THE IMF AND CIVIL WAR IN SRI LANKA: A CRITICAL DIALOGUE

Muttukrishna Sarvananthan[1]

The International Monetary Fund (IMF) has approved a US$ 253 million standby credit facility to Sri Lanka on April 20, 2001, to stabilize the macroeconomic fundamentals. An initial instalment of US$ 131 million has already been released, and the rest is expected to be released in four equal instalments (US$ 30.5 million each) on August 30, 2001, November 30, 2001, February 28, 2002, and May 15, 2002 depending on the performance of the economy. In addition to this, another US$ 250 million may be provided under the Poverty Reduction and Growth Facility (PRGF), successor to the Enhanced Structural Adjustment Facility.

First of all, the Government of Sri Lanka (GOSL) should be commended for requesting the International Monetary Fund (IMF) to make the stand-by arrangement a public document, hence facilitating public scrutiny. This is the first time ever that the full text of an IMF-GOSL agreement has been made available to the general public. This, in itself, is a very welcome step on the parts of both GOSL and IMF towards transparency and good governance in their transactions.

However, it is disappointing and disturbing to note that there are some critical discrepancies in the statistical data, *inter alia*, presented in the IMF Country Report No.01/71 (citing "Sri Lankan Authorities") compared to Annual Reports of the Central Bank of Sri Lanka (CBSL). One striking instance is in the data pertaining to defence expenditures of Sri Lanka.

Defence Expenditure

The Gross Domestic Product at current factor cost prices (nominal GDP) and the actual defence expenditure (recurrent plus capital) incurred in the past five years are given in Table 1. Accordingly, the defence expenditure as a percentage of nominal GDP peaked to 6.8% in year 2000. The figures for defence expenditure are of the Ministry of Defence, which includes the army, air force, navy, police, immigration and emigration, and registration of persons departments. Although normally the expenditure on police is for maintenance of law and order, in the context of civil war in Sri Lanka a significant part of the police service is devoted to national security duties as well (for example, the deployment of police special task force in the eastern province). Therefore, the expenditure on police (law and order), immigration and emigration, and registration of persons departments will be considerably less than 1% of the GDP, though according to the IMF it has been 1% or little more during the past five years.[2] The IMF has provided a breakdown of the defence expenditure into 'wages and salaries' and 'goods and services' which is a welcome step, because the CBSL does not publish this breakdown for public consumption.[3]

For instance, according to the CBSL, nominal GDP of Sri Lanka in 1999 and 2000 were LKR 995 billion and LKR 1,125 billion respectively (Table 1), whereas according to the IMF the corresponding figures were LKR 1,111 billion and LKR 1,263 billion.[4] Further, according to the CBSL defence expenditures in 1999 and 2000 were LKR 54 billion and LKR 77 billion respectively (Table 1), whereas according to the IMF ('security-related expenditure') the corresponding figures were LKR 49 billion and LKR 71 billion.[5]

Table 1: Defence Expenditure as a percentage of GDP in Sri Lanka 1996-2000

Fiscal Year	GDP at current prices (LKR billion)	Defence Expenditure (LKR billion)	Defence Expenditure as a percentage of GDP
1996	696	46	6.6
1997	804	46	5.7
1998	913	57	6.2
1999	995	54	5.4
2000	1,125	77	6.8

Source: 1996 - GDP – CBSL, *Annual Report 1996*, Statistical Appendix Table 1. Defence – CBSL, *Annual Report 1996*, Statistical Appendix Table 51.
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1999 - GDP – CBSL, *Annual Report 1999*, Statistical Appendix Table 1.Defence – CBSL, *Annual Report 1999*, Statistical Appendix Table 55.
2000 - GDP – CBSL, *Annual Report 2000*, Statistical Appendix Table 1. Defence – CBSL, *Annual Report 2000*, Statistical Appendix Table 55.

According to the CBSL, in the past five years, defence expenditure as a percentage of nominal GDP ranged from 5.4% in 1999 (lowest) to 6.8% in 2000 (highest), whereas according to the IMF it ranged from 4.4% in 1999 (lowest) to 5.8% in 1996 (highest) (Table 2).

Thus, defence expenditure as a percentage of nominal GDP according to the IMF was between 11% and 19% less than what was reported by the CBSL in the past five years. This discrepancy reached nearly 20% in the last three years (Table 2).

Besides, the IMF and CBSL figures do not include payments to disabled soldiers and the pensions of retired soldiers, which is a further source of underestimation of defence expenditures in Sri Lanka.[6]

Table 2: Defence Expenditure as a percentage of GDP reported by CBSL and IMF

Fiscal Year	Defence Expenditure as a percentage of GDP report by the CBSL	Defence Expenditure as a percentage of GDP report by the IMF	Discrepancy as a percentage of CBSL figures
1996	6.6	5.8	(-) 12
1997	5.7	5.1	(-) 11
1998	6.2	5.0	(-) 19
1999	5.4	4.4	(-) 19
2000	6.8	5.6	(-) 18

Source: CBSL, *Annual Report*, various years.
IMF, *Sri Lanka Country Report No.01/71* (Internet edition), May 2001: 13.

Therefore, the IMF data on military expenditures are considerable underestimations. The reason for these considerable underestimations is unknown to the best of our knowledge. Whether it is an oversight, typing error or an attempt to dampen the burden of defence expenditure in the public eyes is anyone's guess.

Moreover, defence expenditures disclosed by the CBSL is only part of the total defence expenditure incurred by the GOSL. In addition to these apparent defence expenditures there are considerable amounts of camouflaged defence expenditures, which are by their very nature shrouded in mystery. These camouflaged defence expenditures are mostly expenditures in kind incurred in the course of civil war.

For example, aid deflection seems to be a major contribution to these camouflaged expenditures. According to anecdotal evidence heavy vehicles, machinery and equipment of donor-funded economic infrastructure projects such as highways, ports (air & sea), power & energy, and telecommunications development are occasionally diverted for the use of security forces during major military operations. In this light the combination of power & energy with defence ministry may not be a coincident. Although these aid deflections may be temporary it would undoubtedly delay such infrastructure projects, which would cost the country dearly in terms of higher construction costs, greater interest payments, etc.

One potential evidence of aid deflection is the very low utilization rate of foreign aid commitments in recent years. According to the External Resources Department (ERD) of the Ministry of Finance and Planning, between 1997 and 1999 the utilization rates of the Asian Development Bank (ADB) loans was only 21%, of the International Development Association (IDA) was 18%, and of the Japan Bank for International Co-operation (JBIC) was a mere 10%.[7] It is important to note that the ADB is the single largest multilateral donor, and Japan is the single largest bilateral donor to Sri Lanka in recent times. Besides, ADB and Japan are the greatest contributors to economic infrastructure development projects in Sri Lanka. Therefore, there may be a likelihood of negative correlation between aid deflection and the rate of aid utilization of these multilateral and bilateral donors. This issue is of critical importance for foreign aid policy in Sri Lanka that requires more in-depth study.

Further, some of the expenditures incurred for the defence sector may be classified under a different ministry. For example, health services provided for the armed forces may partly be accounted for in the defence ministry budget and partly in the health ministry budget. Suppose injured armed forces personnel are treated in a military hospital, the expenditures incurred may be accounted for in the defence ministry budget, whereas if they are treated in a civilian hospital it may be accounted for in the health ministry budget. Likewise, we may be able to identify a number of camouflaged expenditures incurred in the war efforts that are accounted for in the non-defence sector. This would result in quite a serious underestimation of military expenditures.

Yet another example of camouflaged military expenditures is that part of the expenditures incurred for the upkeep of the former Tamil rebel groups (EPDP, EPRLF, TELO, etc.) by the government may be accounted for in the non-defence budget. This again would result in underestimation of the total military expenditure. For instance these paramilitary groups are provided with cash and perks in kind as reward for their allegiance to the government and state security forces. It is reported that loans at concessionary terms through the state banks are provided for the business enterprises of these paramilitary groups. Besides, some leading cadres of these groups are provided employment at different ministries. Strictly speaking the cost of such concessionary loans, employment, etc., should be borne by the defence ministry and not by other line ministries.

All the foregoing camouflaged military expenditures, *inter alia*, add to the formidable military budget of the GOSL. Therefore, the actual defence budget (both apparent and camouflaged) would be much greater than what the CBSL would want us to believe. To our understanding the CBSL figures on defence expenditure are itself considerable underestimations. Hence, the IMF defence expenditure data are gross underestimations of the actual total defence expenditure of Sri Lanka.

Defence Expenditure in Comparative Perspective

The IMF has also provided some comparative data on defence expenditure as a proportion of GDP of selected countries and points out that "military expenditures in Sri Lanka, while high, is similar to that in many other countries." [8] We find it hard to stomach the IMF's observation on Sri Lanka's defence expenditure as a proportion to the GDP compared to some other selected countries in the Third World. Firstly, the IMF has compared data pertaining to 1999 only, the year in which Sri Lanka's military expenditure as a proportion to GDP was the lowest during the period 1996-2000.

Secondly, out of the seven countries with which the comparison is made, Egypt, Korea, and Nigeria (2.7%, 2.9%, and 2.8%, respectively) have spent less while Cambodia and Ethiopia (3.8% and 3.5% respectively) have spent marginally higher than Sri Lanka (3.4%)[9] on the armed forces as a proportion of the GDP in 1999. Only Pakistan and Turkey (4.9% each) have spent considerably higher than Sri Lanka. These seven countries with which the comparison is made are not similar to Sri Lanka in many respects. For example, Pakistan and Turkey have had a long history of military regimes where the army still plays a major role in governance. Therefore, historically their defence budgets have been high. Besides, Pakistan and Turkey have major territorial disputes with neighbouring countries (viz. India and Cyprus, respectively) for a very long time. Hence, the choice of countries for comparison with Sri Lanka by the IMF is very inappropriate. It would have been more appropriate to compare Sri Lanka with some other internal conflict-ridden countries.

Here, in Table 3, we produce comparative data on military expenditure as a proportion of GDP of selected South Asian countries as well as internal war-torn countries in the Third World from 1991 to 1999, source being the Stockholm International Peace Research Institute (SIPRI). It is important to point out that the data for Sri Lanka's defence expenditure presented by SIPRI, as a proportion of GDP, is marginally higher than IMF's data but considerably lower than CBSL data as presented in Tables 1&2.

According to Table 3, all the selected countries except Pakistan and Myanmar have consistently spent less on defence (as a proportion of their respective GDP) compared to Sri Lanka throughout the period under consideration, i.e. 1991-1999. Myanmar has spent more between 1991-1994, but since then has consistently spent less than Sri Lanka. Pakistan has spent more during 7 out of 9 years, equal in 1996 and less in 1995 than Sri Lanka has. Thus, during 1995 Sri Lanka was the highest spender of their GDP on defence among the selected South Asian and internal war-torn countries. An important fact to note is that both Myanmar and Pakistan have had a long history of military regimes, and even today the army rules both countries. Even during intermittent times of democratic rule in Pakistan the military plays a powerful role in governing the country, and hence historically military expenditures in Pakistan have been higher than other democratic countries in the region. Due to this factor Myanmar and Pakistan are not strictly comparable countries with Sri Lanka. On the other hand, notwithstanding intermittent military dictatorships in Bangladesh, Colombia, Philippines, Sierra Leone, Sudan, and Uganda, their respective GDP spent on defence is significantly less compared to Sri Lanka. For instance, Sri Lanka has spent—more than double of Bangladesh; significantly greater than Colombia especially since 1994; almost three times of Philippines since 1995; more than double of Sierra Leone since 1995; more than three times of Sudan between 1995-1997; more than double of Uganda—on defence during most years under consideration (Table 3).

Table 3 – Defence Expenditure as a percentage of GDP 1991-1999

Country	1991	'92	'93	'94	'95	'96	'97	'98	'99
South Asia									
Bangladesh	1.3	1.5	1.6	1.6	1.7	1.6	1.6	1.6	1.6
India	2.6	2.5	2.4	2.3	2.2	2.1	2.2	2.2	2.4
Nepal (a)	0.9	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.9
Pakistan	5.8	6.1	5.7	5.2	5.2	5.0	4.8	4.6	4.4
Sri Lanka	**2.8**	**3.0**	**3.1**	**3.4**	**5.3**	**5.0**	**4.2**	**4.2**	**3.6**
Conflict-ridden									
Colombia	2.5	2.6	2.5	1.9	2.1	2.5	2.8	2.2	2.5
Myanmar	3.9	4.5	5.1	4.6	4.7	4.6	3.6	3.3	(b)
Philippines	1.3	1.3	1.4	1.4	1.6	1.5	1.5	1.4	1.2
Sierra Leone	1.8	2.5	2.6	2.5	2.4	2.0	1.0	0.8	1.6
Sudan	2.8	2.5	2.8	2.5	1.7	0.9	1.0	2.2	2.6
Uganda	2.2	1.5	1.8	1.6	1.5	1.8	1.9	2.1	2.1

Source: Stockholm International Peace Research Institute, *SIPRI Yearbook 2001*, Chapter 4, Table 4A.4.

Notes: (a) expenditures on paramilitary forces are excluded. (b) not available.

In addition to the foregoing comparative military expenditure data, we produce a set of military development data of the South Asian region to see how Sri Lanka fares. Table 4 reveals military development of the five largest South Asian countries, viz. India, Pakistan, Bangladesh, Nepal, and Sri Lanka. Though the data is a bit dated it gives an indication of the level of military development in Sri Lanka in a comparative perspective over a long period of time. The defence expenditure of Sri Lanka in 1996 (US$ 700 million) was the third largest in absolute terms after India and Pakistan, despite being the smallest country among the five (in terms of physical and population size). Sri Lanka experienced the highest annual percentage increase of defence expenditure in South Asia during the period 1985-1996 at 11%, which was double the rate of the second highest increase, that of Nepal. The defence expenditure, as a percentage of the GNP in 1995, was highest in Sri Lanka at 5.3%, just above 5.2% in Pakistan. Sri Lanka's defence expenditure per capita of US$ 37 in 1995 was the highest in the region, Pakistan trailing far behind at second place with only US$ 21. The percentage increase of armed forces personnel during 1985-1996 was highest in Sri Lanka at 81%, nearly double that of Nepal, which experienced the second highest increase. The Military Holdings Index of Sri Lanka in 1996, which was 926 (1985=100), was the highest in the region, nearly fivefold that of Bangladesh (the second highest). These regional comparative data are up to 1996 only. Since then, as we all know, the development of defence sector has accelerated in Sri Lanka. Therefore, the gap between Sri Lanka and other South Asian countries would have widened in the past five years.

Table 4: Military Development in South Asia

	India	Pakistan	Bangladesh	Nepal	Sri Lanka
Defence Expenditure 1996 US$ millions in 1993 prices	9,070	3,000	460	40	700
Defence Expenditure 1985-1996 annual % increase	2.1%	3.3%	3.7%	5.5%	11%
Defence Expenditure 1995 As a percentage of GNP	2.8%	5.2%	1.4%	0.9%	5.3%
Defence Exp per capita 1995 US$ in 1993 prices	10	21	3.3	1.8	37
Armed Forces Personnel % increase 1985-1996	10%	18%	23%	42%	81%
Military Holdings Index 1996 (a)1985=100	142	144	198	160	926

Source: Mahbub ul Haq Human Development Centre, *Human Development in South Asia*, 1999: 202.

Note: (a) Military Holdings Index is based on aggregate number of heavy weapons a country has, such as combat aircraft, artillery, ships, and tanks.

The forgoing comparative data presented in Tables 3&4 contest the observation of the IMF regarding Sri Lanka's military expenditure vis-à-vis other comparable countries. These are sufficient evidences of rapidly growing militarization of the economy and society in Sri Lanka despite being a democratic polity. It is ironic that whilst the IMF is quite rightly alarmed by the current account deficit in the balance-of-payments reaching almost 7% of the GDP it does not seem to be overly concerned about the defence expenditure reaching almost 7% of the GDP in year 2000. This apathy perhaps demonstrates where the priority of IMF lies.

We are aware of a decision of the Executive Board of the IMF not to take military expenditures into account in evaluating the performance of their lending and other conditions related to IMF supported structural adjustment programmes.[10] The IMF is entitled to decide on their policy on defence expenditures though we may disagree with that decision. Nonetheless, considerable under-estimations in the military expenditure data provided by the Sri Lankan authorities to the IMF and the acceptance of such data by the IMF is a very serious concern to citizens of Sri Lanka, let alone to the credibility of IMF. Besides, lack of transparency in the huge military budget of Sri Lanka is also of critical concern. Here again we appreciate the fact that military procurements cannot be entirely disclosed for security reasons. However, lack of a proper and open tendering procedure for military procurements (as in other public sector procurements) is a crucial drawback in the management of public finances in Sri Lanka.

The GOSL has given an assurance to the IMF that defence expenditures for the current fiscal year (2001) would be strictly limited to LKR 63 billion as allocated in the budget, and that large military procurements would require the approval of the finance secretary. Imports by the defence ministry are expected to be cut back from about US$ 400 million in year 2000 to about US$ 140 million this year.[11]

However, how successfully the government can keep up this commitment depends on the military situation on the ground. In the past several years defence expenditures have significantly overshot budgetary outlays.[12] Even the present budgetary allocation of LKR 63 billion for defence is very high, accounting for 19% of the total budget for 2001. Now that the LTTE has withdrawn its unilateral cease-fire, if it decides to go on the offensive then the government will be forced to respond. Consequently, the commitments made by the government on restraining military expenditures may not hold. In such a scenario government has vowed to increase taxes, possibly including the rate of Goods and Services Tax (GST), and cut down expenditure on goods and services and domestically-financed capital spending commensurate to the potential increase in defence expenditure,[13] which may negatively impact on businesses and masses alike.

Poverty

Another key statistical anomaly in the IMF country report is the data pertaining to the poor in Sri Lanka. The IMF claims that the number of poor in Sri Lanka is 20% of the total population, which is a gross underestimation.[14] The government's poverty reduction framework as well as a recent World Bank study revealed that almost one-third of the population is poor applying the official poverty line, but about 50% of the population receive cash payments under the *Samurdhi* poverty alleviation programme. The IMF also claims that Sri Lankan authorities have given an undertaking that *Samurdhi* will be reformed and better targeted.[15]

According to the government, whilst the total number of poor are one-third of the population, about 50% of the population receive cash payments under the *Samurdhi* programme. Therefore, already there is an over expenditure on the *Samurdhi* programme. Hence, if the government is serious about reforming the *Samurdhi* programme by cutting down wastage and better targeting, it logically follows that the total expenditure on *Samurdhi* should decline. On the contrary, according to the appropriations bill presented to the parliament, budgetary allocation for *Samurdhi* in 2001 has increased to almost LKR 11 billion (almost 1% of the GDP). The budgetary allocation for *Samurdhi* as a proportion of the total budget of the government increased from 2% in 2000 to 3% in 2001 (a 50% rise). Hence, the government's undertaking to reform *Samurdhi* seems to be quite unreliable. Moreover, a recent World Bank study revealed that the poorest two quintiles do not receive any benefit at all under the *Samurdhi* programme. Furthermore, a substantial proportion of the poor in the conflict-ridden North-East province (who, according to the World Bank, experience most acute forms of poverty and deprivation) are not covered by the *Samurdhi* programme.

The *Samurdhi* poverty alleviation programme is a big political enterprise employing about 30,000 persons (the vast majority of them are supporters of constituent parties in the ruling coalition) and consuming about 1% of the GDP. The employees of the *Samurdhi* programme are a reserve army of political workers. Earlier poverty alleviation programmes, such as the *Janasaviya*, too, was the same. In Sri Lanka national poverty alleviation programmes have always been heavily politicized. Therefore, the most crucial decentralization cum privatization programme Sri Lanka should undertake with utmost urgency is that of the national poverty alleviation programme. The *Samurdhi* programme cannot be reformed or restructured by the state; it can only be resurrected by decentralization cum privatization. In Sri Lanka, social safety net mechanisms are largely political safety net mechanisms. We are told that in many instances the poor have to bribe the *Samurdhi* officers to get access to benefits under the programme. In this context we beg to differ with the IMF mission's view that "if the above programs were implemented efficiently, they would significantly improve targeting of the poor and the valnerable and provide protection for living cost increases."[16] To us the targeting of the poor is so wide off the mark not because of lack of knowledge or efficiency, on the contrary it is a deliberate political act.

The nature of poverty and the poor differ from village to village, town to town, and village to town, and therefore a top-down national poverty alleviation programme based on a single official poverty line cannot address different varieties of poverty and deprivation. An independent poverty alleviation commission with constitutional provisions should be set up and any government in power should allocate a sum of money annually to it. Professionals and experts on poverty should head this commission who should be democratically selected by concerned citizens and not appointed by any government. Each village/town should identify the nature of poverty and the poor in their village/town. Any local government (village/urban council), semi-government, non-governmental, or private organization should be entitled to bid for money from the proposed poverty alleviation commission for poverty alleviation programmes in their respective village/town. The commission should evaluate the proposals from different bidders on their merits with absolutely no political interference. Perhaps such a fundamental change in the way in which the perennial issue of poverty is addressed would make a real impact on poverty in Sri Lanka. Having said that, we are doubtful whether there is sufficient political will (within the ruling or opposition political parties) for such a fundamental overhaul of the national poverty alleviation programmes in Sri Lanka.

The IMF is quite correctly concerned about the fall out of the present stabilization measures that would adversely affect the poorest segments of the population. However, they seem to be satisfied with the assurances of the Sri Lankan authorities that the existing social safety net mechanisms such as the *Samurdhi* programme would take care of such a situation. Given the performance of *Samurdhi* in the past six years, it would be a serious gamble to rely on that for providing effective social protection for the marginalized groups in rural, urban, and war-torn areas.

Public Sector Reforms

Under the standby arrangement the government has committed that no pay rise would be given to public sector employees, and there will be a moratorium on recruitment to the public service (except to fill critical shortages in the health service) during 2001.[17] This commitment has been already violated (see below). As part of reform of the civil service, voluntary retirement scheme, pension reform, and treatment of government and private employees on equal footing are on the offing.[18]

Sri Lanka is burdened with one of the largest civil services in Asia. Therefore, the proposed reforms are of critical importance. However, the last time when a voluntary retrenchment scheme was implemented in the early-1990s, under an IMF structural adjustment programme, some of the most able and competent civil servants made avail of the scheme and departed. This led to further deterioration in the quality of public services, especially in the Ministry of Finance and the Central Bank. We hope that this time around a proper targeting of voluntary retirement scheme is implemented.

Garments

There is a lot of expectation that the garments manufacture and exports would increase in 2001 due to the removal of quota restrictions by the European Union (EU) from this year.[19] However, we are sceptical about this, because even under a quota regime Sri Lanka's utilization rate of quota to the EU has been quite low, averaging only 57% during 1998-2000.[20] There seem to be supply constraints in making use of the available garment quota to the EU. That is, Sri Lanka seems to be unable to cater the items for which there is demand. Hence, any hope of increasing garment exports to the EU significantly in the near future seems to be a bit premature.

In the same way, it was anticipated that the Indo-Lanka free trade agreement (effective from March 2000) would boost garment exports to India. Despite having a quota of 8 million pieces of garments annually for export to India under the free trade agreement, during the first year of operation very little exports actually took place.

Tourism

There was some improvement in the tourist trade during the first quarter of this year compared to year 2000. Thanks to about ten thousand English fans visiting to watch the cricket matches between England and Sri Lanka, non-operation of the LTTE in the southern parts of the country (particularly Colombo and suburbs) as part of the peace process, and the depreciation of the rupee due to free float, tourism picked up considerably. However, the withdrawal of a unilateral cease-fire by the LTTE in late April has once again led to uncertainty as regards their continued non-operation in the south. Any renewal of military operations in the south by the LTTE would be a setback to the tourist industry.

Therefore, the projected increase in foreign currency earnings from the export garments and tourism industries as envisaged by the IMF is a bit precarious.[21]

Highlights

Some other highlights of the standby credit package by the IMF to the GOSL are as follows:

* The projected financing gap in the balance of payments for year 2001 is US$ 528 million, which is to be filled by credit from the IMF (US$ 200 million), commercial borrowings in the international market (US$ 200 million), the World Bank (US$ 68 million), and bilateral donors (US$ 41 million).[22]
* The major objective of the stabilization programme is to curtail domestic demand (especially for consumer imports) through higher tax burden and lower real incomes.[23]
* According to the IMF the immediate policy goal of the CBSL should be to reduce the rate of inflation below 10% at the same time accumulating foreign exchange reserves.[24]
* From December 2001 the petroleum prices would be automatically adjusted according to the rise or fall of world oil price and the importation of petroleum products are expected to be liberalized in 2002, thus ending the monopoly of the Ceylon Petroleum Corporation.[25]
* The Sri Lankan authorities are planning restructuring of ports, postal service and the Ceylon Electricity Board in addition to the Ministry of Finance and the CBSL.[26]
* External debt stock increased to 64% of the GDP by end of 2000. However, the debt-service ratio declined to 14.25% as the nominal exports of goods and services increased by 16% whilst the nominal increase in debt service was only 9%.[27]
* The IMF has expressed concern that the present stabilization programme could negatively impact on the banking sector, though the government and the banks seem to be optimistic.[28] However, there are indications that even a formidable private bank such as the Hatton National Bank is going through a challenging period.
* Under the structural adjustment programme Sri Lanka is expected to resort to commercial borrowings in the international market to a significant extent (about US$ 200 million), which has been quite low hitherto because of access to concessionary loans from donors.[29] This would inevitably increase the cost of debt service.

Reneging on Policy by the Government

The government has pronounced several policies and given a number of undertakings to the IMF in order to get the standby credit facility approved by the Executive Board of the IMF. However, some of these are too ambitious for a coalition government with not even a simple parliamentary majority, which depends on three minor political parties (CWC, EPDP, and NUA) for its survival. Already there are several instances of faltering on public policy pronouncements and undertakings given to the IMF, which are outlined below.

Public sector reform is one of the cornerstones of the IMF-GOSL standby arrangement. Accordingly, the government has given a firm undertaking to the IMF that there will be a moratorium on recruitment to the public service during 2001. But, recruitment to the armed forces continues unabated. In April and May the air force and navy placed advertisements for recruits, which continues to date. Further, the police special task force has launched a recruitment drive during late June and early July.[30] Moreover, the defence ministry has launched a recruitment drive for the army on 1 July in order to recruit ten thousand soldiers.[31] This is the first time for this year that recruitment to the army is set to take place. This upsurge in the recruitment to the armed forces flies in the face of the government's commitment to a moratorium on public service hiring. This may also be an indication of the government launching renewed hostilities towards the LTTE as a way of diverting the attention of the masses in the face of an impending no-confidence motion in parliament and rapidly rising cost of living. Any escalation in civil war will seriously undermine economic revival as envisaged in the standby arrangement.

In early July, the government has pledged to the trade unions of the Sri Lanka Ports Authority (SLPA) that all employees of the authority will be provided a salary increase of LKR 2,000 per month beginning October 2001, backdated from January 2001.[32] Earlier, the trade unions of the SLPA threatened to go on strike if their demand for a salary increase is not met. The proposed pay rise is in contravention of the government's commitment to freeze the salaries of the public sector employees during 2001. This may have a ripple effect on other public sector employees who may demand a similar pay rise.

Though the government is committed to pass on the world fuel price hikes to the consumer, and phase out the National Security Levy (NSL) by increasing the rate, broadening the base, and minimizing exemptions of the Goods and Services Tax (GST), there are question marks over how far it would implement these changes.[33] For example, in early June the government offered subsidized bank loans at 5% annual interest for import of buses by the private bus operators, and GST on the private transport sector was abolished in order to dissuade private bus operators from increasing bus fares. The government was able to offer the former concession because of two large commercial banks in the state sector. Further, concessionary loans to paramilitary groups aligned to the government as mentioned above are yet another political abuse of the state banks. These perhaps explain why the government is still committed to retaining the state dominance of the banking sector. The exemption of GST to the private transport sector is against a commitment made to the IMF that such exemptions would be curtailed.

The government imposed a 40% surcharge on import duty effective from February 2001 for one year. Although the government claimed at the time of imposition that it would be in operation for only a year the IMF claims that the government has indicated it would be removed "by no later than 2003." [34] Therefore, signs are that the 40% surcharge on import duty is poised for a long haul despite the initial imposition for one year. This surcharge on import duty may only partly contribute to dampening imports of consumer goods, and thereby increase foreign exchange reserves, because the very same measure has the potential to increase unofficial trade and hence deprive tariff revenue and official foreign exchange reserve. Besides, prolonging the period of imposition of surcharge on import duty would further delay the arrest of rise in cost of living.

Although the government has indicated to the IMF that rail fares will be increased by mid-2001 to cover the rise in cost of operation due to fuel price hikes it has not materialized yet.[35] It is important to note that in the past year, though fuel prices were increased several times, the rail fares did not follow suit despite hikes in bus fares.

A cabinet sub-committee appointed recently to look into the possibility of regulating prices of essential commodities has reportedly decided to enforce price controls on food items such as sugar, potato, onion, dhal, dry fish and wheat flour,[36] which is a setback to liberalization of the economy. On the one hand, the government handed over the importation and distribution of wheat flour to a multinational company last month (which was hitherto undertaken by the state-owned co-operative wholesale establishment), and on the other hand it is contemplating regulating the price of wheat. These two actions give different signals to the market, which does not bode well for economic revival in Sri Lanka.

Conclusion

One of the glaring omissions in the prescriptions of IMF to the ailing Sri Lankan economy is the potential privatization of state media. The print and electronic media in the ownership of the state is one of the biggest impediments to a vibrant market economy, good governance, and an effective democratic polity in Sri Lanka. Successive governments in power abuse the state media by propagating misinformation, which does not bode well for a private sector-led market economy. The ruling and opposition parties have no desire to privatize these vital institutions due to vested political interest. An effective market economy requires an absolutely independent media. Therefore, it is high time that the international donors take up this vital institutional reform with the GOSL.

In conclusion, first and foremost the country analyses by the IMF itself requires structural adjustment due to deficiencies in key statistical data. Secondly, political will of the government to undertake far reaching reforms of the economy as enunciated in the IMF country report is suspect as per early indications (some of which were pointed out above). At the same time it is also quite unrealistic for the IMF to expect a coalition government without a parliamentary majority to fulfil such a broad reform agenda. Nonetheless, standby credit facility by the IMF has provided a temporary respite to an ailing economy.

Notes

1. Dr. Sarvananthan is a Research Fellow, International Centre for Ethnic Studies (ICES), Colombo. Views expressed in this paper are solely of the author, and not of the ICES.
2. IMF, *Sri Lanka Country Report* No.01/71 (Internet edition), May 2001: 13.
3. Ibid.
4. IMF, op cit: 33.
5. Ibid.
6. IMF, op cit: 13.
7. External Resources Department, *Foreign Aid Review*: Sri Lanka, 1999: 3.
8. IMF, op cit: 13.
9. Military expenditure here includes only the army, air force and navy.
10. BUFF/91/186 cited in IMF, op cit: 13.
11. IMF, op cit: 19.
12. CBSL, *Annual Report*, various years.
13. IMF, op cit: 15.
14. IMF, op cit: 24.
15. IMF, op cit: 17&24.
16. IMF, op cit: 17.
17. IMF, op cit: 14.
18. IMF, op cit: 21-22&27.
19. IMF, op cit: 19.
20. CBSL, *Annual Report 2000*, statistical appendix table 25.
21. IMF, op cit: 9.
22. IMF, op cit: 35.
23. IMF, op cit: 9.
24. IMF, op cit: 10.
25. IMF, op cit: 19.
26. IMF, op cit: 19.
27. IMF, op cit: 20.
28. IMF, op cit: 21.
29. IMF, op cit: 25.
30. *Ceylon Daily News*, 13-06-2001: 3.
31. *Virakesari*, 13-06-2001: 1.
32. *Ceylon Daily News*, 05-07-2001: 12.
33. IMF, op cit: 12,14&26.
34. IMF, op cit: 23.
35. IMF, op cit: 18.
36. *Ceylon Daily News*, 12-06-2001: 1.