Sri Lankan government to intensify austerity measures

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The International Monetary Fund (IMF) released the fifth instalment of its $US2.6 billion loan to Sri Lanka last month, cautiously noting that the government's performance was "satisfactory," but calling for further austerity measures to reduce the budget deficit.

In a press statement on September 24, IMF deputy managing director Murilo Portugal focussed on next month's budget, declaring that "the 2011 budget will be key to demonstrate the government's continued commitment to the [IMF] program's goal". He called for "broad-based structural and financial sector reforms" to ensure "higher levels of private investment".

In its letter of intent, the Sri Lankan government reiterated its intention to cut the budget deficit to 8 percent of the country's Gross Domestic Product this year, then reduce it to 6.8 percent and 5 percent over the next two years. The cutting of the budget deficit from 9.9 percent last year already has been at the expense of public sector jobs, conditions, services and price subsidies.

There has been a severe impact on working people. Prices for basic items have risen sharply. Last month, the government slashed the price subsidy on flour by two thirds, from 225 rupees to 75 rupees ($2 to $0.67) per 50 kilograms. As a result, the price for one kilogram of flour went up by 12 rupees. The price of a 450 gram loaf of bread went up by 6 rupees twice in the past four weeks. During the past five months, the price of bread has shot up by 28 percent.

The government has dismissed public criticism, declaring that people should eat rice, rather than imported flour, to help the farmers. Speaking to Sirasa TV on October 11, Cooperatives and Internal Trade Minister Johnston Fernando declared: "We are self sufficient in rice. Our priority is to protect the farmer and thus we have no intention of providing relief in this regard [on wheat prices]."

The government knows full well that flour products are, along with rice, staples for the poorest layers of society, particularly the plantation workers. For them, higher prices mean eating less. As for the price increases, the profits will not go to paddy farmers, who struggle to survive each year, but to the various intermediaries that thrive by trading in rice.

The government's letter of intent foreshadowed the "rationalisation of the tax system for trade taxes, VAT and income taxes". As in other countries, the IMF's prescriptions will mean a lowering of taxes on businesses and the income of the wealthy through increases in consumption taxes, such as VAT, that impact disproportionately on the poor.

The government pledged to improve "the performance and efficiency of loss-making, state-owned enterprises" by implementing an "ambitious plan" toward privatisation. As reported on October 4 in the *Daily Mirror*, State Resources and Enterprise Development Ministry secretary W. Gamage reported that the government would set up a State Resources Management Corporation to absorb 17 loss-making state enterprises and restructure them over three years. The corporation will be run as private-public partnership as a prelude to full privatisation.

Gamage did not name the 17 enterprises. But the government had earlier identified the Ceylon Electricity Board, the Ceylon Petroleum Corporation, the National Water Supply and Drainage Board, Sri Lankan Airlines, the Sri Lanka Transport Board, and the railway and postal service departments as major loss makers. The restructuring of these enterprises will inevitably mean major cutbacks to jobs and conditions for workers, on top of increased prices and charges for consumers as subsidies are wound back. The government has assured the IMF that subsidies for electricity tariffs will be ended by 2011.

The government's letter of intent promised that the "government stands ready to take additional measures" and would "continue to liaise" with the IMF. President Mahinda Rajapakse, who is also the country's finance minister, is seeking IMF backing to obtain further loans. Recently the international credit rating agencies Fitch Ratings and Standard & Poors upgraded the country's ratings because of the IMF's assessment.

The government is deeply in debt due to heavy military spending in its civil war against the Liberation Tigers of Tamil Eelam (LTTE), compounded by the global financial crisis. Over the past two years, it has raised $2 billion through sovereign bond sales, including $1 billion last month. The money is being used to pay off expensive commercial loans—one of the only sources of credit during the war that ended in the LTTE's defeat in May 2009.

Total public debt continued to rise from 4,161 billion rupees ($37 billion) in December to 4,293 billion rupees in May. Interest and principal repayments together amount to more than the total budget revenue, forcing the government to take out new loans to repay the old. Noting the high level of public debt, the *Sunday Times* economic columnist recently warned: "In this context the government resorts to further borrowing to meet its recurrent as well as capital expenditure. This results in further increases in debt servicing costs. The country is caught up in this vicious cycle of a debt trap."

The government boasts about the supposedly miraculous economic recovery at the end of the war, pointing to an estimated growth rate of 8 percent this year, and a stock market that is "the best performing in the world". In the last week of September, the Colombo stock exchange passed the 7,000-point mark. Central Bank Governor Nivard Cabraal dismissed concerns about financial speculation, declaring "we are not unduly worried about that".

However, the hothouse character of the economic expansion highlights the vulnerability of Sri Lanka to sharp shifts in the global economy. The recovery of the country's foreign reserves from mid-2009, when the country faced an acute balance of payments crisis, has been dependent on foreign loans, increased remittances from workers employed overseas, and a marked improvement in tourism and commodity export prices.

Remittances were up by 12.5 percent over the first seven months of the year, reaching $2.1 billion, compared to the corresponding period of 2009. Income from tourism rose 68.8 percent in the first seven months of this year to $301 million. Agricultural exports grew by 23.5 percent, with tea up 20.6 percent. Industrial exports increased by only 7.9 percent, affected by a fall in garment exports of 3.7 percent. Imports, however, grew far faster, widening the trade deficit to $3.3 billion or by 103 percent during the first seven months.

Foreign investors are treating the "world's best performing stock market"—which has risen by 110.9 percent so far this year—with extreme caution. Over the same period, net foreign investment in Sri Lankan shares has fallen 16 billion rupees. There is a speculative frenzy by domestic investors, reflecting a ready availability of bank credit and a lack of alternative, profitable investment opportunities.

Price earnings ratios for Colombo shares have blown out to levels not seen since the 1993 share market collapse in Sri Lanka. Analyst Amal Sanderatne told *Lanka Business Online*: "In my opinion the market is overheated. The valuations are the highest in Asia. Forward multiples are 19 times earnings; far higher than we have ever been, except perhaps in 1993." Such speculative bubbles inevitably burst, sending shock waves through the economy.

Some business sectors may temporarily be making profits but the majority of working people confront falling living standards. That is certain to worsen after the Rajapakse government announces its next budget, scheduled for November 22, in line with the dictates of the IMF and global finance capital.