

FOREIGN PRESS VIEWS

Colombo faces a painful battle on another front

(David Housego looks at the country's ailing economy)

Continuing terrorist conflicts in the north and south of the country, strikes and shut-downs imposed by Sinhalese and Tamil extremists, vote-catching spending in both the presidential and general elections – all have taken their toll on the economy. Inflation, which has risen to 15 per cent at the end of last year has probably passed 20 per cent and is still climbing.

The budget deficit which should have come down to 10 per cent of gross domestic product this year under the existing structural adjustment programme agreed with the IMF, surged last year to 15 per cent and will reach 12 – 14 per cent this year on the basis of budget estimates.

Monetary growth was still a high 22 per cent on an annual basis at the end of March though down on the 29 per cent at the end of last year.

Most indicative of the government's lack of space for manoeuvre is that with the current account deficit still rising (an expected 9 per cent of GDP this year) and Sri Lanka's high debt service ratio virtually barring it from further commercial borrowings, the foreign exchange reserves have dipped to a low for the decade of the equivalent of six weeks imports.

Interest rates which had been raised to absorb inflation were abruptly reduced before recently resuming their upward trend. The currency which was depreciating at the beginning, was briefly revalued before resuming a downward slide. Price controls were imposed on pharmaceuticals though the President's real instincts appear to be market-oriented.

Against this background economic growth has remained low, particularly by comparison with the rapid expansions that followed the initial opening up of the economy in the late 1970s. Real GDP has risen at only 2-3 per cent over the last two turbulent years. Unemployment, which is at the root of the frustrations that have allowed the extremist Sinhalese JVP movement to build up its strength, is around 18 per cent.

The bright spot in the economy, demonstrating Sri Lanka's potential if ever it can get back on the rails, has been export-oriented manufacturing and services. Aitken Spence, a large, diversified, local group with interests in shipping, garments, container traffic and tourism says it had record profits last year in spite of their hotels being closed down in the peak winter holiday period.

A new Taiwanese Sri Lankan joint venture exported \$ 3m of garments in its first year, last year, and is expecting a \$ 14m turnover this year while also constructing a factory to make sweaters. Substantial Japanese investment is waiting to pour in but is deterred by economic and political uncertainties.

The task of the IMF mission is to decide on what terms Sri Lanka will be able to make an overdue SDR 66M second tranche drawing on its three year structural adjustment loan. On the Fund's approval depends the release of concessional aid by western donor nations.

Until recently the new government had hoped the Fund would not be too pressing in its demands. But the mood among Fund and the Bank officials is that Sri Lanka has now twice postponed much needed stabilisation measures because of political difficulties.

Because of government determination to hold down inflation last year, the currency was allowed to appreciate by 5 per cent in real terms (as adjusted for inflation and measured against that of Sri Lanka's main trading partners).

This year's depreciation in nominal terms has not begun to make good the loss of competitiveness caused by Sri Lanka's soaring inflation rate. A substantial devaluation (10-20 per cent) would boost export earnings, but the immediate rub for the government is that it would further exacerbate inflation – with the risk of unrest spreading from students to industrial workers and public employees.

To contain the inflationary consequences the Fund is expected to insist on tight fiscal and monetary policies – possibly a budget deficit limited to 10 per cent of GDP and a target for monetary growth of 10-15 per cent. This would require bringing down government expenditure as a proportion of GDP from 34 per cent to about 28 per cent and sharply raising interest rates.

Austerity policies are never popular. President Premadasa's government can be expected to put up a tough fight over the details. But the dwindling foreign exchange reserves leave the country little choice but accept the policy changes that the Fund will propose.

*Excerpts from
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Sri Lanka faces hard economic decisions

David Housego (in Colombo)

With the trade and current account deficit continuing to widen, the foreign exchange reserves have virtually disappeared. A sign of Sri Lanka's plight is that the government is having to finance imports of wheat, sugar, rice and fuel on 180-day letters of credit. Suppliers are demanding that off-shore foreign banks independently confirm that payment will be made. Importers of non-essential goods are being asked to put up a 100 per cent cash margin.

As business circles see it, the balance of payments squeeze is putting an irresistible pressure on the government to come to terms with the International Monetary Fund. One IMF mission left 10 days ago without an agreement, and another arrives in 10 days. The IMF is withholding a \$87m drawing on a structural adjustment facility until Sri Lanka enters new commitments. Payment on this would unlock \$60m more in balance of payments support from the Fund and new aid from western donor nations.

Some hard decisions have already been taken. The President's Janasaviya programme, involving a Rs. 2500 a month (£44) payment for the poorest families, has been shelved for this year,

along with another welfare programme for mid-day meals. The two would have cost Rs. 4 bn for 1989.

But the most difficult decisions remain. The removal of subsidies on wheat and flour could push up the cost of a loaf of bread by over 40 per cent to about Rs. 5.

Overall, the IMF wants to contain the budget deficit to 12 per cent of GDP, as against the 15 per cent in the government estimates. This marks a softening on its original goal of 10 per cent of GDP.

Parallel with this the Fund is seeking a slight slowing of monetary expansion (M1) to 18 per cent this year – which allows for an optimistic 2.3 per cent real growth in GNP and 15 per cent inflation. Interest rates have been rising, with one year Treasury bills now at 19 per cent, reflecting the tightening of monetary policy.

The influence of Fund thinking is already being reflected in the accelerated depreciation of the rupee over the last two weeks.

*Excerpts from "Financial Times"
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