Spotlight: Econ Op-eds in Summary

Week ended 26th August '20

In Summary

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

1. Sri Lanka's triple shackles converge to slam economy in Coronavirus crisis
By: Bellwether

- Monetary instability through REER targeting has resulted in steep currency depreciation and a trade lockdown. Sri Lanka's sovereign bonds might not have traded at such a steep discount, had it adhered to a policy corridor and avoided needless liquidity injections.

- Regime uncertainty, especially regarding taxation policy, is also linked to monetary instability. Import and price controls can also be attributed to money printing. Focusing on indirect taxes would be a better source to raise money in contrast to restrictive direct taxation that is also cyclical in nature.

- If Sri Lanka is to progress, it must break free of such shackles. Sound money should replace monetary instability and regime uncertainty should be eliminated and the policy framework should be strengthened in order to avoid an otherwise inevitable sovereign default that would take significantly longer to recover from than a currency crisis.

Leg Shackle No 01 – Monetary Instability

Though there have been several records about monetary instability and currency debasement in Sri Lanka's history, from the ancient to the more recent history, nothing may compare with what has happened after 1951.

It was not an occasional bubble that hit the country, but a continuous, debasement through REER targeting, currency collapses and import restrictions.

In 1951 a central bank was set up with the assistance of an expert from the Fed, John Exter. Since then the currency had fallen from 4.70 to 185 to the dollar.

If Sri Lanka had a policy corridor and more restrained central bank which did not target a call money rate and recklessly inject liquidity the country's sovereign bonds would not be trading at steep discounts.

Sri Lanka would be like Vietnam, where there is a two-way cash auction with a wide policy corridor to protect the currency. The 2024 international bond would be trading at an 11 cent premium on the dollar.

If no money is printed and dollar bonds are trading at a premium, a country can borrow abroad for stimulus, or bite the bullet and see it through. When the US prints money, pegged nations with monetary stability can use it. Or if there are reserves, they can be used directly.

Far from promoting demand, Sri Lanka's economy is now in a trade lockdown killing even the normal economic activity.

Leg Shackle 02: Regime Uncertainty

The second leg shackle on the economy is regime uncertainty, sudden policy reversals and explicit and implicit expropriation of citizens, non-citizens and businesses.

2020 started with tax cuts, reversing two years of hard-fought value added tax reforms. The income tax hikes was a mistake that was better corrected. High direct taxes kill jobs and growth. Indirect taxes are the way to raise money.

Sri Lanka has value added taxes and high import duties and to raise income taxes to high levels was wrong. Income tax should be kept at 15-17 percent. To depend too much on income taxes is also bad, since direct taxes are highly susceptible to economic cycles.

Regime Uncertainty worsened with a vengeance during the crisis. Tinned fish and dhal disappeared as the Consumer Affairs Authority slammed price controls.

Regime uncertainty is also closely linked to monetary instability. The high taxes that come during IMF programs are also due to currency collapses, which bring the IMF program in.

The destructive import controls also come from money printing. So does price controls. The Import and Export Control Law along with the Department should be abolished. The midnight gazette makes taxes a fluid comedy. They should all be abolished to restore the rule of law. The price control authority of the CAA should also be taken out and junked.

Leg Shackle 03: Nationalism

Monetary instability not only triggers import controls but also import substitution.

Sri Lanka does not have a public sector that treats everyone equally, there is no just rule of law. Selective political directions rule. The independent public service with permanent secretaries was an institution of liberty. But many institutions of liberty were dismantled after self-determination from the British and arbitrary rule promoted.

The immigration law was enacted in 1949 in a parliament set up by colonial rulers. The same immigration law and its visa regime are now keeping the country from gaining knowledge and moving to new sectors.

Foreign Ideas

A hopeful sign is that there is broad agreement that default is wrong, which is as good as a law. In Sri Lanka expropriation happens because there is no knowledge that it damages investment.

If Sri Lanka has to progress, the country has to be freed from the grip of these three shackles.

Sound money should replace monetary instability, which will bring back free trade and prosperity and stop rent-seeking import substitution, rent-seeking businesses from exploiting consumers poor or otherwise.

The greed of the import substituting, domestic producer Mercantilists, the blood profits of food producing landowners, who trade on the hunger of the poor, will end as they will not have a leg to stand on if the rupee stops depreciating.

Regime uncertainty should be eliminated, expropriated firms returned, and taxes fixed for long periods, preferably for a decade or more.

If there is monetary stability, frequent tax changes would not be necessary. If the central bank is reformed, Sri Lanka would not have to go to the IMF for balance of payments support.

IMF also helps with default workouts. It is possible to default with even dollarization. If markets lose confidence, it can happen.

While nothing much works without monetary stability, the reverse is not true.

If the policy framework is bad, with import substitution, putting tax money into loss-making state enterprises, sudden tax hikes, policy changes, re-nationalization and a large public sector, growth will stall, which is bad for a country with 50 percent or more foreign debt.

A recovery from default may be more prolonged than a currency crisis. The sooner these three shackles are junked the better for everyone's money.

For the full article – Refer Economy Next

2. Revival of exports a sign of economic recovery
By: Dr. Nimal Sanderatne

- The rise in exports in July is an indication of the economy's revival. Maintaining and accelerating this export momentum would ease the country's balance of payments that has been adversely affected by the shortfall in workers' remittances and negligible tourist earnings.

- The main sectors that had contributed to this increase are tea, garment and rubber and rubber related products. The tea exports were propped by higher demand while the other sectors were propped up by demand for PPE. Thus, the Sri Lankan industries should take this lesson into mind and should be able to produce to keep up with the demand and should be willing to adopt to new needs in the markets.

- The import restrictions too should be reduced to support these export industries, which would result in a positive impact on the trade balance and the balance of payment. It is also vital that such gains are not frittered away by imprudent public expenditure that increases imports.

First half

Exports exceeded US$1 bn in January this year but dipped during the next five months. Consequently, total exports were only US$ 4.4 bn in the first half of the year compared to US$ 7 bn in the first half of 2019. This 26% decrease was mainly due to the global economic recession.

Exports in July

The increase in exports to US$ 1.1 bn was achieved by increased exports of tea, sea food, garments and rubber manufactures. The latter two were not the usual items in these categories. They were new products for personal protection from COVID-19.

Tea exports

Tea exports that constituted 12% of total merchandise exports in July, increased by 16% from that of July 2019. Tea exports in June 2020 too were 1.4% more than in June 2019.

This improvement in tea exports is attributed to higher demand for tea from Turkey and Russia. Tea production has to be increased to ensure an expansion in the tea export surplus to meet international demand and bolster our export earnings.

PPE

Earnings from exports of apparel, textiles, rubber and rubber-based products grew significantly during July 2020 owing to higher demand for personal protective equipment (PPE) such as face masks, protective suits, surgical gloves, and similar goods. These PPE related exports amounted to US$ 115 mn in July 2020.

The diversified rubber and textiles exports demonstrate the innovative capacity of the private sector. They would need to keep responding to changing international demand and emerging new export opportunities. It is crucial that imports of raw materials are not restricted as the country's manufactured exports are dependent on imported raw materials. Conversely, the reduction of tariffs and para-tariffs on imported materials and reduced electricity costs could enhance exports.

Projection

Monthly average exports of US$ 1 bn in the next five months would result in annual export earnings of US$ 10.5 bn in 2020. This is only about US$ 0.5 bn less than last year's export earnings of US$ 11 bon. Taking into account the leap in exports in July, there is every prospect of the 2020 export earnings exceeding last year's US$ 11 bn to reach US$ 12 bn, if the current global demand continues and perhaps improves. One must however be cautious in expecting this as the global containment of the pandemic is still distant.

Trade deficit

Such an improved export performance, with the curtailment of "non-essential" imports and reduced intermediate and capital imports could reduce the trade deficit this year to around US$ 6 bn. If this was to be achieved, it would ease the balance of payments that is seriously weakened by the drop in workers' remittances and loss of earnings from tourism.

Export prospects

The significant improvement in exports in July lends hope for a revival of Sri Lanka's export dependent economy. However, the initial gains in exports have to be consolidated and strengthened to expand exports significantly. The development of new products demanded by the changed conditions and aggressive marketing in new markets are crucial to achieve this.

On the other hand, there are demands for merchandise from countries that have revived. A case in point is the surge in demand for expensive jewellery from the rich classes in China. This is a new market for the country's depressed gem and jewellery trade.

Conclusion

Hopefully the trade dependent Sri Lankan economy is on the road to recovery and the global containment of the pandemic and the global economic recovery is not far off. It is vital that these gains in trade are not frittered away by imprudent public expenditure that increases imports. On the other hand, import restrictions should not impede export manufactures.

[For the full article - Refer The Sunday Times]