Spotlight: Econ Op-eds in Summary

Week ended 09th September '20

In Summary

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

1. Ignoring the crisis
By: Victor Ivan

- The government of Sri Lanka is possibly looking at a large twin deficit, with a reduction in tax revenue due to tax relief measures introduced last year which is expected to hinder the ability of the government to finance its expenses using tax revenue. In such a situation the only option the government has is to borrow.

- Borrowing too poses an issue as on top of the debt burden, the country is also facing a deep external balance deficit. With worker remittances expected to fall as workers lose their jobs, Sri Lanka is in a dire need of foreign currency to repay the loan installments and interest. A failure to do so, will result in the economy being recognized as being bankrupt.

- In this context, the government had implemented extensive import controls to save foreign currency as much as possible. These controls are not a long-term solution as some of the leading exports in Sri Lanka is highly dependent on imports. The Government should explain to the public the policy it is going to adopt to overcome this crucial challenge Sri Lanka is facing.

Revenue of the State

In terms of revenue, the State is in a desperate and crisis situation where the main sources of State revenue have depleted on a large scale, rendering it impossible to sustain even day-to-day expenditure. The country's balance of payments has reached a level of an explosive crisis.

Even before the outbreak of the COVID-19 pandemic, Sri Lanka's foreign exchange earnings remained at a very low level which was not adequate to meet the costs of imports and the payment of instalments and interest on foreign loans. The pandemic that broke out on top of the economic crisis led to double or treble the burden of the economic crisis of the country.

There is a sharp decline in the country's transitional income as a large number of Sri Lankans working abroad have lost their jobs in the face of the pandemic situation. The downturn in the tourism and garment industries has also led to a sharp decline in the earnings of those two sectors, making it extremely difficult to balance the cost of imports and the instalments and the interest payable on foreign loans obtained.

At the same time there was a rapid decline in Government revenue. The tax relief policy introduced by the new President also reduced the Government's tax revenue by as much as 33%.

Explosive features of the crisis

According to the Vote on Account, tabled at the Parliament for the next four months, the Government spending for the period will be Rs. 1,700 bn. The Government revenue for the four months will be Rs. 400 bn; accordingly, Government expenditure for one month amounts to Rs. 425 bn whereas Government revenue per month will be only Rs. 100 bn. Consequently, Rs. 325 bn or 76.48% of monthly expenditure will have to be covered by loans, which cannot be considered a sustainable measure in the long run. Under the circumstances, the Government has banned the importation of large quantities of goods as a measure of reducing the cost of imports. However, it is unlikely that the restriction on imports may have a positive impact on the economy.

According to the World Bank's latest forecasts on the economic impacts caused by the coronavirus, Sri Lanka's economic growth is expected to slow down to -3% in 2020. It is estimated that around 500,000 Sri Lankans working in the Middle East will lose their jobs. The number of job losses in all sectors will be around one million. Further, a large number of those who had made a living from tourism and the garment industry have lost their jobs. Though it is not clear what the exact number is, the number of people who have lost their jobs in those two sectors alone can be very high.

The magnitude of the challenge

Although the number of people losing their jobs in different sectors of the economy, is one million, the impact it would have on the country's socio-economy and politics might be huge. That situation will accelerate the decline already set in the economy.

Despite the economic woes having grown to a maximum, Sri Lanka is compelled to allocate $ 3 bn for payment of instalments and interest on foreign loans alone, obtained on commercial basis. Sri Lanka runs the risk of being declared a bankrupt country in the event it fails to pay even one instalment. If such a situation arises, Sri Lanka is most likely to be plunged into a miserable situation that will persist for long and will not be easy to recover from.

The Government should explain to the public the policy it is going to adopt to overcome this crucial challenge Sri Lanka is facing. How many people will lose their jobs? What is the extent of damage caused to the economy in consequence thereof? What is the policy that the Government intends to follow in respect of the large number of job losses? How does the Government expect to increase State revenue? What policies does it intend to adopt? What policies does it intend to implement to increase Government revenue? What are the means of revenue to be introduced? What is the expected growth rate of each of them? The Government should explain the above issues to the public.

The Government should also explain to the public how it is going to resolve the issues on balance of payments that have reached a level of explosion. How is it going to pay instalments and interest due on foreign loans? How to find foreign exchange earnings required for that? Selling rare and valuable assets of the country to superpowers may be the easiest way to do so; but it will only aggravate the problem rather than solving it. A strong policy of imports restrictions alone will not help build productive capacity of the economy in the country. But the Government seems to think that a policy of slashing imports will lead to generating a strong productive economy in the country.

Overcoming false dreams

The garment industry was the leading industry in Sri Lanka among several other industries; it can be considered the one that earned the bulk of foreign exchange requirements for Sri Lanka. There were 800 medium and large scale garment factories in Sri Lanka employing as many as 300,000 workers. The annual revenue Sri Lanka earned from the garment industry remained at a level as high as $ 6 bn.

In view of the progress achieved by Sri Lanka in the sphere of garment industry and the problems it has encountered in the face of the current crisis, will there be a possibility to transform it into an industry producing garments for the local market instead of running it any longer as an export industry? Probably the answer of many will be in the affirmative that Sri Lanka has the potential to effect such a transformation. Yet, about 70% of raw materials and 90% of accessories required for the garment industry constituted the items imported. What was done in Sri Lanka included only the designing and production of finished goods utilising the imported raw materials and accessories, for the markets in the USA and Europe. The system of garment industry is not geared to be used to produce items like saris, lunges, trouser materials and printed cotton materials like cheeththa needed for Sri Lanka.

The situation in agriculture also is no different. But Sri Lanka must overcome this crisis. Otherwise, the future of the children of the country will inevitably be miserable. The Government must pay maximum attention on how to overcome this crisis the country is facing. The Opposition movements also should join this process, discreetly, and nurture the dialogue launched in this regard by expressing their views.

For the full article - Refer Daily FT

2. Progressive taxation vital to reduce fiscal deficit
By: Nimal Sanderatne

- Sri Lanka has faced persistently high fiscal deficits in recent years, with indications that it may be in excess of 9% this year. It has the impact of distorting public spending while also resulting inflationary pressures which increase production costs- necessitating currency depreciation to maintain export competitiveness.

- Additionally, high fiscal deficits also drive up the cost of living and the debt burden due to borrowings to finance the deficit. Efforts to bring down the deficit have been hampered by excessive spending in election years, with low revenue due to economic slowdown and necessary stimulus expenditure compounding the issue.

- Reducing the deficit must be achieved through progressive taxation and public expenditure rationalisation by targeting to reduce the deficit to around 5% of GDP in 2021. Maintaining a revenue to GDP target of 20% in the coming years is also important. However, high taxes must not disincentivise savings and investments, in order to stabilise the economy and achieve economic and social development.

VOA 2020

The Vote on Account (VOA) of Rs 9.1 trillion for expenditure in the last four months of this year, together with the expenditure incurred in the first eight months of the year, would widen the fiscal deficit for 2020 to one of the highest, if not the highest, in recent years.

High fiscal deficits

Fiscal deficits have been large in recent years. From 2013 to 2019 they were over five percent of GDP and as high as 7.6 percent in 2015 and 7.5 percent in 2019. The lowest was 5.3 percent of GDP in 2018.

Elusive

The objective of bringing down the fiscal deficit to the desired 3.5 percent of GDP has eluded us. It is likely to be one of the highest in 2020. Although estimated to be 8.5 percent of GDP this year, indications are that it may exceed nine percent of GDP.

Impacts

Large fiscal deficits destabilise the economy and hamper economic growth. Recurring large fiscal deficits over the years have distorted priorities in public expenditure and retarded the nation's economic and social development.

Inflation

Large fiscal deficits result in inflationary pressures, which in turn increase costs of production and erode the country's export competitiveness. Consequently, the depreciation of the Rupee is needed in order to remain competitive with other countries that have lower rates of inflation.

Otherwise, lesser export earnings would increase the trade deficit and strain the balance of payments. Reduced export earnings would result in loss of employment and lower incomes to workers in export industries.

Cost of living

Inflationary pressures caused by large fiscal deficits increases the cost of living that result in severe hardships to the lower wage earners and pensioners and leads to strikes demanding higher wages and social unrest.

Debt

The large accumulated debt is a result of persistent fiscal deficits over the years. The public debt has increased mainly due to large foreign and domestic borrowing. The public debt that rose to 85 percent of GDP at the end of last year would have risen further this year.

Elections

Efforts to reign in fiscal deficits have often been derailed by excessive expenditure during election periods.

Furthermore, the new Government had to face a fall in revenue owing to the economic slowdown and the fiscal stimulus policy. These recurring large fiscal deficits over the years have been a core reason for the county's economic instability and inability to achieve the desired economic and social developments.

Resolution

The fiscal deficit must be reduced from 2021 by increasing revenue through progressive taxation. At the same time, government expenditure should be prioritised towards economic development and improvements in education, health, expansion of care for the elderly, improved social welfare and targeted social security programmes to alleviate poverty. Unproductive and wasteful expenditure must be reduced drastically.

Increasing revenue

While the priorities in government expenditure should be reoriented, there is little scope for reducing aggregate expenditure.

The Budget for 2021 must increase government revenue to decrease the fiscal deficit to around five percent of GDP in 2021.

Immediate measures to increase revenue that have been proposed by the government have to be followed by a comprehensive programme of taxation in the Budget for 2021. Such increases in taxation should not fall on the poor: taxation should be on the rich.

Progressive taxes could be both direct and indirect. Since tax evasion and avoidance is widespread, those evading direct taxes should be taxed through appropriate taxes such as licence fees, stamp duties, taxes on property and luxury goods and services. However higher taxes should not be disincentives for savings and investment.

Low revenue

The country's revenue as a proportion of its output or GDP is one of the lowest, if not the lowest for the level of per capita income in the country. It was about 14 percent of GDP a few years ago, but may have fallen this year. The Government's objective should be to increase this ratio to around 20 percent of GDP in the next few years. It must be achieved through taxation of the rich rather than by burdening the poor through indirect taxation of widely consumed consumer items.

Progressive taxes

Enhancing revenue through progressive taxation should be a fundamental principle and objective of the government's fiscal policy. The reforms in taxation should be undertaken during the commencement of the Government's tenure when political compulsions to increase expenditure are minimal.

For the full article – refer the Sunday Times