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MEDIA RELEASE

Tax and debt crisis of the yahapalana government

(Text of a speech on the “Tax and debt crisis of the yahapalana government” delivered by former President Mahinda Rajapaksa at the Battaramulla office of the Joint Opposition on Wednesday 29 June 2016.)

Venerable members of the Maha Sangha, clergymen of other religions, Members of Parliament, and distinguished guests,

It can be seen that the increase in the Value Added Tax has run into a great deal of opposition countrywide. Owners of small and medium businesses and traders in many towns have come out onto the streets against this tax hike with the support of the general public. The government tried to justify their tax increases by placing advertisements in all media stating that this tax increase is necessary to pay off the loans taken by my government. I thought it is only right that I explain to the people what has really caused this situation. The amount of debt that a country can take on depends on our capacity to pay back the loans as they become due. My government always ensured that borrowing was kept within manageable limits. Treasury reports reveal that during the last seven years of my administration, foreign loan repayments (principal plus interest) that came due each year were as follows:

2008 – 1.4 billion USD

2009 – 1.3 billion USD

2010 – 1.2 billion USD

2011 – 1.5 billion USD

2012 – 2.2 billion USD

2013 – 2.4 billion USD

2014 – 2.2 billion USD

These were not excessive amounts that could not be met. Furthermore it should be borne in mind that my government did not take loans for consumption. We obtained loans to carry out the war against terrorism and to develop infrastructure which can be used by our people for decades if not centuries. What we have built can be seen all over the country. Leaders of this government are still opening only

the projects that my government commenced. One minister publicly acknowledged this fact recently. Whenever we took out any loans for a project, it was done carefully in a planned manner which is why we never had to contend with an unmanageable piling up of debt.

However, since January last year, the present government has been on a reckless borrowing binge. They have borrowed 2.3 billion USD from India in the form of currency swaps on three occasions in March 2015, October 2015 and March 2016. Then they have borrowed 2.15 billion USD through sovereign bond issues in May and October 2015 and a further 3.1 billion USD through Sri Lanka Development Bond issues between March 2015 and June 2016. The total foreign loans taken by the yahapalana government now amounts to 7.7 billion USD. No less than 3.3 billion USD of this falls due for payment before the end of 2016.

Some of these dues such as the 1.1 billion USD six month currency swap from India have already been paid as have some of the short term Sri Lanka Development Bonds that were issued last year. Yet there is much more to be paid off before the end of this year. All this is over and above the loans taken by previous governments which also have to be repaid. The loans taken by previous governments is not a reference to the loans taken only by my government. Long term loans taken even during the J.R.Jayewardene era are still being repaid. Every government pays the debts of the governments that preceded it. After being elected into office in 2005, I too paid the debts taken by previous governments.

Reckless borrowing by the present government is the main reason why Sri Lanka was given negative outlook categorisations this year by Moody's, Fitch and Standard & Poor - the three top international credit rating agencies. All three ratings agencies had cited the huge liabilities coming due for payment before the end of this year as the main reason for their decision to downgrade Sri Lanka. Standard and Poor's not only gave us a negative outlook categorisation but also warned that in the coming three years, the debt burden would increase further. They also warned that if there was no improvement in the situation, a further downgrade may follow.

In this situation, the government obtained a loan of 1.5 billion USD from the IMF. When the IMF gives a loan to a country, they also impose conditions that are meant to create an environment where the recipient country would be able to pay back the loan taken. As a result of this, when a country enters into a programme with the IMF, the standing of that country in the credit market improves.

However, even after the IMF decided to give Sri Lanka a loan, both Fitch and Moody's issued press statements saying that they were not confident about the capacity of the Sri Lankan government to meet the targets set by the IMF. Moody's stated that Sri Lanka's needs will not be met by the IMF loan and that they expected the debt burden to increase further this year and the next. In June this year the IMF executive board approved the loan to Sri Lanka and the first tranche of 168 million USD was also received. It was after the IMF money started coming in that Moody's gave Sri Lanka a negative outlook categorisation on 20 June. Experts say this is the only known instance when even acceptance into an IMF programme has failed to bolster market confidence in a country. Having given us a negative outlook categorisation, Moody's went to the extent of warning that a further downgrading of Sri Lanka

may take place if the situation does not improve. Even though entry into an IMF programme usually bolsters confidence in that country, the moves made by the yahapalana government to use the IMF programme as a cover to borrow more and more, seems to have unnerved the ratings agencies. The task of ratings agencies is to inform the markets about the creditworthiness of those taking loans so that the lenders can make an informed decision.

We have thus far been talking only of foreign debt, but domestic debt too has increased by 16% (Rs. 681 billion) from Rs. 4,278 billion at the end of 2014 to Rs. 4,959 by the end of 2015. This was the highest yearly increase in domestic debt since independence. The Auditor General too has revealed that the loans taken in 2015 were nearly double the borrowing limit mandated by parliament. Despite all these borrowings, the government has not started a single development project. When the contracts that my government signed are completed, leaders of this government go for the opening ceremonies. There isn't a single development project that has been initiated by this government. Yet they obtain loans as no government has done before. We did not get indebted like this even during the war.

The present government is using borrowed money for day to day expenses. They won the 2015 presidential election by uttering lies and making false accusations against me and my government. Because they could not win the 2015 August parliamentary election using the same tactics, they practiced a different kind of deception by giving people large salary increases and tax concessions that the economy could not sustain. They never told the people that it is the people themselves who will ultimately have to pay for all this election related largesse. They told the people that the Rajapaksas could have given all those concessions but they had used the money for the comfort of the ruling elite instead. They told the people that now that the wasteful Rajapaksas had been ousted, it was possible to give various concessions to the people. Because they could not increase taxes immediately to raise the income to meet the additional expenditure, they began to borrow money to fulfill their pledges.

You can live on credit for a number of months. But at a certain point the credit markets begin to get nervous. It is at that point that the government approached the IMF. The IMF gives a programme of action along with the loan. The first thing they would tell you is to start collecting the money to repay all the loans you took. The IMF tranches are released only after reviewing progress on the implementation of their conditions. Then we see VAT being increased and the application of the NBT being broadened to increase government revenue. This creates an anomalous situation in Sri Lanka. Over the past eighteen months, the global prices of milk food, wheat flour, sugar, crude oil, steel, cement and virtually everything that we import, has declined precipitously. But because of the yahapalana taxes, the prices of these goods have been increasing only in Sri Lanka. This is why I called on the people of Sri Lanka to rise up as one against these tax increases, a few days before May Day this year.

Now the government is looking for more ways to tax the people. They have announced that a capital gains tax will be introduced in the coming weeks on the grounds that people accumulated a lot of wealth in the recent past and that this should be taxed. It is ironic that while insisting that I ruined the economy,

this government says in the same breath that people earned a lot of wealth during my tenure which has to be taxed. When ordinary people hear the phrase 'capital gains tax' they may assume that this is a tax levied only on rich people who own 'capital'. But what is meant by capital in this case is property owned by anybody. If a farmer, labourer or schoolteacher disposes of his land or house, he will have to pay a tax on the difference between the price at which he bought it and the price at which he sold it. The capital gains tax is no less objectionable than the VAT and NBT increase.

Today the government sees the whole nation as a cow to be milked to sustain themselves. They clearly showed where their priorities lie by presenting a supplementary estimate to parliament to buy expensive luxury vehicles for ministers right in the middle of the unprecedented floods, landslides and manmade disasters that befell the country in the past several weeks. Now a new danger has manifested itself. Using the credentials provided IMF programme, the government has made hasty arrangements to take a syndicated loan of up to 3.5 billion USD facilitated by a consortium of five banks including HSBC, Citibank and Credit Suisse. This would have been a factor causing concern to the credit ratings agencies as well. According to the Sunday Times, the attorney general has objected to certain clauses in the relevant agreement where the loan can be cancelled and the Sri Lankan government required to pay back the entire loan upon the occurrence of certain events.

Such clauses are introduced to give the creditor priority over all other creditors. The banks in the consortium can transfer all their rights to other banks and whoever owns the debt will be entitled to cancel the loan and demand immediate repayment upon the occurrence of certain events. As reported by the Sunday Times, the Attorney General has pointed out that if this loan is recalled, and the government is unable to pay the loan in full, it will automatically trigger default provisions in other loan agreements as well, making those loans also payable in full immediately. At this moment, the government is desperate enough to agree to any condition to get their hands on some money.

I earnestly request the government to table this loan agreement along with the Attorney General's observations before parliament. The legislature needs to be informed about the financial management of the country at this critical moment. This is a country that has gone through 30 years of civil war and two insurgencies in the south. We have even had foreign armies on our soil. Yet we have never faced a crisis as acute as the one created by the reckless borrowing of the yahapalana government. The people of this country should be aware of the situation that is developing.

Thank you.