Spotlight: Econ Op-eds in Summary

Week ended 10th June '20

In Summary

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

1. Sri Lanka Currency depreciation and sustainable path towards economic redemption
By: Shamika Ramanayake

- Sri Lanka's currency depreciation saw its peak in April this year as both the local and global economies were put into turbulence due to the pandemic. Since then, the CBSL's sterilization measures complimented by weak import demand and capital controls have resulted in successful controlling of further downward pressure on LKR. This, however, may not be sustainable in the long run.

- The above measures are put in place to stop the two main sectors which could put pressure on the currency – imports and outflows arising from foreign holdings held in debt and capital markets. As the foreign participation in markets are anyway relatively low in Sri Lanka, the pressure on the currency is normally absorbed by four main sectors - exports, worker remittances, tourism income and FDIs.

- Among these sectors, exports remain the highest contributor and strongest shock-absorber. As such, measures such as expanding non-apparel-based industries with special focus towards manufacturing and establishing new Free Trade Zones should be taken to support the development of the export sector, in turn creating a sustainable path towards economic redemption.

Boiling point

Relative LKR depreciation against the USD, over the past decade (June 2010-May 2020) attributed to more than 63%. To draw a comparison of this same period to SAARC ally Bangladesh, Taka's relative depreciation against USD remains at a low 22%.

Whilst the pandemic-caused ripple effects led to the recorded USD/LKR peak spot of 199.75 on 9 April as per CBSL data. Understandably, this led to the USD selling rate crossing Rs. 200 mark for the first time in corresponding dealer markets.

On the global stage, DXY or Dollar Index which acts as an indicative gauge for the USD strength against a basket of six other global currencies (i.e. EUR, YEN, GBP, CAD, SEK and CHF), reached its recent peak of 102 during the third week of March which was last seen in 4Q 2016 – 1Q 2017 period. As the world's capital was largely moving towards safer investments (likes of US treasuries) during the pandemic, natural cause-effect path reflected the DXY reaching 100 and beyond index levels since February this year.

In spite of DXY effects, CBSL's sterilisation efforts in the current year up to April stemming from intervening USD sales nearing 336 mn, ably complimented by import demand lax and capital controls have been successful in largely controlling further downward pressure on LKR. Nevertheless, the country's debacle on defending the LKR against natural market forces continues, with mixed results over the past decade.

Root cause

‘Currency deprecation’ in general remains one of the major challenges faced by developing or emerging market economies. Whilst it may arise due to many intricacies, the significant import-reliance, remains as one of the most critical forces.

To a great extent, the import reliance on scarce commodities (crude) and/or superior industrial products (automobiles) which naturally shows similar traits in developing economies. In Sri Lanka’s context, the above bill (fuel + consumer automobiles) collectively accounted for almost 24% of total imports in 2019 (i.e. $ 4.7 bn).

In essence, imports drive the demand for foreign currency domestically which in turn pressurizes the local currency value to edge downwards. Whilst the States may time to time be successful in imposing certain controlling measures to contain the domestic demand for imports and secondarily on means of Forex repatriation, which mostly restricted to short-time bounds.

Further, outflows arising from foreign holdings held in debt (government securities) and capital (i.e. CSE) markets during turbulent times too may reverberate pressures on local currencies. In Sri Lanka’s context, such outflows which recorded their recent highest levels during 2018 (~Rs. 187 bn) and 2019 (~Rs. 66.4 bn) have had roughly accounted for 5% and 2% respectively as against the corresponding annual import costs (i.e. 2018 – Rs. 3.6 tn and 2019 – Rs. 3.57 tn).

Considering the relatively lower levels of foreign participation in Sri Lanka’s debt and capital markets, the corresponding shocks arising from such sectors on LKR, assumed to be largely remain manageable even during infrequent stress times.

In this context, it is the general sense that in order to contain or counter this overriding demand for foreign currency in developing economies, the strength and sustainability of foreign currency (Forex) generating avenues become utmost important.

In Sri Lanka’s context if these key Forex generating/inflow avenues to be highlighted, those will fall under the categories of Exports, Worker Remittances, Tourism income and FDIs.

In essence, the captioned four forces remain as the shock-absorbing cushioning in terms of containing the LKR depreciation to a large extent whilst Foreign debt (~Rs. 6.4 bn and 49% of total national debt as of 2019 FYE) mostly acts as the subsequent void-filler. In the context of contemporary Sri Lankan economy, the more stronger and sustainable captioned forces remain, the lower the incremental impact of foreign debt component going forward.

Exports remain the highest contributor and strongest shock-absorber among the four forces in the long-run survival of the economy. The reason for same is due to the inflows from worker remittance and tourism sector remaining relatively more susceptible to external conditions beyond country’s control (as in the case of current pandemic), than the flows deriving from a competitive exports base.

On the other hand, strong and competitive country exports help to create a thriving industrial ecosystem, entrepreneurship and consequently become an enabler for higher FDIs.

Out of FDIs of $ 1.2 bn flown-in to the country in 2019, BOI based export-led enterprises drew an aggregate of $ 446 mn attributing to 37% of total FDI flows (2018 – $ 525 m) proves this point.

In light of above, the following will dig into the current competitive status of Sri Lanka's exports, criticality of exports for future progress and paths to be followed to make same a reality.

Sri Lanka's exports – Status quo

Comparing the decade back status from 2010 and the latest (2019), total Sri Lankan exports in absolute terms have grown only by 38.4%.

In comparison Bangladesh exports for same period were more than doubled from $ 19.23 bn to $ 39.95 bn whilst the country is holding the fastest growing economy in the Asia-Pacific ahead of India.

Sri Lanka exports: Status after a decade

In terms of major export earners, apparel and tea remain the highest contributors. However, the collective contribution of both Apparel and Tea for the overall export income during 2010 and 2019 remain as 55.6% and 58.2% respectively which reflects only a marginal growth in 10 years (table 2). Whilst the share from Tea shows a decline from 16.7% to 11.3%. In turn, signals lack of real impact from export strategies or international relations to promote critical earning sectors.

If contribution from apparel is to be excluded from industrial exports, the income generated from remaining sectors such as rubber and petroleum products, precious stones and jewellery, F&B, tobacco, etc. remain stagnant at 32% of total exports for both periods in 2010 & 2019. This shows, absence of a clear strategy to uplift the industrial business growth/volumes and diversification from apparel.

In terms of key international markets for Sri Lankan exports in 2010 and 2019, the key geographies remain hardly unchanged. Even more starkly, despite the historically close ties with neighbouring India, Sri Lanka seems to be missing a real pull-factor to boost the volumes to India as the past decade data suggests (India and Asia export share in 2010 – 16% Vs. 2019 – 17%).

Sri Lanka's low share of producer-driven exports suggest a lack of global production sharing which critically highlights the importance of linkages to Global Value Chains (GVC) to make country's produce more competitive.

Paths for future progress

1.Expansion of non-apparel based industries with special focus towards manufacturing

After more than seven decades of post-imperial independence, the most visible brands of Sri Lankan origin are restricted to only few, such as 'Ceylon Tea', 'Dilmah', 'Spa Ceylon' and 'Sri Lanka Tourism' which again falls under the captioned 'buyer-driven'.

Hence the critical focus should be to develop this non-apparel based industrial sector, ideally foraying into more technical-based goods/produce and value-additions. Such an enterprise-ecosystem will eventually bring/promote the following long-term benefits to the country:

- Higher premium for exports in the global marketplace and relatively more dependable Forex income.
- Exports diversification out of agri and apparel including new market penetration.
- Globally proves to be an enabling ground for future GVC affiliations which in turn would fast-track thriving local enterprise development (e.g. automobile, aircraft component, computer-chip manufacturing, etc.).

- Forcing business-oriented changes to existing economic zones and industrial parks becoming more globally-appealing (e.g. identified zones and parks becoming tax-free for extended lease periods).
- Follow-on benefits such as tech and knowledge transfer to local industries, local work-force upskilling, business-focused local innovations, etc.

2.Establishment of new Free Trade Zones

As BOI Investment Guide 2019 suggests, Sri Lanka currently has a base of 10 active Economic Processing Zones (EPZ) and two Industrial Parks (IP) accommodating 269 enterprises with a total employment base of 500,000+ and generating nearly 69% of total export revenue in the country. Further, three EPZs in Mawathagama, Bingiriya and Milleniya remain in pipeline.

Benefits currently enjoyed by investors in these EPZs and IPs include 100% foreign ownership, repatriation of earnings/liquidation proceeds, duty exemptions on raw material imports intended for exports, enhanced capital allowance schemes, duty exemptions for capital goods on selective basis and reduced income tax rates starting from 14%.

The State should realise that the strategic location in the Indian ocean alone is not going to bring-in global corporates and MNCs to its doorstep, unless the country resorts to accommodative free-tax regimes (unlike in the case of existing EPZs/IPs located in the country) and incentivise the investors to shift their focus from other peers, towards Sri Lanka.

Conclusion

Without a doubt, the development of exports landscape remains the critical salvage-point for Sri Lanka's many persistent economic fouls including the local currency stability in the long run. Moreover, a bedrock for future economic sustainability as the current status suggests. Moreover, the country's enabling factors such as high intellect and proven ICT capabilities of the current workforce can be put for better use to expedite this national agenda sooner than later.

For the full article - Refer Daily FT

2. Five opportunities for Sri Lanka to grow its economy post-pandemic
By: Gayan Koralage

- The pandemic has resulted in a significant loss to the Sri Lankan economy. While numerous efforts to revive the economy have been unsuccessful in the past, revitalising the economy now must also take into account the fact that the modern age is digital and self-aware, and generate economic growth based on this.

- To overcome its Balance of Payments crisis, Sri Lanka must move away from its traditional strategies and instead attempt to integrate with modern trends as well as encouraging new investment into the country. However, this will also require policy reforms.

- Achieving this can be done on multiple fronts, with investments into building up the country's digital infrastructure and improving our tourist ecosystem being key. Additionally, encouraging investments from firms moving away from China and building up our SMEs will be crucial.

Unfortunately, COVID-19 has dealt another blow to our economy while we're still recovering from the gruesome Easter Sunday attack less than a year ago. The 49-day

lockdown has resulted in a loss of $ 5 b of gross domestic product value or 6% of the GDP, shifting our economy into a de-growth for the first time since 2001, when our country was at the peak of the civil war.

Since the end of the civil war, there have been many attempts to kick start the economy, but external dollar-denominated debt, among other factors, stalled its developments. Since then, we keep borrowing more money to settle past commitments, the cycle continues as our debt continues to balloon.

1. Revitalise the sharing economy and digitisation

One key pillar in modern economic growth is the 'sharing economy'. This means someone who work in a day job, spend additional few hours to provide peer to peer services via digital apps and/or marketplace to provide additional services to another party.

Predicted by Forbes to grow to $ 335 b in 2035 from just $ 15 b six years ago, the sharing economy has been a driver for growth to many modern economies. With the peer-to-peer model of the sharing economy, its contribution to a nation's economic growth could double. Typically, both the provider and the user are individuals instead of businesses, allowing it to put cash straight into the pockets of everyday people. This is the best way to stimulate the GDP instead of our traditional methods of pushing for foreign direct investments, which wouldn't exist in post-pandemic world and/or borrow at high cost to push infrastructure projects. In Malaysia, the digital economy represents 20% of the national economy.

In Sri Lanka, companies like Uber and PickMe deliver an average of 25,000 meals per day to local homes. This means 25,000 deliveries that are transacted and delivered within the hour by freelance riders who could come from any economic status or levels of education. In short, both sides of the service are now available for all. Therein lies the path to bridging the delta between the current $ 86 b economy and a $ 200 b economy by 2030. But I believe this is just a start.

This level of consumption is driven by the millennial and Gen Z generations. Over 25% of Sri Lanka's total population is aged below 14 years, and over 40% of total population is in the age group 25-55 years. Their demand is simple – more data for less.

The demand will continue to grow post-pandemic. As many food businesses relying on foot traffic struggle for customers, there will naturally be an increase in adoption for digital platforms as the main channel to receive orders and payments. Plus, the convenience of home deliveries and self-pickups will be a no-brainer for both providers and end customers.

Growing the sharing economy requires supporting infrastructure in the form of fibre networks. A World Bank study finds that 10% increase in broadband penetration will result in a corresponding increase of 1.38 percentage points in national GDP growth. Simply put, the higher the broadband penetration, the faster we grow our economy.

2. Allocate funds to build digital infrastructure instead of highways

As road traffic eased up in the current pandemic, another type of traffic jammed up.

Our broadband connections.

New data shifts that telco companies have found during the lockdown:

- 15% surge in per capita mobile data usage,
- change in the usual pre-COVID peak time of 9-11 p.m. to daytime,

- a shift in nature of use to increase in virtual private networks,
- increase in video streaming and overall web traffic driven by work-from-home policies,
- surge in e-commerce transactions.

To allow SMEs and corporations to continue their business and allow all to work from home, we need to build last mile fibre today, instead of roads and traditional infrastructure.

As an example, the UK Government has reconsidered a £ 28 b commitment for new roads, and switched that investment into broadband instead. It has planned an additional investment of £ 5 b – focused on 20% of the hardest-to-reach premises – to ensure that 'gigabit-capable broadband' is able to cover every home by the end of 2025. British Telecom has increased the target of fibre to the home (FTTH) and fibre to the business (FTTB) to 20 million by Q3 2020, mainly to support the usage during the pandemic.

While Sri Lanka's fiber coverage is comparable to regional peers, commercial take up rate for FTTH/FTTB lags behind.

Due to pandemic-induced economic shock, Sri Lanka's sovereign credit rating has been downgraded to B- with a negative outlook. However, two key telecom assets remain unimpacted. Both Dialog Axiata PLC (AAA/Stable) and Sri Lanka Telecom PLC (AA+/Negative) maintained their ratings. They could play a pivotal role in building the next level of broadband access to connect cities and communities.

3. Build a resilient arrival eco system to revitalise the tourism sector ahead of others

Our tourism sector accounted for 12% and 4.3% of GDP in 2018 and 2019 respectively, a drop attributed to the Easter Sunday attack last year. With the pandemic, we can expect a further decline in 2020 tourism revenue. If the decline continues to 2021, it would paralyse our economy, so it's paramount that an economic rebound plan be activated immediately.

One of the key elements to that, I believe, is the improvement on several factors on a tourist's experience upon entering Sri Lanka. While other countries are laying out long, difficult processes, we may want to consider the following strategies to grab the tourist market again:

i. Faster turn-around for COVID-19 test results. This may be possible with the emergence of higher-quality research and better technology as it becomes available to governments. Following this, the period of quarantine may also be reduced, allowing tourists to enter the economic cycle as soon as possible.

ii. Quarantine centres must be in acceptable conditions. Many countries, including Malaysia, have taken advantage of the plunging hospitality industry by using five-star hotels as quarantine centres. Allowing our tourists to quarantine at more comfortable, hospitable accommodations would send a welcoming signal to travel junkies worldwide.

iii. Reducing contact with an end-to-end contactless boarding process. Multiple airlines have set in place boarding processes that no longer require human interactions. This is possible with the use of readily available inventions such as facial recognition technology and cashless payments. It's time we implement this at our very own Bandaranaike.

Digitally savvy Gen Z and millennials are expected to be amongst the first international tourists, as they are comparatively less affected by COVID-19. Adopting these practices will allow us to attract them and be amongst the first international travel destinations to reopen during the pandemic.

4. Build the right ecosystem to attract relocating manufacturing outfits

Closure of borders and frictions in the global supply chain revealed the limits of globalisation. Now is the time to secure production contracts that needed to move from China, strengthen our manufacturing capacity and address shortages of urgently required goods.

In the short-term, the WHO has outlined three areas that require private sector support:

i. Keeping supply chains and logistics open so that drugs, vaccines and masks are available to deal with surging demand.

ii. Providing a flow of trusted information to employees. Companies should be as honest, transparent and as informed as possible.

iii. Engagement in specific sectors of health and pharma in critical research. This includes diagnostic tests, research in public health and prevention, and the development of new drugs and vaccines, therapeutics and drugs for patients who have already contracted COVID-19.

In the long term, we must proactively incentivise manufacturers relocating from China. As the most immediate advantage, our industrial wage costs in some technical categories are lower, or at least competitive to China. To succeed as an alternative manufacturing destination, we need reforms on trade, investment and improve ease of doing business. Measures may include issuance of tax exemptions and other incentives for manufacturing plants, promotion of low-cost, high-quality and locally-customised digital solutions for manufacturers.

5. Nurture SMEs and local economy

Small and Medium Enterprises (SMEs) are easy to destroy but hard to build. They are the bedrock of Sri Lanka's economy, accounting for 75% of the total number of enterprises active in the country, providing 45% of employment and contributing 52% to its GDP.

The Government must, therefore, immediately consider innovative funding mechanisms such as issue of bonds for companies affected by COVID-19, or set up of a relief fund to alleviate its impact on SMEs and livelihoods of the people. In the long run, the Government must enact a structured funding and exit mechanisms for Sri Lanka's investor landscape.

SMEs rarely have access to bank funding to scale and expand their businesses. This is because they are usually loss making at the time of investment, though they promise high returns in the future. Only a few private equity firms exist in Sri Lanka, and exit options for venture capital funds remain unattractive.

Established SMEs include family-held businesses in apparel, textile, construction, while start-ups include technology businesses led by Gen Z and millennials. According to the Asian Development Bank, the potential demand for capital by Sri Lanka's established SMEs is estimated to be \$ 0.5-\$ 1 billion, and similar demand by start-ups is expected to reach ~\$ 200 million by 2022.

There is a great bright future ahead of Sri Lanka, perhaps one rare chance offered in this century. Above five strategies will potentially help restart the domestic economy and eventually reduce our persistent balance of payment crisis. It may even allow the government to consider renegotiating 2017's 99-year lease of Hambantota port and 15,000 acres of land around it to China. We have new hope and yet another chance in the direction of prosperity.

For the full article – Refer the Daily FT

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