Debt restructuring, austerity and the IMF: a panacea or an exacerbation?

Part 1

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An outline of the problem

Post-independent Sri Lanka (Lanka) has suffered from recurrent economic crises; the more notable ones being in August1953, in the late 1970s and most pertinently the current crisis which essentially bankrupted the country. The trigger for the current crisis was the prolonged pandemic that affected the world and the Russian – Ukrainian war in February 2022. The government's misguided policies on agriculture, taxation and other sectors made the crisis worse. Post-independence, successive Lankan governments, regardless of their political hue and rhetoric have made more financial allocations to service its debt than it has allocated to education, healthcare, water, power and other essential social necessities. The advent of Covid-19 undermined trade and exacerbated this imbalance.

The pandemic resulted in a downturn in the Lankan economy, which is dependent on remittances from abroad, tourism and exports such as garments from the Free Trade Zones and agricultural products such as tea from the Malaiyaha areas. Global public debt as a percentage of GDP rose from an unacceptable 84 per cent at the end of 2019 to 100 per cent by the end of 2020. Even the world's two largest economies China and the United States (US) were not immune. Their public debt ratio to GDP increased.

The conflict between Russia and Ukraine led to a spike in global commodity prices, particularly fuel, fertiliser and food. This adversely affected the poor and those who lived from one paycheck to the next. Furthering their misery was the strengthening of the US dollar - the "recognised" currency for world trade - thus making the defaults of low-performing economies like Lanka and Ghana a seeming inevitability. This becomes even starker when Lanka's debt is looked at forensically.

Public Debt Situation

According to the IMF figures cited for March 2023, total public debt of the government of Sri Lanka was USD 83.6 billion of which the outstanding foreign debt was USD41.5 billion, i.e., 63.5 percent of the public debt. Of the GDP, multilateral debts were 17.6 percent and bilateral debts about 17.5 percent. About 52 percent of the bilateral creditors were Chinese, about 25 percent Japanese and 16 percent Indian.[1]

This is sadly not something new. Sri Lanka's economy since at least the early 1950s has failed to produce sufficient foreign exchange to meet the cost of imports. Add to this the fact that the vast majority of the population, given the informal nature of employment and business practices, do not pay tax. In addition, the largest share of government revenue is devoted to the military, dwarfing expenditure on health and education.

Successive governments were able to hide this underlying weakness in the economy and their incompetence, and corruption of the public purse when it came to accountability, the rule of law and transparency by evoking the spectre of the "other" usually in the form of minorities and they were thus able to shift the attention of the populace from their own and the economy's shortcomings.

Hiding this fact that governments in the past, regardless of their political hue like in the present, have continued to borrow for non-productive and mostly wasteful and mismanaged projects leading to a huge external trade deficit, without being able to meet the country's debt obligations; resulting in the country declaring bankruptcy. Lanka still produces few of its avidly sought-after consumer goods making the situation even more economically untenable. The top 20 per cent of the population enjoy 42 per cent of the island's income while the lowest 40 per cent make do with 17.8 per cent.

"Free market" economy

The government as well as those in opposition are still advocating a free-market economy combined with a strategy of an export-led recovery process. So, the mantra of providing more and more incentives to attract foreign direct investment, promote tourism, and push local human resources abroad to make more foreign remittances continues. They conveniently forget that "free" market economics created the crisis in the first place and required the country to be bailed out by international financial agencies on numerous occasions.

Sri Lanka defaulted on its sovereign debt repayments last year and entered negotiations with the International Monetary Fund (IMF) for access to a loan package on the premise of implementing structural macroeconomic change. After obtaining USD 2.9 billion of financing from the IMF, Sri Lanka was required to initiate and complete its domestic debt restructuring process (reworded innocuously as debt optimization) in early July. As this process will lead to serious economic shocks, the government imposed a five-day bank holiday at the end of June 2023, to "facilitate" the market in absorbing those shocks and to avoid a run on banks.

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1 International Monetary Fund March 2023, IMF Country Report No. 23/116, Sri Lanka Annex 11. Public Debt Sustainability Analysis, Pp 53-54, available at: https://www.elibrary.imf.org/view/journals/002/2023/116/002.2023.issue-116-en.xml

This sort of brutal restructuring is not new to Sri Lanka. Since independence, Sri Lanka has had to go to the IMF with cap in hand 17 times. This will be the tenth IMF loan Sri Lanka received since the country was made into a free-market economy in 1977. The last loan was in 2016. The question the country needs to ask itself is, are we going to be hoodwinked yet again as the panacea offered by the IMF has been a systemic failure?

Restructuring and austerity

The impact of restructuring will depend on what social layer one belongs to. To a majority, it will be austerity once again, and once more people will be forced to demand economic justice. Those who loudly advocate for the IMF-led restructuring have become conveniently blind to tax avoidance and evasion, illegal siphoning of funds and money laundering and corruption, mismanagement and wastage of resources in the state sector. They have also been muted on the vital need to restructure the economy to meet the needs of the populace, not a minority of very wealthy individuals and families. Austerity has historically made the majority of the population poorer and has increased income disparity.

This paper forcefully challenges the economic mantra that debt restructuring needs to accompany fiscal austerity. A blind obedience to the a priori dictates of neo-liberalism is a sure fire recipe for disaster. The way the neo-liberal economy is designed, tax evasion and avoidance have become a systemic issue. It allows the siphoning off of taxable profits that corporations earn in developing countries like Sri Lanka to tax havens around the world. In Lanka, the tax base is not wide enough due to its extensive informal economy, and the large human resource component in overseas employment, who make remittances.

Accepting the IMF package requires cutting down of vital public expenditure such as on education, healthcare and social safety nets. It will also promote direct and indirect tax hikes, selling state-owned enterprises as well as natural resources to the private sector, establishing public-private partnerships, liberalization of public procurement and trade, increasing labour market ‘flexibility’ to hire and fire and reduce wages and pensions, increasing interest rates etc. Nothing will be done about corruption, cronyism and economic mismanagement.

The next section will cast a critical lens at the neo-liberal approach the IMF has adhered to.

To be continued