

# The IMF and Civil War in Sri Lanka: A Critical Dialogue

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The International Monetary Fund (IMF) has approved a US\$ 253million standby credit facility to Sri Lanka on April 20, 2001, to stabilise the macroeconomic fundamentals. An initial instalment of US\$ 131million has already been released, and the rest is expected to be released in four equal instalments (US\$ 30.5million 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\$ 250million 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 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<sup>1</sup>. The IMF has provided a breakdown of the defence expenditure into

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<sup>1</sup> IMF, *Sri Lanka Country Report No.01/71* (Internet edition), May 2001: 13.

‘wages and salaries’ and ‘goods and services’ which is a welcome step, because the CBSL does not publish this breakdown for public consumption<sup>2</sup>.

For instance, according to the CBSL nominal GDP of Sri Lanka in 1999 and 2000 were LKR 995billion and LKR 1,125billion respectively (Table 1) whereas according to the IMF the corresponding figures were LKR 1,111billion and LKR 1,263billion<sup>3</sup>. Further, according to the CBSL defence expenditures in 1999 and 2000 were LKR 54billion and LKR 77billion respectively (Table 1), whereas according to the IMF (‘security-related expenditure’) the corresponding figures were LKR 49billion and LKR 71billion<sup>4</sup>.

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

<b>Fiscal Year</b>	<b>GDP at current prices (LKR billion)</b>	<b>Defence Expenditure (LKR billion)</b>	<b>Defence Expenditure as a percentage of GDP</b>
<b>1996</b>	696	46	6.6
<b>1997</b>	804	46	5.7
<b>1998</b>	913	57	6.2
<b>1999</b>	995	54	5.4
<b>2000</b>	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.  
 1997 - GDP – CBSL, *Annual Report 1997*, Statistical Appendix Table 1.  
 Defence – CBSL, *Annual Report 1997*, Statistical Appendix Table 51.  
 1998 - GDP – CBSL, *Annual Report 1998*, Statistical Appendix Table 1.  
 Defence – CBSL, *Annual Report 1998*, Statistical Appendix Table 54.  
 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<sup>5</sup>.

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

<b>Fiscal Year</b>	<b>Defence Expenditure as a percentage of GDP reported by the CBSL</b>	<b>Defence Expenditure as a percentage of GDP reported by the IMF</b>	<b>Discrepancy as a percentage of CBSL figures</b>
<b>1996</b>	6.6	5.8	(-) 12
<b>1997</b>	5.7	5.1	(-) 11

<sup>2</sup> *ibid.*

<sup>3</sup> IMF, *op cit*: 33.

<sup>4</sup> *ibid.*

<sup>5</sup> IMF, *op cit*: 13.

<b>1998</b>	6.2	5.0	(-) 19
<b>1999</b>	5.4	4.4	(-) 19
<b>2000</b>	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 under-estimations. The reason for these considerable under-estimations 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 amount 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 of the potential evidence for aid deflection is the very low utilisation 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 utilisation 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%<sup>6</sup>. 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 utilisation 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

<sup>6</sup> ERD, *Foreign Aid Review: Sri Lanka*, 1999: 3.

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 under-estimations. Hence, the IMF defence expenditure data are gross under-estimations 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”<sup>7</sup>. 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%)<sup>8</sup> 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

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<sup>7</sup> IMF, *op cit*: 13.

<sup>8</sup> Military expenditure here includes only the army, air force and navy.

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	1992	1993	1994	1995	1996	1997	1998	1999
<b>South Asia</b>									
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
<b>Sri Lanka</b>	<b>2.8</b>	<b>3.0</b>	<b>3.1</b>	<b>3.4</b>	<b>5.3</b>	<b>5.0</b>	<b>4.2</b>	<b>4.2</b>	<b>3.6</b>
<b>Conflict-ridden</b>									
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.

The forgoing comparative data presented in Table 3 contests the observation of the IMF regarding Sri Lanka's military expenditure vis-à-vis other comparable countries. These are sufficient evidences of rapidly growing militarisation 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 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<sup>9</sup>. 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 63billion 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\$ 400million in year 2000 to about US\$ 140million this year<sup>10</sup>.

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<sup>11</sup>. Even the present budgetary allocation of LKR 63billion 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<sup>12</sup>, which may negatively impact on businesses and masses alike.

### **Conclusion**

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. 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.

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<sup>9</sup> BUFF/91/186 cited in IMF, *op cit*: 13.

<sup>10</sup> IMF, *op cit*: 19.

<sup>11</sup> CBSL, *Annual Report*, various years.

<sup>12</sup> IMF, *op cit*: 15.