board and Petroleum Corporation.

Asked last Thursday what the IMF meant by widening the tax base, Aitkin replied that the government had to "include those who do not pay taxes now". He added that "it would be wrong to increase the taxes of those who already pay taxes". While Aitkin's words are deliberately vague, the meaning is clear: the government should not increase taxes on corporations and the wealthy elite, but should ensure that the poorest layers of society do not escape the tax net.

By not bringing down the budget, Rajapakse has hidden the magnitude of last year's budget deficit. Even the IMF team admitted that it had "not seen the final figures yet". According to *Lanka Business Online*, however, the figure is far higher than the target of 7 percent of GDP. It estimates that the overall figure for 2009 was 11.3 percent of GDP last year and may have been much higher.

The Rajapakse regime borrowed to the hilt from domestic and international money markets to pay for its war against the Liberation Tigers of Tamil Eelam (LTTE). Even though the army defeated the LTTE last May, the government has announced no plans to reduce the size of the military, which is one of the largest per capita in the world. During Rajapakse's first term, the national debt doubled in rupee terms from 2 trillion to 4.1 trillion. Of that, the foreign debt amounts to 1.77 trillion rupees ($15.5 billion).

The IMF's refusal to release the third loan instalment of $US318 million will have a significant impact on the island's financial system. Last week the Central Bank increased the interest rate on its benchmark treasury bills in a bid to attract domestic investors. *Lanka Business Online* explained rising interest rates were likely to continue "as the government seeks short term funds until the budget is presented by the new parliament by May".

Rajapakse and the Central Bank have both highlighted the fact that the foreign reserves have improved significantly since last July when the country appeared to be on the brink of default. While reserves now stand at $5.2 billion, the IMF delegates pointed out that the improved position was largely due to foreign borrowings, including the IMF's own loan, and increased foreign investment. All of the country's major exports—tea, garments and rubber—are significantly down.

Equity.com reported this week that "Sri Lanka has attracted more than $1.6 billion in foreign investment into government securities and $500 million into a sovereign bond". But this rise in short term investment from overseas is paralleled by a marked decline in foreign direct investment in the island's productive capacity—from $889 million in 2008 to $600 million in 2009.

Early this month Central Bank governor, Ajit Cabraal, acknowledged that the IMF loan was a "critical issue." Cabraal has already begun to look for other sources of finance, announcing that Sri Lanka will launch another sovereign bond issue of $500 million

Rajapakse has pointed to the performance of the Colombo stock exchange as an indicator that the country is becoming an Asian wonder. In 2009, the Colombo exchange was the best performing in Asia and second best in the world behind Russia. The index went up 122 percent in 2009 and has risen by 12.5 percent this year.

But the overall figures mask an underlying trend that could quickly wipe out all of the gains over the past year. Foreign investors, who were net buyers since 2001, became net sellers in 2009, selling 785.3 million rupees worth of shares for the year. Foreign investors have been net sellers in 29 out of 36 trading sessions this year. Last Friday after the IMF's announcement, the net foreign turnover amounted to 160 million rupees in sales.

The figures underscore how speculative capital which flowed into the Colombo stock exchange last year could just as easily flow out if investors lose confidence. Analysts have pointed to "debt worries" in Europe, "a slower than expected global recovery" and political instability in Sri Lanka as potential triggers for a further outflow of capital. One could add that the IMF's decision to withhold the latest loan instalment will be interpreted as a lack of confidence in the Rajapakse government's economic policies.

The working class must take the IMF decision as a sharp warning. As soon as the election is over, the next government is going to be compelled to make deep inroads into public spending on essential services such as education and health and price subsidies. The government's crackdown on opposition parties, including the arrest of opposition presidential candidate General Sarath Fonseka, is in preparation for the looming confrontation with working people.