After years of refusing to become tied to the strings attached to IMFmonies, Sri Lanka has agreed to a massive new loan. But will it be enough to lift the economy from its current morass?

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After several months of prevarication, on 24 July the International Monetary Fund's (IMF) Executive Board approved its largest single line of credit ever offered to Sri Lanka. The staggering USD 2.6 billion loan is significantly higher than the initial request of USD 1.9 billion, and its magnitude is best appreciated through comparison with the island's total foreign debt of USD 12.5 billion, as of the end of 2008. The first instalment of USD 322 million was disbursed immediately; subject to periodic review, seven further allotments will now follow until March 2011. Yet with the agreement signed and the money now flowing, the loan remains the centre of intense debate both at home and abroad.

Even in the months leading up to the IMF's decision, the loan was embroiled in controversy. Overseas, there was disgruntlement regarding the message it could send regarding the humanitarian and human-rights situation; at home, there was anxiety over perceived threats to sovereignty and a potential 'debt trap'. One group, the New York-based Human Rights Watch, protested that the loan would be construed as a "reward for bad behaviour, not an incentive to improve"; in a statement on 22 July, it called upon the IMF to "make the release of each new tranche of funds contingent on tangible human rights progress." The loan has certainly been greeted in Colombo as another victory, following that in May over the LTTE. However, as Dushni Weerakoon of the quasi-governmental Institute of Policy Studies commented in early August, "Victory is not something you would normally associate with an IMF loan … you approach the IMF when you have run out of options." Still, in a sign of the times in post-war Sri Lanka, it is now apparently 'un-patriotic' to criticise dealings with an international financial institution that was once reviled as an agent of neo-colonialism by many of the constituents in the centre-left United Peoples Freedom Alliance (UPFA) coalition.

The avowed objective of this 'stand-by agreement', which provides short-term support for the country's balance of payments, is to boost foreign reserves, which plummeted over the past year as military spending ballooned. The loan itself is being touted by both the government and the IMF as a vote of confidence in the flagging Sri Lankan economy, as well (many hope) as a catalyst for foreign direct investment. It certainly provides a lifeline to the government in its preparation of the November budget, which will precede snap presidential and scheduled parliamentary elections in 2010.

The application for the loan was first made in March, and approval was anticipated shortly thereafter. However, the Sri Lankan request coincided with an intensification of its military campaign to eradicate the LTTE from its remaining stronghold in the island's northeast. Simultaneously, the international media began reporting on allegations of indiscriminate bombardment of Tamil civilians, including in the so-called no-fire zone, as well as on shortages of food, water and medicines for those trapped between the warring sides. Western diplomatic pressure was subsequently exerted to seek a negotiated end to the war. But sensing that the LTTE was cornered, and confident in the unconditional support it was receiving from a war-weary Sinhalese populace, the government became combative with both its foreign and its domestic critics. The IMF loan inevitably became entangled in these manoeuvrings, and it was only some two months after the LTTE's comprehensive military defeat that it was finally sanctioned. Even then, though, Argentina, France, Germany, the United Kingdom and the United States abstained from support, laying bare the rifts within the Fund's Executive Board.

The current face-saving bravado aside, the IMF was indeed the government's lender of last resort, and recourse to it a measure of Colombo's desperation for foreign assistance in the face of the economic crisis at hand. Sri Lanka's relationship with the IMF extends back to 1950, but the latter's influence and importance in domestic policymaking grew, alongside that of the World Bank, with the post-1977 introduction of economic-liberalisation reforms by the rightwing

United National Party (UNP) government. As the first country in Southasia to embrace deregulation, liberalisation and privatisation, Sri Lanka quickly became a donor favourite. Its remarkable social-welfare indicators and resilient democratic

institutions, achieved in the context of a 'closed economy' and amidst modest rates of economic growth, made its seem ing recantation of statist paradigms all the more sweet. As such, bilateral and multilateral loans and grants flooded into the country, despite the often less-than-faithful adherence to neo-liberal policy 'conditionalities' in the following decades, and the descent following the July 1983 anti-Tamil pogrom into war.

New relationships

Between 1991 and 2001, Sri Lankan borrowed no new money from the IMF. Yet this decision had more to do with the con straints of economic conditionalities on political actors (who are forced, periodically, to secure an electoral mandate), rather than any break with the growth-centred model of capitalist development promoted by international financial institutions. Following Mahinda Rajapakse's election to the presidency at the end of 2005, it was signalled that the new government would forgo concessionary loans offered by the IMF and World Bank, rather than tolerate intrusions into its economic sovereignty. The IMF subsequently drew the appropriate conclusion, and closed its country office in January 2007.

In a significant shift, the new government sought to substi tute the dependence on the IMF and World Bank by borrowing from commercial banks and the international money markets. Simultaneously, it sought to diversify aid relationships to non traditional donors such as China, India and, more recently, Iran and Libya, in place of Canada, the European Union and the US. Despite punitive rates of interest (averaging eight percent per year) and short-term repayment period, loans were also contracted with private international banks such as Citicorp and HSBC; in 2007, the government raised USD 500 million through a single sovereign bond underwritten by HSBC, the proceeds from which were promptly exhausted in servicing existing debt obligations.

Perhaps the most significant element in this expansion has been the new bilateral relationships. To finance its ambitious mega-development schemes, for instance, the government obtained Chinese credit, including for the construction of the Norochcholai coal power plant near Puttalam, as well as for the Hambantota deep-sea port. Indian state investment has also been secured for at least one and possibly two thermal power plants near Trincomalee. Meanwhile, Iran is funding the Uma Oya hydropower-and-irrigation scheme in Moneragala District, the expansion of the Sapugaskanda oil refinery near Colombo, and is providing a substantial credit line on purchases of Iranian oil.

In 2008, then-foreign secretary and now Sri Lanka's perma nent representative to the United Nations, Palitha Kohona, accounted for the rise of the new donors in his customary plain-speak: they are neighbours, they are rich, and they conduct themselves 'differently'. He expanded on the last point: "Asians don't go around teaching each other how to behave … There are ways we deal with each other – perhaps a quiet chat, but not wagging the finger." Indeed, in addition to the Asian Development Bank (the ADB, which in the days fol lowing the approval of the IMF loan announced a 50 percent increase in its own lending to Sri Lanka), the constant in donor relationships has been the Japanese government, which is notoriously immune to environmental and human-rights concerns. Nevertheless, it was ultimately the unwillingness of Western donors to finance development projects in the context of the government's militarist approach (and mini malist approach to power-sharing with minorities), and the strains on Chinese and Indian bilateral aid in view of their domestic economic difficulties, that drove the government back into the embrace of the IMF – which itself is desper ately trying to re-invent itself and reclaim its legitimacy in the fallout from the global economic crisis.

So, in the wake of this turnaround, what of the new IMF loan itself? To start with, it is repayable within four years, starting in April 2012. The rate of interest averages between one and two percent, with additional surcharges depending on the size and pace of repayments. In contrast to commercial borrowing, the interest rates are low, and repayments can be spread over a longer period. However, contrary to the blithe assertions of Colombo politicians in recent days, there are indeed conditionalities attached to the loan, as there have been in the past, though these are of a somewhat more general character. The most debated of these has been the assurance of a reduction in the budget deficit to seven percent of national income by the end of 2009, with an even larger cutback to five percent by 2011. For this reason, many economic commentators – particularly enthusiasts of downsizing the public-sector workforce, divesting state-owned enterprises and decreas ing state subsidies – are ecstatic. Nonetheless, they are also overwhelmingly pessimistic as to the realisation of these goals. Year after year, after all, the central government has overestimated the revenue it has projected to receive, while underestimating its expenditure, as if by design. In 2008, the budget deficit was almost eight percent, and is predicted to rise to almost ten percent this year – indicating that, with only a few months remaining, the 2009 target is already unattainable.

Another condition is an increase in tax revenues by at least two percent of national income by 2011. This is to take place through the expansion of the number of those liable to direct taxation, the reduction of tax exemptions, and the plugging of tax evasion through better enforcement. A Tax Commission was recently appointed, and its recommenda tions for reform are due by mid-October. Still, if revenue collection continues to disappoint, where will the scalpel be wielded on state expenditure? The logical choice, par ticularly post-war, would be the military budget. However, no sooner had victory over the LTTE been declared than the former army commander and now chief of defence staff, General Sarath Fonseka, announced his intention to in crease the strength of the armed forces by 50 percent, to a whopping 300,000. Likewise, the heads of the air force and navy also made public their intentions to upgrade their own capabilities through the acquisition of 'smart' technology – accompanied, presumably, by matching price tags. In the absence of a 'peace dividend' from reallocated military-re lated expenditure, the other candidates for cuts would be public-sector salaries, transfers to loss-making public utilities and public companies, and the long-awaited reconstruction and development.

In its agreement with the IMF, the government has

committed to ensuring that its two largest loss-making enterprises, the Ceylon Electricity Board (CEB) and Ceylon Petroleum Corporation (CPC), will break even by 2011. Yet again, it was only in 2008 that electricity tariffs were increased by a massive 35 percent, while global fuel price hikes are already dutifully passed on at the petrol pump. It is also unclear how savings would be made in state enterprises when rhetoric on eliminating mismanagement, corruption and waste has yet to translate into fruitful action. Some trade unions and the left-nationalist Janatha Vimukthi Peramuna insist that the IMF conditionalities will eventually lead to the privatisation of the CEB and CPC. Clearly stung by such charges, in mid-August the government hurriedly announced the abolition of the Public Enterprises Reform Commission, which had been created in 1996 to divest state-owned enterprises. However, the Commission had been inactive since Mahinda Rajapakse took office, and its closure was largely symbolic.

The government would also be loath to freeze reconstruction and development, even if donor assistance were suddenly to dry up completely. The reconstruction of the north and east is a central part of Colombo's political strategy, with an eye to weaning Tamils away from separat ism; it is also cited as a precondition to the resettlement of the hundreds of thousands of displaced Tamils who were interned during the final phase of the war. Mega-projects elsewhere are no less important in conveying the govern ment's grand vision for development, its direction of state revenues to rural areas, and its integration of 'peripheral' regions into the national economy.

IMF + remittances

Meanwhile, critical sectors have been badly hit, and have yet to begin to turn around, many of which will not be affected by the new IMF injection of funds. The global economic crisis has affected demand for readymade garments in Sri Lanka's main export markets, the US and EU. Beyond 2009, there are bleak prospects for the extension of the country's current duty-free access into the EU, owing to poor implementation of core international human-rights and labour treaties and conventions, particularly as manifest in the ongoing humanitarian crisis. This would be a major self-inflicted blow to an industry in which dozens of factories have already closed. Likewise, the tourist trade, which had been in trouble since the December 2004 tsunami and the return to war, has been battered again by the global crisis. Finally, industrial action in August and September for a higher daily wage in the tea sector has seriously affected state revenues in what is still the island's highest net export earner. The only consolation in all this is that migrant remittances – which remain the largest source of foreign exchange – have not fallen, despite the global meltdown, as originally feared.

With the short- to medium-term economic outlook being hardly promising and in need of its next 'fix', the government has announced its intention to raise a further USD 500 mil lion in another international sovereign bond, to be issued in October. Those who raise concerns over the mounting debt burden and the all-too-familiar cycle of new loans to service old ones will no doubt run the usual gauntlet of abuse as 'traitors' and 'terrorists'. At the war's end and in pre-election mode, the 'patriotism' card keeps being played – evidently to distract from the weakness of the rest of the hand.