Spotlight: Econ Op-eds in Summary

Week ended 12th January '22

In Summary

The underneath contains summaries of the articles given above, including key extracts from these articles.

1. Going to the IMF still an option?
By Dinesh Weerakkody

- The existing economic crisis of Sri Lanka could be attributed to the massive drop in tourism as a result of the pandemic coupled with tax cuts, high public spending and large debt payments which is pushing the country towards near bankruptcy.
- In such a situation, while payment of US$ 500 Mn due in January would be certainly paid off, with tourism not expected to see a full recovery until 2023 and no permanent fix to drive up exports and FDIs, attracting the balance of US$ 7 Bn required within the year is going to be a heinous task.
- Therefore, with early crisis concessions from the world bank having expired, a new framework led by the G20 and supported by private sector creditors will be critical to unlock IMF financing for debt-ridden countries.

The FT on Wednesday (5th January) had a very insightful editorial titled "Time for the IMF". The editorial noted that the "Country's economy is in as dire a state as it has ever been, and now is not the time to protect one's political standing, while it's hard to imagine that the conditions imposed by the IMF could be any worse than the predicament facing the public at present. The goal of the Government right now is to eliminate the country's macroeconomic imbalances, resolve the debt crisis, and boost investor confidence. As unpalatable as it may seem in some quarters, the IMF might just be the best way to achieve those goals."

Cause of the crisis

The economic crisis in Sri Lanka was largely driven by the pandemic fallout and the massive drop in tourism income – the No. 2 foreign exchange earner for the country. But unlike Sri Lanka, those countries with similar income streams have managed their finances much better than Sri Lanka and are now on the path of recovery. The tax cuts, high public spending, and large debt payments have pushed the country to near bankruptcy in 2022. Rising inflation and shortages has impacted those lower middle-class families that were reasonably well off prior to the pandemic. According to the World Bank nearly 500,000 additional people have now fallen below the poverty line post-pandemic.

Options

The Government to ease the burden of the public due to the ever-increasing COL could continue to print more money to provide relief, to prevent a massive pushback from the public, while the Government buys some time as they seek debt relief from their various lenders and get budget support from friendly countries like India and China. The US$ 500 Mn ISB that is due in January will certainly be paid on time. Some of it is held by local banks. In the next 12 months around US$ 7 Bn has to be found to pay off all the loans falling due and others. This is no easy task given the re-emergence of a new

COVID variant – Omicron.

Tourism income is set to improve but would be 2023/24 before Sri Lanka sees a full recovery in that sector. So, Sri Lanka's financial position is not what the country wants. Whilst the country looks to India and China for debt relief, joining an IMF's COVID relief program may be the best option for the country according to several economists. Successive governments have blamed each other for piling up current debt. This debt situation is clearly not sustainable. Some governments had even piled up large amounts of government debt via the state-owned enterprises which is all off the books of the treasury.

Various solutions to the debt crisis have been proposed by the opposition and experts, such as swaps, selling SOEs, going to the IMF and bilateral loans. All these are temporary fixes. We must have a program to drive up exports and attract FDI. The banks must wake up and play a special role in this effort.

Going to the IMF

Whether the IMF is willing to provide Sri Lanka with a bail out in the form of a loan, in addition to the traditional policy advice and technical assistance is not certain and will certainly come with conditions attached as pointed out by Basil Rajapaksa. In the early days of the crisis according to World Bank sources – debt service suspension initiative and low interest loans were made available under a framework. Many of these concessions have now expired. Like Sri Lanka, several low-income countries are still finding it increasingly difficult to service their sovereignty debt as these countries are forced to make a choice between servicing their debt and protecting the livelihoods of its people.

In the final analysis, 2022 will continue to be a challenging year for all low-income countries that need concessionary debt treatment, therefore a new framework led by the muscle of the G20 and supported by private sector creditors will be critical to unlock IMF financing for debt-ridden countries. Therefore, multilateral action is urgently needed for sustainable debt support until the pandemic starts winding down

For the full article – Refer Daily FT

2. Economic recovery; the IMF, SOE reforms and Sri Lanka's options
By Tennakoon Rusiripala

- Decreasing foreign reserves, rising inflation seems to pressure the stability of economy. There is increasing uncertainty within the country about food security. Amidst these uncertainties, the Central bank raised rates in order to control inflation.

- Despite these perilous conditions, there is still a debate about IMF assistance, with those who are against pointing out that conditions attached to a program would leave the country worse-off. However, Sri Lanka have sought assistance from IMF before and conditions imposed by IMF were more towards structural reforms, lower budget deficits, policy reforms and strong financial management.

- The advantage in associating ourselves with the IMF in an economic recovery program overweighs these conditions. The biggest advantage is the benefit accruing to us through their monitoring function which involves surveillance and capacity building in addition to their lending function.

The World Bank Overview update of 7 October 2021 about Sri Lanka, quoted below.

"Growth is expected to recover to 3.3% in 2021, but the medium outlook is clouded by pre-existing macro-economic weaknesses and the economic scarring from the COVID-19 pandemic. Official reserves remain low relative to short-term liabilities amid constrained market access. A severe foreign exchange shortage is exerting pressure on the exchange rate. Urgent policy measures are needed to address risks to debt sustainability and external stability."

More recent developments point towards a gloomier situation. The CCPI (Colombo Consumer Price Index) rose beyond 9.0% in Nov/Dec with the inflation surrounding food items reaching 17.5%. There is a strong uncertainty about food security and households are concerned about running out of food. The increase in food prices and shortages of many essentials are adding to the rising inflation. The fuel increase after a long period of nearly two years has aggravated the living conditions as well as the general hardships in day-to-day life. This was despite the Central Bank having increased the policy rates raising both Standing Deposit Facility and Standing Lending Facility to 5.0% and 6.0% respectively in order to curb the inflationary pressure.

Foreign reserves are used mainly to service the debt within the available limits and the reserve position is becoming highly volatile with slowing down of remittances from overseas employed and reduced income from other sources such as the tourism sector. The depleting foreign reserves are causing further vulnerabilities making it imperative to resort to stringent Import restrictions.

It is in this context urgent policy measures are needed and takes the priority in addressing the growing uncertainties. Among the various proposals and suggestions made seeking assistance of international agencies is considered as a basic necessity and as the bottom line of the solution.

Is the IMF a 'Crown of Thorns'?

The ongoing debate is centered mainly on two aspects.

1. There is one school of thought that the IMF will grant assistance only on conditionality that will be imposed on the borrowing country. Such conditions according to the understanding of some have been and could be harmful and cause hardships to the people.

2. The other view is, there is no need for us to subject ourselves to external conditions when we can resort to other methods of alleviating our difficulties without burdening the people. We are compelled to look at the pros and cons of both viewpoints in a balanced way.

Historical background

Sri Lanka's relationship with the IMF is nothing new. Since joining the IMF as a member country in August 1950, we have received 16 facilitations and the last standard loan we got from IMF was in June 2016. The IMF approved a loan to the value of SDR 1.1bn which was equal to US$ 1.5bn under the Extended Fund Facility with a repayment plan to be completed by 2028 beginning 2020. The lending arrangement was spread over a period of 36 months with the disbursement of the loan in six instalments. In 2009 Sri Lanka obtained the highest amount as a loan from the IMF which was more than US$ 2.5bn as a stand-by arrangement.

Our record with the IMF is very clear and we have never defaulted or failed to repay our obligations to the IMF. We have a member quota of 80mn SDR (equal to US$ 800mn) in the IMF as a member country which provides us a voting right of 0.14 on the IMF board of Governors. We have experienced difficulties with the compliance conditions on a few occasions such as the Compliance with the EFF facility of April 2003, which was due to the tsunami situation.

The most contentious issue about going to the IMF is the conditionality of lending. There is also a fear that the developed countries which have the final say in the fund as its influential members, act discriminately when it comes to granting assistance and are less mindful about the basic welfare nature of our democratic system of government. Therefore, the conditions imposed at their initiative can be tyrannical to our governance structure. While we do not totally reject these views, we have to weigh the pros and cons in the context of the global economic trends and adjust ourselves to the mutual satisfaction of all parties. In a modern world with rapidly changing scenarios and emerging economic issues there will be sufficient space for reaching negotiated understandings among the stakeholders more freely.

Let us now take a look at these so-called draconian conditions imputed by many objecting to the IMF option. Generally, these conditions vary with each borrowing country depending on their individual status. But if we look at the conditions the IMF imposed on us in our last borrowing program, we can have a clear picture about the nature of those and whose interest they are trying to safeguard.

1. Lower budget deficits

2. Monetary policy reform

3. Higher government revenues

4. State enterprise reform

5. Stronger public financial management

6. Supporting higher trade and investment

Now these were the conditions imposed on us when the IMF approved the 2016 June Extended Funds Facility. It is interesting to note the circumstances under which this facility was requested by the Sri Lanka Government. Three main reasons were given;

- To deal with the immediate balance of payment pressures

  There was an unsustainable situation that arose due to weaker FDI inflows and capital outflow from the Govt. Bond market caused a severe fall in the foreign exchange reserves.

- To unlock and facilitate other financing arrangements

  The assistance coming from the IMF was believed to strengthen the credibility of the govt. in the finalization of pending multilateral and bilateral loans to supplement the reserves.

- To reassure private investors.

  The stepping in of the IMF at that moment would contribute towards the elimination of doubts about the probability of a default of the existing private sector debts.

This situation existing then is not much different to what we are seeing today. In fact, we see them in a much more serious form now. But there was no pandemic then. If the IMF was ready to accommodate a request, then, under such a scenario, there should not be any apprehension about approving a facility now to overcome the present-day crisis. Particularly when it is not a problem confined to us only, but a global phenomenon due to reasons well beyond one's control and circumstances unforeseen.

Another advantage in associating ourselves with the IMF in an economic recovery program is the benefit accruing to us through their monitoring function which involves surveillance and capacity building in addition to their lending function. We have to remember that a member country of the IMF is entitled to request and obtain financial assistance in a situation of a lack of sufficient foreign financing and reserves to meet its international payments. In our case the factors that have gone to trigger the current economic impasse will be accepted as due to circumstances beyond our control.

Under these circumstances an effective economic revival program could only be successful with external support which in addition to the financial strengthening contributes to the confidence building and the catalyzing effects it could generate associated with the financing program. A loan or a currency SWAP obtained under a bilateral agreement will not deliver this benefit. These will be effectively addressed best by an international organization such as the IMF.

It is no secret that we have already imposed many conditions by ourselves to put the house in order despite the fact that they are causing hardships. It is highly unlikely that the IMF will impose any hardships beyond the vital corrective steps necessary as essential adjustments to correct the system.

Their assistance could be solicited in a number of ways including policy planning as well as corrective assistance. We have no doubt there will be alarming revelations if the IMF surveillance role is effectively implemented to identify the risks, malfunctions and to recommend appropriate corrective measures.

The only growth that will be shown by the few white elephant turned SOEs is in their indebtedness. Their operations only contribute to increasing our cost of living due to the necessity to finance them with Public Funds for their survival and maintenance. If our governments cannot effectively introduce corrective measures the only other option is to subject ourselves to stringent controls imposed on us by way of conditions by a lending agency duly monitored under a program of surveillance and capacity building.

We are sitting on a volcano. How soon and at what moment the eruption will take place is something we are yet to witness. All regimes under whom we were governed allowed this state of affairs to continue. The caravan moves on. Dogs bark. We are dancing on the edge of the abyss.

For full article – Refer Daily FT