Spotlight: Econ Op-eds in Summary

Week ended 01st July '20

In Summary

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

1. Global debt and economic recovery
By: Dinesh Weerakkody

- As the pandemic continues to hit economies around the world, many low-income countries had had to resort to foreign debt to finance their economic recovery. In such a context, low-income countries, with significant existing foreign debt and facing collapsing oil and commodity prices and tourism, are at a higher risk.

- As such, major global creditors like China will have to have a major role in rebuilding the global economy by supporting these debt-ridden economies. China has already agreed to reschedule debts falling due in 2020. However, China could be expected to do more by rescheduling payments due in 2021 or provide financial relief to a broader set of countries if the effects of the pandemic are prolonged.

- A prolonged pandemic situation and a large-scale disruption of the economies means that further fiscal interventions will inevitably be needed to enable developing countries to weather the crisis. As such, forward-looking international cooperation is required in the face of a virus that knows no borders, both in terms of economic recovery and in the vaccine process.

International Chamber of Commerce Chairman Paul Polman speaking at a top-level UN Summit last week noted that a $ 5 tn of trade financing capacity will be needed in 2021 to restore global commerce to its pre-COVID-19 trend. The Secretary General of the UN has noted, many multiples of the $ 8 bn already pledged will be required to ensure universal access to tests, treatments and vaccines.

With the coronavirus pandemic governments in both the developed and low-income world have intervened decisively to soften the economic blow. Most governments have borrowed big to try to limit the economic and social impact. Low-income countries, with significant existing foreign debt and facing collapsing oil and commodity prices and tourism, have been hard hit.

Some countries have substantial debt, but also substantial external reserves. Some countries have mostly borrowed in their own currency, while others have primarily borrowed in foreign currency. Some have borrowed from private creditors; others have borrowed from other governments. In general, countries that have borrowed in foreign currency from the private market could face severe financial stress. Many of the so-called frontier market countries would need to watch their capital flows.

A broader set of countries may struggle to raise the funds to fight the pandemic successfully. But borrowings is only half of the problem; export revenue also matters.

Many of the countries in big trouble are Ecuador, Gambia and Zambia, for example – have substantial external debt and rely on oil and commodity export such as copper, or tourism for export proceeds. For countries in Africa whose debts have been rising even before the pandemic the situation will be very challenging and daunting and will require help from the developed world.

Global creditors

The global debt load is currently $ 264 tn. Countries with large amounts of debt could be in a state of distress, depending on how the pandemic pan out in the long term. China's external foreign currency debt is roughly 10% of its gross domestic product (GDP). The external foreign currency assets of China's banks and its government account for close to 42% of China's GDP. Chinese state-owned firms and Chinese local governments have substantial internal debt. However, a few Chinese companies have borrowed from abroad. China is now a big global lender. Therefore, China could obviously contribute significantly to stabilize the situation in many low-income countries that have borrowed substantial sums from them.

African countries in particular have borrowed over $ 100 bn from Beijing. Many African countries owe more to China than they owe to private bond holders. In dollar terms, Angola has been the biggest borrower – it has over $ 20 bn worth of outstanding loans to China.

Djibouti, an extreme case, owes China more than 70% of its GDP. At a meeting of Group of Twenty (G20) finance ministers, China has agreed to reschedule debts falling due in 2020. China would be expected to do more by rescheduling payments due in 2021 or provide financial relief to a broader set of countries. And depending on how the global economy evolves, China may need to write off, not simply agree to defer payments until 2020.

Way forward

The WHO Director General on 24 June said that the infected people are expected to reach a total of 10 mn within the next week.

The scale of the disruption means that further fiscal interventions will inevitably be needed to enable developing countries to weather the crisis. The scale of public financing required in this regard should not be underestimated.

It is unlikely commercial markets can satisfy this need without appropriate public support. Most businesses can access the credit needed to trade internationally once demand returns to the economy. While the priority for any government is to protect the immediate wellbeing of its citizens, this does not obviate the need for forward-looking international cooperation in the face of a virus that knows no borders.

Therefore leadership is urgently required as pointed out by Paul Polman, the International Chamber of Commerce Chairman from the G20 – and, more broadly, members of the WTO – to establish a cogent roadmap to ensure that the access to a future vaccine is not artificially restricted by asinine trade and economic restrictions.

For the full article - Refer the Daily FT

2. Reflections on economic development policy perspectives
By: Nimal Sanderatne

- Many economic policy recommendations in the wake of the pandemic have not been overly practical and tend to be more ideological, with real effects still to be seen. Further, growing criticism of neo-liberal policies is fuelling advocacy towards inward-looking economic policies.

- However, extensive measures to restrict and substitute imports may cripple the economy as the free import of raw materials is essential for exports. Another reason is that domestic goods can lack competitiveness compared to international goods which can lead to scarcities. Similar to Sri Lanka in the 70's, India's import substitution strategy too failed despite its wealth of resources.

- Liberal trade policies benefit small countries with limited raw materials and small domestic market. Sri Lanka needs to address fundamental structural issues that prevent it from producing competitive goods and should have economic policies that look to increase and diversify exports, not limit imports.

A plethora of economic policy recommendations to revive the economy and achieve economic growth has emerged. The general thrust of these is that the country needs to pursue different policies after the dislocation of the global economy by the COVID-19 pandemic.

Recommendations

Most of these recommendations are based on the premise that the economy should be re-modelled and that a new path or model of economic development is needed. However, many of these are ideological and not pragmatic. They are often an overreaction to the global recession brought about by the COVID-19 pandemic.

Fashion

It is fashionable to be against the policies pursued in the recent past. The impact of COVID-19 must be differentiated from the fundamental principles of economic growth and development. Overreaction to the disastrous effects of the COVID-19 pandemic could result in policies that aggravate economic problems. It could be likened to 'throwing the baby out with the bathwater.'

Good economics

There are only two kinds of economics–good and bad economics. Good economics achieves the goals and objectives of growth and development. Bad economics fail. The iron laws of economics are like gravity, you cannot change them. You can take actions to ameliorate the results with countervailing policies, but cannot prevent the consequences of economic actions.

Neo-liberal label

One of the deficiencies of current Sri Lankan thinking on the economy is to label economic policies and repeatedly attack them. Frequently criticised policies are described as "neo-liberal policies". The criticism is for the whole gamut of policies that most economies have pursued in recent decades with much success. The implication of this mode of thinking is that all free market policies are bad for the economy. The new policies advocated may worsen the problem.

Does this mean there is a need to pursue inward-looking economic policies? Should we ban most imports and produce these at home? Should we ignore the theory of comparative costs and once again attempt to produce almost all our requirements locally?

Import substitution

It is certainly popular to advocate import substitution and import restrictions. Undoubtedly, there is an economic rationale in banning certain imports. However, an extensive ban on so called non-essential imports could cripple the economy as it did in the 1970-77 period and limit exports.

Policies in 1970-77

The memories of the failure of inward-looking policies of 1970-77 are not in the minds of most people as it was around 50 years ago. Those policies led to a stagnant economy with low economic growth, industrial inefficiency and low utilisation of industrial capacity. It was a period of scarcities of basic needs. One could characterise it as a period of shared poverty.

In jettisoning "neo-liberal policies" are we moving towards proven failed economic policies? Nevertheless, the political rhetoric of condemning "neo-liberal" policies pursued since 1977 and a call for import substitution are popular political slogans.

Import substitution is bandied about as the panacea for our balance of payments difficulties. It is not uncommon for law makers to proclaim that they would resolve the country's large trade deficit by banning imports and ensuring import substitution. Import substitution is music in the ears of the public most of whom believe that the country is rich in resources and can produce most requirements, especially all food requirements.

Rationale of import substitution

The economics of import substitution and its limits are little understood. The rationale of import substitution is that when there is a potential to increase production with a price incentive and protected market for an initial period such protection is beneficial. If such protection continues over a long period, then consumers would have to pay higher prices, there may be shortages and the quality of the product inferior. This was the case in many industries that were protected in the 1970-77 period.

India

It was the case in India too. With its stringent import restrictions and a local market for whatever it produced, India was unable to export its industrial manufactures despite its rich resources of raw materials. It was after the liberalisation of trade and investment that India was able to export manufactured goods, including cars.

Liberal trade

Unfortunately, we have limited resources. The economic rationale for liberal trade policies is stronger for a small country with limited raw materials and small domestic market than large countries. However large countries like India and China have benefitted from liberalised trade.

Failure

Similarly, Sri Lanka failed to diversify its exports and remained mainly an agricultural exporting nation till the late 1970s. Manufactured exports were only 14.2 percent of total exports. Agricultural exports were 79.2 percent of total exports. In contrast, in 2019, manufactured exports exceeded agricultural exports. It was only after the liberalisation of the economy that exports of garments, rubber goods and other manufactured goods expanded.

However, the actual significance of agricultural exports compared to manufactured exports is higher as the domestic value addition is much higher than in manufactured goods with a high import content.

Import content

The fact that manufactured exports have high import content implies that a free import of raw materials is essential for exports. If there are restrictions on imports of raw materials or high taxes export industry competitiveness would be eroded. This is why countries with liberalised trade such as South East Asian countries, Vietnam and Bangladesh have achieved success as exporting countries.

Growing protectionism

Sri Lanka too provided an economic environment after the liberalisation of 1977, but over time increased protection owing to imposition of various charges on imports that have increased import costs. It is vital that these para-tariffs are removed for raw materials.

Misconception

A popular misconception is that there are manufactured exports for which there is little need for imported raw materials. The manufacture of tyres is considered such an export industry. In fact, tyre manufacture requires imported synthetic rubber, canvas, metal wires, chemicals and machinery and spare parts. Consequently, manufacture of even tyres has a high import content. Yet, the manufacture of tyres is a success story as Sri Lanka is the largest manufacturer of solid tyres in the world.

Another misconception is that imports of food could be taxed in order to give protection for domestic food production to achieve food self-sufficiency. In fact, the inadequate production of many food items such as sugar, is not due to a price incentive. The consumer price of sugar is excessively high compared to international prices. There are fundamental and structural reasons for the inability to produce sugar at a competitive price. These must be resolved to produce a much higher amount of sugar.

Cost of living

The imposition of import duties on basic foods increases the cost of living and in turn, the costs of production. An important reason for our non-competitiveness in labour intensive industries is higher wages compared to Vietnam, Bangladesh and India. This is also a reason for the inability to attract FDI.

Conclusion

Sri Lanka's economic future lies in increasing and diversifying exports, not limiting imports. Economic policies must ensure this.

For the full article – Refer the Sunday Times