Sri Lanka: IMF demands currency devaluation

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The International Monetary Fund (IMF) last month delayed the final two instalments of its loan to Sri Lanka, demanding the devaluation of the rupee. After the IMF postponed the instalments, worth $US400 million each, due in June and December, Koshy Mathai, the fund's residential representative said no timetable had been fixed for the completion of its review.

The IMF warned the government that another foreign reserves crisis loomed if it did not heed the request for a "flexible exchange rate." The fund also pressed for further fuel price hikes and higher domestic interest rates.

The IMF assessment undermines President Mahinda Rajapakse's absurd claims that the surging economy has weathered the global economic crisis. Not only is Sri Lanka highly vulnerable to international economic storms but the IMF's demands will greatly heighten social tensions within the island.

The Washington-based institution wants President Mahinda Rajapakse's government to take further measures that make the working people pay for the impact of the worsening global economic situation. The devaluation of the rupee would trigger new rounds of price increases for essentials, again slashing the living conditions of the working class.

The IMF's demands flow from the conditions it imposed when the Rajapakse regime obtained a $2.6 billion bailout loan in July 2009 to avert an imminent balance of payments crisis. The financial emergency was a result of the worldwide economic breakdown that began in 2008, compounded by the Rajapakse government's heavy borrowing for military spending. The austerity measures dictated by the IMF included slashing the budget deficit from 10 percent of gross domestic product (GDP) in 2009 to 5 percent by 2012.

Brian Aitken, who headed the IMF delegation that came to review the Sri Lankan economy, praised its "rapid expansion" and "sound economic fundamentals." At the same time, he warned that although the "headline reserves [of Sri Lanka] are at a comfortable level," the "non-borrowed reserves have steadily declined" because the Central Bank had sold foreign exchange to defend the value of the rupee.

The Central Bank sold foreign exchange worth $416 million in July and $300 million in August to prevent a rupee depreciation. Aitken insisted that "the Central Bank should henceforth limit its intervention." He said the IMF was making this demand because of uncertain external developments—that is, the global economic turmoil produced by the European debt crisis as well as recessionary trends in the US and other major economies.

Central Bank Governor Ajith Nivad Cabral initially declared that the Central Bank would not adhere to the IMF's targets because the bank held strong foreign reserves. This week, he said the fund's review would resume in December. There is no doubt that the government will toe the line. Early last year, the IMF similarly withheld its third instalment, forcing the government to comply with budget deficit targets.

Rajapakse's government has already implemented severe austerity measures during the past two years—increasing taxes and the price of essentials, freezing wages, reducing subsidies and privatising university education. Aware that popular discontent will deepen with further attacks, the government is waiting until after elections for 23 local government bodies on October 8.

The Central Bank states it has $8.1 billion in foreign reserves, sufficient for more than five months' imports. However, a considerable portion of the reserves consist of foreign borrowings. The bank obtained another Euro Bond loan of $1 billion last month at a high interest rate in order to repay previous loans.

Economists have also expressed concern over the trade deficit, which expanded by 70 percent to $4.25 billion in the first half of 2011, compared to last year. In the first six months of this year, imports rose by 46.5 percent to $9.3 billion while exports increased 35 percent to $5 billion.

Global price increases for essential goods have been a major factor in the deteriorating trade deficit. The average import price of crude oil increased by 43.9 percent in June 2011, compared to a year earlier. Wheat and sugar prices have also risen.

Sunday Times economist Nimal Sanderatne warned that the Middle East turmoil and the global economic downturn could adversely affect Sri Lanka's trade performance during the second half of the year. He said the projected trade deficit of $8-9 billion "threatens the balance of payments and the foreign reserves."

The government is increasingly reliant on remittances from Sri Lankan workers overseas—worth about $4 billion in 2010—to bridge the trade deficit. Most of these workers are domestic servants in Middle Eastern countries, subjected to oppressive working conditions. The uncertain political situation in those countries is a growing threat to this source of income.

The government has highlighted the economy's high growth rate, which the Central Bank has forecasted to be 8.5 percent. The IMF estimate is 7.5 percent, with the fund pointing out that export markets will be affected by the world slowdown during the last quarter of 2011.

One main reason for the high growth rate is the building of infrastructure to lure foreign investment, and resorts and hotels to attract tourists. The Central Bank is keeping domestic interest rates at 7 percent to provide relatively cheap credit for these projects. This in turn has pushed up imports, widening the trade deficit.

Accumulated debts reached 4,872 billion rupees at the end of June 2011, up 12 percent or 525 billion from the previous year. The IMF stated: "Sustained rapid credit growth bears close monitoring and may need to be slowed." It indicated a need to increase domestic interest rates.

The government has also failed to attract significant foreign direct investment (FDI). During the first half of 2011, the total amount received was $413 million. Significant portions came from China and India—both of which are seeking more influence over Sri Lanka—mostly to construct power plants and hotels.

The IMF is also demanding higher electricity and oil prices, because of the rapidly rising debts of the state-owned Ceylon Electricity Board and Petroleum Corporation. The workers of these corporations have strongly resisted privatisation, so the government is currently marking time in this mooted "restructuring."

There is no doubt that the IMF will tighten the noose, compelling the government to implement its demands, while cutting spending, including on welfare measures. Further attacks on living conditions will trigger explosive struggles of the working class, youth and the poor. That is why the government is keeping intact its police-state regime, as shown by its recent adoption of essential services provisions to replace emergency regulations (see: "Sri Lankan government revives emergency powers in a new guise").