Sri Lankan Central Bank chief covers up debt crisis warnings

Saman Gunadasa
20 August 2014

Central Bank of Sri Lanka Governor Ajith Nivard Cabraal last week downplayed warnings issued by the International Monetary Fund (IMF) and global rating agencies on the country's worsening debt situation. Instead, he declared Sri Lanka was smoothly progressing toward becoming a "middle income country."

Cabraal, interviewed by Reuters on August 8, offered as proof of the country's "easing debt level" a fall in the ratio of debt to gross domestic product (GDP) to 74.3 percent, from last year's end indicator of 78.3 percent. His claim was aimed at appeasing international commercial creditors, from whom President Mahinda Rajapakse's government is frantically borrowing to sustain a fragile "economic growth."

The government's much-touted growth depends on loans at high interest rates for infrastructure developments, including new highways. It spends massively on extravaganzas, such as of beautifying cities, mainly Colombo, to attract foreign investors and tourists. The growth rate has been projected at 7.3 percent this year, but relies primarily on the service sector and infrastructure, not production.

After ending one of its periodic consultations on Sri Lanka, IMF directors issued a news release on July 29 saying: "Sri Lanka's economic growth has been one of the fastest among Asia's developing economies." However, the IMF related the economic growth to spiralling debt and warned: "Medium-term sustainability will depend on maintaining an outward orientation, diversification of the export structure, and a judicious use of foreign borrowing—particularly given the rapid increase in debt servicing costs."

The IMF statement expressed concern about the government's shift to seeking new loans on commercial terms. It stated that its analysis "highlights the sensitivity of Sri Lanka's debt sustainability to growth and foreign exchange shocks."

By the end of March, the country's public debt reached 7.18 trillion rupees ($US55.2 billion), of which 44 percent was foreign debt. Most came from commercial borrowings, raising the debt servicing burden.

Though the IMF statement was diplomatic, global ratings agencies have bluntly raised concerns over the deepening debt problem. According to Moody's: "Sri Lanka's external debt is now 59 percent of GDP, the highest in the Asia Pacific after Mongolia (rated B2, negative) and Papua New Guinea." Moody's pointed out that short-term debts maturing during 2014 stood at 118.6 percent of the country's official reserves. If there were a sudden halt to the expanding supply of credit, this figure could climb to 124 percent.

Another ratings agency, Standard & Poor's, suggested it was "high time" for the government to seek another loan facility from the IMF. "We expect Sri Lanka to be able to secure new external liquidity support from the IMF or bilateral sources if the need arises," it commented. This amounted to a warning about the potential for a debt default or a balance of payments crisis.

On July 28, in a discussion with big business about the technical investment plan for next five years, Technology and Research Minister Patali Champika Ranawaka said the government's ability to repay debts was rapidly decreasing.

Ranawaka noted that in 1977 total debt payments amounted to 28 percent of government revenue but by 1994 they rose to 55 percent and in 2013 to 102 percent. He declared the government would be forced to sell public property to make the payments, as in Greece, Ukraine, Iceland and Italy. Ranawaka is a leader of the Sinhala chauvinist Jathika Hela Urumaya, which is a partner in the ruling coalition.

Treasury Secretary P. B. Jayasundara, addressing the Sri Lanka Economic Summit organised by the Ceylon Chamber of Commerce on August 5, insisted: "The government dispelled through credible actions the perceived fears of having to print money, excessive debt financing and high debt." He failed, however, to explain the "credible actions."

The IMF's reference to possible "foreign exchange shocks" reflects the volatile situation developing in the world's financial markets. In July, International Bank of Settlements chief Jaime Caruana indicated that the global financial system was more vulnerable than during the 2007–08 crisis. He said "emerging markets" had accumulated massive debts since the 2008 collapse of Lehman Brothers investment bank in the US.

Such high debts in countries like Sri Lanka could intensify the financial instability. The boasting by Cabraal and President Rajapakse about averting external shocks is ridiculous. Sri Lankan capitalism is tightly knit into the world financial markets.

One "solution" in the IMF's prescriptions is debt reduction via tight fiscal deficit targets, set at 5.2 percent of GDP for this year. The IMF set these targets when the Rajapakse government obtained a $2.6 billion loan in July 2009 in order to avert its balance of payments crisis.

According to the IMF, the government's spending cuts have reached a limit. One option is to boost revenue by increasing taxes. At present, revenue collection is mainly based on indirect taxes imposed on the day-to-day needs of the working people, such as dhal, sprats, milk powder, tinned fish and diesel. Last month, the government increased the special commodity levy on sugar from 20 rupees to 28 rupees per kilogram. From August 15, the government approximately trebled the levies on imported potatoes and large onions.

Rajapakse's government is still pursuing cost-cutting at the expense of the working class, with pensions a major target. This year, the government decided to replace the public employees' gratuity payment—a lump sum paid at retirement—with repayable bank loans. Public sector workers have depended on this pension payment to settle loans and cover other essential expenses.

According to Treasury information, 14,000 pensioners were not paid the gratuity by March. The total amount payable to them was about 7 billion rupees.

The government also decided to transform the Employees Provident Fund (EPF) into a monthly paying pension scheme. Managed by the Central Bank, the EPF is a pension fund contributed to by workers and employers in the private sector and state-owned corporations. The total amount accumulated runs into trillions of rupees, and the legislation requires the bank to pay workers the full amount of the contributions at retirement.

The Central Bank arbitrarily invested the EPF in selected companies and on the stock market, resulting in losses of billions of rupees. So the government proposed to make it a monthly payable scheme and also divert the remaining funds into its various projects.

As well as being seriously affected by debt repayments, Sri Lanka's balance of payments relies heavily on overseas workers' remittances, mainly from the politically-fragile Middle East, and exports to the stagnant economies of Europe and the US.

While the Central Bank chief is downplaying the warnings issued by the IMF and the ratings agencies, the government is preparing further attacks on the living conditions of workers and the poor, and strengthening its police-state measures to deal with any social unrest.