Sri Lankan government prepares for austerity measures

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14 June 2010

The Sri Lankan government last week presented parliament with expenditure estimates as part of an appropriation bill for 2010. The large allocations for debt repayments and defence indicate that savage cuts will be made elsewhere, in particular to social spending, when the budget is finally brought down on June 29.

President Mahinda Rajapakse, who is under pressure from the International Monetary Fund (IMF) to slash the budget deficit, has repeatedly delayed introducing a full budget for 2010, which was due last November. Last week's bill does not include revenue measures, thus preventing an accurate estimate of the deficit.

The two largest budget items—defence and debt—are an indication of the precarious state of government finances. The government dramatically increased military spending and borrowed heavily to finance its war against the separatist Liberation Tigers of Tamil Eelam (LTTE), which was defeated in May 2009. One year later, it has maintained the defence budget at 202 billion rupees ($US1.8 billion) or 21 percent of the total expenditure of 974 billion rupees allocated to government ministries.

Rajapakse has increasingly rested on the military, one of the largest per capita in the world. New bases are being built in the war-torn North and East of the island creating what amounts to a permanent military occupation. At the same time, the president is preparing for opposition from working people as his government carries out its "economic war" to "build the nation".

In July last year, the government was compelled to take out a $2.6 billion IMF loan to ward off a balance of payments crisis. The IMF has released two installments, but withheld a third in February after the government failed to indicate how it would rein in the budget deficit, which hit 9.75 percent of GDP in 2009. The IMF targets were 7 percent last year, 6 percent this year and 5 percent by the end of next year.

Treasury Secretary P. B. Jayasundara told Reuters on June 4 that the deficit would be 8 percent this year, which is still well outside the IMF limit. The IMF demands also include the restructuring of loss-making state-owned corporations, measures to cut public spending and tax increases. Having put off cutbacks until after the country's presidential and parliamentary elections earlier this year, Rajapakse must now do the IMF's bidding.

The government is preparing its budget in the midst of a growing international "sovereign debt crisis", which is centred in Europe but impacts on every country. The "second schedule" of the budget estimates—separated from the allocations to government ministries—reveals that Sri Lanka confronts a burgeoning public debt with repayments amounting to 767 billion rupees this year, or 44 percent of the overall budget expenditure of 1,780 billion rupees.

Last year government debt hit 4.1 trillion rupees—of which 1.8 trillion rupees was foreign debt, a 22 percent rise. The Central Bank annual report pointed out: "The ratio of debt service to government revenue increased further to 117.5 percent from 90.5 percent." Total debt servicing rose by 39 percent to 825.7 billion rupees in 2009, including a huge interest payout of 309.7 billion rupees that comprised 26 percent of total expenditure.

World Bank Director for South Asia Ernesto May launching the World Bank's *South Asia Economic Update 2010* in Colombo last week noted: "South Asia has very high levels of public debt—over 60 percent of GDP for the region. As seen in Europe with markets focusing on highly indebted countries, markets will start penalising those with high debt." He pointed out that Sri Lanka's debt was the second highest in the region after the Maldives—increasing from 81 percent of GDP in 2008 to 86 percent in 2009.

The World Bank's reference to Europe is a clear warning that South Asia, particularly Sri Lanka, will confront a major financial crisis unless major cutbacks to public spending are made. Starting in Greece, European governments are freezing wages, cutting pensions and welfare benefits, and slashing health and education spending. The debts were accumulated as a result of the bailouts and stimulus measures implemented to prop up the financial system in the wake of the global financial crisis that erupted in 2008-09.

Given the huge allocations for defence and debt repayments, the Sri Lankan government will be compelled to make major inroads into social spending. In last week's bill, it halved the allocation for the rehabilitation ministry from 4 billion rupees to 2 billion rupees for this year. As a result, hundreds of thousands of war refugees will continue to lack homes and essential services. More than 250,000 million civilians were detained by the military following the end of fighting and are now being "resettled". Many have nothing but makeshift shelters.

Allocations for health and education were 52 and 46 billion rupees respectively—a total of 10 billion rupees less than for 2009. The budget for 2009 was itself 12 billion rupees lower than the amount for 2008. The combined allocation for health and education this year is less than half of defence expenditure.

The government promised an IMF team in May that it would considerably reduce recurrent spending. It intends to cut government subsidies to the Ceylon Electricity Board, Petroleum Corporation, Central Transport Board, railways and postal services. Total losses in these sectors amount to 49 billion rupees and can only be reduced by axing jobs, cutting wages and increasing prices.

Treasury Secretary Jayasundara said in April that the government's budget would include a "new tax regime while rationalising public spending." The comment foreshadows new tax burdens that will inevitably fall most heavily on working people. The government has already reduced tariffs on a range of items including vehicles, cameras, mobile phones and wristwatches as well as machinery and raw materials, which will mean increased taxes in other areas. Big business praised the tariff reductions.

For the past quarter of a century, successive governments have used the civil war to justify the imposition of economic hardships and divide working people on communal lines. Now the government, which boasts about winning the war, is preparing to put new burdens on workers and the rural poor. Well aware that such measures will provoke resistance, Rajapakse has retained the huge police state apparatus built up during the war to suppress any opposition.