IMF demands "decisive action" on Sri Lankan austerity cuts

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The International Monetary Fund (IMF) last week issued warnings about the impact of "external factors" on the Sri Lankan economy and said the government had to strictly follow commitments made in exchange for loans under a three-year Extended Fund Facility (EFF) agreement.

The comments followed a two-week IMF visit to assess the progress of the government's austerity measures. The IMF is due to release $119.9 million, the third tranche of a $US1.5 billion concessionary loan, in mid-April.

An IMF statement noted that Sri Lanka's international reserves had fallen short of projected targets. Progress on implementing "structural benchmarks" and some of the "reforms"—i.e., the sale of state owned enterprises—was "behind intended timelines."

The IMF mission said it had met Sri Lankan authorities and "discussed decisive actions to maintain the reform momentum in light of the uncertain external environment."

The "uncertain" environment is a reference to international recessionary conditions, concerns about the future of the European Union following last year's Brexit vote in the UK and nervousness over the Trump administration's "America first" program. Interest rate increases under Trump have severely affected the Sri Lankan capital market and seen an outflow of investment funds.

Franklin Templeton, a US hedge fund and one of the world's largest investment management companies, has started withdrawing from Sri Lankan government bonds, and other investors have stopped trading rupee bonds. Over 64 billion rupees ($420 million) has been withdrawn from government bonds so far this year. Central Bank officials have responded with road-show promotions of Sri Lankan bonds in the US.

There has also been a drastic reduction in the country's exports. The trade deficit increased from $7.5 billion in 2013 to over $9 billion last year. Foreign direct investment has halved, from $600 million in 2015 to $300 million in 2016. The government increasingly depends on unreliable sources of foreign currency, such as workers' remittances, mainly from the Middle-East, and tourist income.

It is not clear whether last week's IMF report will delay the third IMF tranche. The loan is crucial for the government, which has to pay $5.4 billion on loan instalments and interest this year.

Last week, Prime Minister Ranil Wickremesinghe told parliament the government has to settle $15 billion in loans from 2017 to 2020 and the country confronted a "global economic crisis."

Local media openly speculated about whether the government would default on its loans. An editorial entitled "Sri Lanka in a catch-22 situation" in the March 6 edition of the *Daily Mirror* declared: "Since independence Sri Lanka has never defaulted on its repayments, but today a repayment default is staring the country in the face."

IMF managing director Christine Lagarde was scheduled to visit Colombo on March 5. Her trip was cancelled, but the very fact that the IMF chief was planning to speak with government officials in person was another indication of the IMF's concerns. Finance Minister Ravi Karunanayake has now been summoned to IMF head office in Washington before the release of the third tranche of the loan.

The IMF team instructed government officials to immediately sell six "non-strategic" assets to obtain funds. According to press reports, the sale of two ventures—Lanka Hospitals and Sri Lankan Air Lines—is being finalised.

The IMF directed the government to publish "statements of corporate intents" for the sale of the Hyatt Hotel, Water's Edge, the Grand Oriental Hotel and the Colombo Hilton. The government hopes to obtain $1 billion from these sales.

Colombo is also attempting to sell a $1.4 billion long lease to China Merchants Port Holdings for an 80 percent stake in Hambantota Port, which was built with Chinese loans. Negotiations have stalled following local protests and disputes within the cabinet. Ports and Shipping Minister Arjuna Ranatunga opposes the proposed arrangement and has written a 15-point letter, voicing his disagreements. The government, however, has assured the IMF that the Hambantota Port deal will be finalised soon.

Colombo has said it will obtain funds for loan settlements through syndicated loans, international sovereign bonds and direct purchases in the market. The IMF mission, however, opposed these plans, warning they would drastically depreciate the rupee and not strengthen the country's international reserves.

Instead of more loans, the bank wants more rapid imposition of social spending cuts and other austerity measures that will impact on the working class and the poor.

The IMF wants subsidies cut to state-owned enterprises, such as the Ceylon Petroleum Corporation, Ceylon Electricity Board and National Water Supply and Drainage Board, and new price formulas to match international supply costs and current overheads. State funds for education, health and other subsidies, such as for fertilisers and school uniforms, will be substantially cut.

Colombo has begun implementing these measures in successive budgets, seeking to reduce the budget deficit from 7 percent of gross domestic product in 2015 to 3.5 percent by 2020.

The IMF mission objected to the Central Bank using foreign reserves to try to prevent the rupee's devaluation. Sri Lanka's external reserves fell from $4.5 billion in 2016 to $3.5 billion at the end of January 2017. In the final six months of 2016, the Central Bank spent $109 million to prop up the rupee.

The depreciation of the currency pushes up the cost of imported goods, resulting in price increases in essentials needed by workers and the poor. The rupee fell by almost 4 percent in 2016, and 1.2 percent so far this year. Currency dealers estimate that it will depreciate by 6 to 8 percent this year.

The government of President Maithiripala Sirisena and Prime Minister Wickremesinghe is already facing widespread strikes and protests by workers, students, farmers and the poor against its austerity measures. It has responded to the growing popular opposition by strengthening the police and armed forces.

Under the guise of fighting crime gangs and the illicit drugs business, Colombo is introducing new repressive laws to curb the struggles of the working class and poor. One of the planned laws will ban protests in public places and on roads.