

Sri Lankan Central Bank report covers up economic problems

By Saman Gunadasa
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In presenting his institution's 2006 annual report last month, Sri Lankan Central Bank governor Ajit Nivard Cabraal congratulated President Mahinda Rajapakse on the country's high rate of growth. The annual rate of 7.4 percent, Cabraal said, was close to the 8 percent promised by Rajapakse in his *Mahinda Chinthanaya* (Mahinda Thinking) manifesto for the 2005 presidential election.

This year's Central Bank report reads more like a piece of political propaganda than an objective assessment of the economy. It repeatedly refers to *Mahinda Chinthanaya* and devotes a special section to explaining its importance. Cabraal was appointed to his post by Rajapakse.

Behind the high growth rate, however, lies a series of economic and social problems as the report at least briefly acknowledges. "Despite these favourable developments, emerging inflationary threats posed a serious challenge for policy makers," it declared, without offering any explanation.

A column in the April 22 issue of the *Sunday Times* offered a more sober assessment: "The fact that the growth was accompanied by high inflation, the highest trade deficit, strains on the balance of payments and the depreciation of the currency, lets the cat out of the bag. These indicators lend credence to the commonsense view that the growth was qualitatively insubstantial."

The movements on the Colombo stock market reflect the pessimism in business circles. High company profits last year led to a 40 percent surge in stock prices, which reached a peak of 3016 points on February 13. Since then the share index dropped sharply to reach 2665 on May 13—a total fall of 13 percent.

Neither the report nor the economic commentators point to the underlying reasons for the high growth and accompanying economic ills. A major factor was Rajapakse's renewal of the war against the Liberation Tigers of Tamil Eelam (LTTE). At the centre of his November 2005 campaign and the *Mahinda Chinthanaya* manifesto was a repudiation of the so-called international peace process and a series of ultimatums to the LTTE. Having narrowly won office, Rajapakse let the military loose in a dirty covert war of provocation and attrition, then ordered it onto the offensive in July 2006 in open breach of the 2002 ceasefire.

A closer examination of the economic figures points to the impact of the war, a lack of any significant expansion of the productive sectors of the economy and a growing social divide.

* The GDP growth rate of 7.4 percent is certainly higher than the 2005 figure of 6 percent. In fact, it is the highest since 1978 when, in the wake of the massive electoral defeat of the Sri Lanka Freedom Party (SLFP), the incoming right-wing United National Party (UNP) began implementing open market reforms. The same restructuring and privatisation policies have been followed by successive governments—SLFP and UNP—leading to a deepening chasm between rich and poor.

More than half of last year's growth—4.1 percent—is attributable to the services sector and was, as the report cautiously noted, "partly due to the expansion in armed forces". No breakdowns are given, but other aspects of this sector include the expansion of private health care and education as well as financial services, including those related to the overheated and parasitic operations of the share market. There was just 2 percent growth in the industrial sector and only 1.3 percent in agriculture.

* The country's total debt burden grew by 17 percent to 2,606.5 billion rupees (\$US23.6 billion) at the end of 2006. Debt service payments increased by 28 percent in 2006 to 444.3 billion rupees, equivalent to almost 75 percent of total government revenue. According to the Central Bank, foreign debt increased by 174.4 billion rupees in 2006, mainly due to the continued depreciation of the rupee, which dropped 9 percent against the US dollar the last year and a further 3.2 percent during the first four months of this year.

* In 2005, the country's balance of payments showed a surplus of \$US501 million, in part due to the inflow of foreign aid following the December 2004 tsunami. In 2006 the surplus fell to \$204 million. The main reason for the surplus was remittances from around 1.5 million Sri Lankans working in the Middle East and elsewhere. The figure, which reached \$2,400 million last year, is not a sign of economic health, but an indication of the country's pervasive poverty that many are migrating to avoid.

The continuing rise in remittances has masked the economic impact of the war on tourism—another major foreign exchange earner. Following the outbreak of open fighting in July, a

number of countries have issued travel cautions for Sri Lanka including Italy, Germany, France and Australia. The number of tourist arrivals fell in the latter part of last year and slumped further this year, falling by 15.6 percent in the first two months and another 36 percent in March.

While there was an overall balance of payments surplus, Sri Lanka's trade deficit increased by a massive 25 percent from \$2,516 million in 2005 to \$3,370 million in 2006. One of the main reasons was the continued rise of the oil import bill, which jumped from \$1,655 million in 2005 to \$2,070 million in 2006. The growth in garment exports slowed in 2006 due to increasing international competition from China, India and other countries. Tea production was down by 2 percent, even though the value of tea exports increased to \$US881 million.

* While no figures are contained in the report, large purchases of foreign military hardware will also have contributed to the trade deficit. One indicator is the size of the defence budget, which increased by 45 percent to 139.6 billion rupees in 2007, compared to 96 billion rupees for 2006. The new tactics of the security forces have involved the heavy use of costly air strikes, as well as artillery and rocket barrages.

A *Lanka Business Online* article on May 5 predicted that military outlays and thus government spending would increase even further after the LTTE mounted a series of air attacks in March and April using light planes. "Sri Lanka's defense spending is set to go up further as the Air Force looks to acquire new hardware, putting pressure on the already high budget deficit," the website stated. A former air force commander, Harry Goonetilleke, has estimated that the defense budget could rise by more than 50 percent.

* *Lanka Business Online* reported that a "serious balance of payments crisis was only averted by heavy official dollar borrowing". During the first four months of this year alone, the government borrowed more than \$300 million on the international financial markets. When loans could not be found, the government resorted to the expedient of running the printing presses. The Central Bank printed 38.5 billion rupees, equivalent to 1.4 percent of GDP, to finance last year's budget deficit of 8.4 percent. The deficit is predicted to rise to 9.2 percent this year.

* The burden of the war has fallen directly on working people through sharp price rises and cutbacks to essential services such as welfare, public education and health. The annualised inflation rate for December 2006 was 19.3 percent compared to the average for the year of 13.7 percent. The cost of living index rose by 555 points from 4055.5 in December 2005 to 4610.8 in December 2006. In the four months of this year, it increased another 414 points.

According to Central Bank statistics, the real wages of private sector workers fell during 2006. The losses were 11.8, 10.8 and 9.5 percent in the service, industry and commerce, and agriculture sectors respectively. Public sector workers maintained their real wage levels after the government was

compelled to grant increases to defuse mounting resentment and protests. But rising inflation this year is further eroding public sector pay as well.

Acting on the instructions of the IMF and World Bank, President Rajapakse, who is finance minister and defence minister, has slashed key subsidies along with the country's meagre welfare programs. Cutbacks to fuel subsidies, causing sharp rises in the prices of fuel and transport, have hit ordinary working people hard.

The number of recipients under the government's Samurdhi welfare scheme fell 2.5 percent from 1,960,664 families in 2005 to 1,913,568 in 2006. While the Central Bank report offered no explanation, the government has toed the IMF-World Bank line of restricting welfare in the name of "targeting only the poor". Samurdhi payments range from just 250 to 1,000 rupees (about \$US10) a month.

The Central Bank reported that the paddy harvest reached a record high in 2006, with a 2.9 percent increase over the 2005 figure. However, many farmers could not sell their produce at the state guaranteed price of 13.50 rupees, as the government did not provide sufficient facilities. As a result, farmers either sold their crop to unscrupulous private traders at lower prices or could not sell it at all.

The Central Bank governor may have been keen to praise Rajapakse for his results on the economic front but the impact on the vast majority of the population has been disastrous. Moreover, by plunging the country back to war, the government appears to have completely forgotten that one of the major reasons for signing the 2002 ceasefire was a major economic crisis precipitated by disastrous military reverses. The much praised growth figure for 2006 could quickly evaporate as it did in 2001 when the Sri Lankan economy did not grow at all, but contracted sharply.

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