Spotlight: Econ Op-eds in Summary

Week ended 04th November '20

In Summary

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

1. Fiscal policy responses to COVID-19 What can we learn from the international context
By: Chamini Thilanka

- The COVID-19 pandemic had disrupted economic activity around the world. A pickup or a maintenance of economic activity in such an instance is greatly dependent on the income flows of economic agents being uninterrupted. This is where fiscal measures taken by each country play a major role.

- Globally, governments of COVID-19 affected countries have adopted various fiscal policy measures in line with the IMF/WB recommendations. However, each country's policy responses vary depending on the income levels and its financial position, with developed countries having more ability than developing countries.

- In Sri Lanka while many actions had been taken to strengthen the health sector preparedness and to minimize the economic fallout, the limited fiscal space has impacted the adequacy of such measures. As such while the government should continue to provide assistance, such programs need to be well-focused and followed up with pre- and post-implementation evaluation to ensure an optimum impact on the economy.

Amidst the severe disruptions triggered by the COVID-19 pandemic, it is important for economies to formulate and implement effective policies to mitigate the negative impacts induced by the crisis.

As noted by the International Monetary Fund (IMF), the pandemic has intensified the need for fiscal policy actions at an unprecedented level. The length and depth of global economic shocks can be shortened by prudent fiscal measures by governments, thereby providing a protective shield against the adverse effects on people's lives.

Despite national-level policy responses, a sustained recovery cannot be assured unless coordinated action is pursued at the global level as well.

Mitigating the adverse impacts

Governments need to address different aspects of the economy at various levels, to prevent or limit a catastrophic economic collapse during disasters. An economy continues progressively with its activities only when the income flow of economic agents (households and businesses) is uninterrupted; a disruption to this flow results in the slowdown of economic activities.

MFIs – the IMF and World Bank (WB) – recommend that governments follow specific fiscal measures to minimise the adverse effects arising from COVID-19. In a broader context, fiscal policy measures can be described as

- expenditure-side measures (immediate relief related spending on health and non-health sectors),
- revenue-side measures (tax deferrals, tax cuts, etc.),
- government-supported liquidity measures (cash flow support to businesses), and
- supplementary economic revival measures (relief to fast-track recovery).

In particular, revenue-side measures and government-supported liquidity measures can help reduce the severity of the impact, while economic revival measures can help boost growth in the medium and long-run. For instance, increased infrastructure expenditure can accelerate the revival of economic activities and create employment opportunities.

The global fiscal response

Globally, governments of COVID-19 affected countries have adopted various fiscal policy measures in line with the IMF/WB recommendations. However, each country's policy responses vary depending on the income levels and its financial position.

More advanced countries collect more revenue as a share of their Gross Domestic Product (GDP) and spend more. Further, developed economies benefit from being able to borrow more without adverse risk factors. For example, advanced economies or HICs, emerging markets, and LICs have allocated on average 8.6%, 2.8%, and 1.4% of GDP as fiscal stimulus packages as responses to COVID-19, respectively.

Sri Lanka's response and the way forward

Like other countries, Sri Lanka has also taken a range of measures to contain the spread of COVID-19, of which strengthening its health sector preparedness as well as adopting measures to minimise the economic fallout, have been priorities.

As of August 2020, the Government is estimated to have allocated 0.1% of GDP for containment measures and announced an additional allocation of nearly 0.25% of GDP for cash transfers for vulnerable groups, under its fiscal package.

In line with MFIs' recommendations, policy responses are directed to spending (health and non-heath spending) and revenue-side measures (extending payment deadlines for income tax, and tax exemptions on health imports), government-supported liquidity measures (debt moratoriums and working capital loans), and supplementary economic revival measures (loans for investments at concessional rates to businesses in IT, apparel, plantation, and tourism sectors).

However, the available fiscal space has limited the adequacy of allocations. In fact, Sri Lanka's fiscal package is relatively small compared with other emerging and MICs in the Asian region such as Malaysia (17. 2% of GDP) and Thailand (11.4% of GDP).

The COVID-19 pandemic is expected to dampen growth substantially through reduced export earnings, private consumption, and investment in the short-run. In these circumstances, it is a challenge to adopt effective policy measures.

Countries with relatively weak initial conditions such as Sri Lanka must therefore ensure that resources are utilised efficiently, taking into account the time path and feasibility.

In addition to measures implemented so far, some complementary measures that can be considered are:

(i) provision of financial assistance (government-supported liquidity measure) to start and continue e-commerce for industries such as healthcare, agriculture, and ICT, where new opportunities have emerged during the current pandemic;

(ii) increasing infrastructure expenditure (supplementary economic revival measure) given large employment multiplier effects.

In view of Sri Lanka's limited fiscal space, denoted by high fiscal deficits and public debt ratios, such programmes need to be well-focused and followed up with pre- and post-implementation evaluation to ensure an optimum impact on the economy.

For the full article - Refer Daily FT

Prospects and uncertainties in the balance of payments
By: Nimal Sanderatne

- Global uncertainty with COVID-19 alongside the recent COVID-19 wave in Sri Lanka make economic projections difficult to make. The consensus on the containment of the global pandemic would be in late 2021. In line with this, global growth is expected to pick up in the latter half of 2021, with emerging markets seeing a stronger recovery than developed economies.

- The second wave of Covid in Sri Lanka places significant risks to production and export capacity. This in turn, places difficulty increasing exports as demand for various exported products in western markets have reduced as well. Since import controls have already been imposed, cutting imports further from current levels is quite a difficult task.

- An improvement in the BOP is very much dependent on a recovery in the global economy. This can be strengthened by obtaining loans or swaps from multilateral agencies in the coming months. If greater foreign funding is secured however, the BOP can record a surplus for 2020 and 2021.

Considerable uncertainties in the global containment of COVID-19 and when the international economy would rebound as well as the recent resurgence of COVID-19 in the country, make economic projections quite hazardous. It is in this uncertain health and economic environment that we venture to discuss the prospects of Sri Lanka's balance of payments.

Global economy

Economists are diverse in their views on when and what shape the international economic recovery will take. Will it be U shaped, V shaped or W shaped? However, there is a broad consensus that the earliest likelihood of containing the global pandemic would be in late 2021. Any global economic recovery till then would be restrained by COVID-19.

IMF assessment

The recent assessment of the global economic outlook by the International Monetary Fund (IMF) is that COVID-19 "is still unfolding around the globe. In Asia, as elsewhere, the virus has ebbed in some countries but surged in others. The global economy is beginning to recover after a sharp contraction in the second quarter of 2020, as nationwide lockdowns are lifted and replaced with more targeted containment measures".

Consequently, the IMF has revised the global economic growth to −4.4% in 2020, "because of better-than-expected second quarter outturns in some major countries where activity began to improve sooner than expected after lockdowns were scaled back."

Next year

Furthermore, "In 2021 global growth is projected at 5.2%, a little lower than projected earlier, consistent with the expectation that social distancing persists into 2021 and fades thereafter," the IMF said.

With respect to Asia and the Pacific, it says: "It is also starting to recover tentatively, but at multiple speeds. Economic activity is expected to contract by −2.2% in 2020, due to a sharper-than- expected downturn in key emerging markets, and to grow by 6.9% in 2021—0.6% lower and 0.3% higher, respectively, than in the June 2020 World Economic Outlook Update."

Implications

The relevance of these global developments for Sri Lanka is that the global economic conditions would not be conducive to us in the remaining months, especially with respect to our manufactured exports, but would see a modest revival sometime next year, perhaps in the second half of 2021.

The resurgence of the virus since October is a serious threat to our production and export capacity. The constraints in demand for our exports due to lower international demand could be compounded by lesser production and export capacity. Therefore, effective control of the virus and ensuring lockdowns are at a minimum are vital to ensure export growth. On the other hand, inadequate precautions could spread the virus and aggravate the economic downturn.

Balance of payments

The revival of the Sri Lankan economy, especially the country's trade and balance of payments, is very much dependent on the improvement of global economic conditions and revival of international trade and travel. An improvement in the balance of payments (BOP) would ease the debt repayment liability in 2021 and reduce the country's external financial vulnerability.

Trade balance

A lower trade deficit is vital to achieve this, especially as tourist earnings and workers' remittances, the two strengths of the BOP, have been weakened to a large extent. A lower trade deficit has to be achieved by containing imports and increasing exports.

Increasing exports is difficult owing to the reduction in demand for our manufactured exports from western markets that are the main markets for apparel, tyres, ceramics and other manufactured exports. Reducing imports from our current levels too is no easy task as reduction of most non-essential items have been done already. The continued low prices of oil that has been a significant advantage to the reduction of the trade deficit in 2020, will be important to ensure imports at current levels.

Expectations

Imports that were US$10.3 Bn in the first eight months of this year, could increase to about US$ 15 Bn in 2020 and to about US$ 16 Bn in 2021. Exports that were US$ 6.4 Bn till August could be expected to increase to nearly US$ 11 Bn, if the current wave of COVID-19 does not disrupt industrial production. Given an improvement in international trade exports could expand to US$ 14 to 15 Bn next year.

Trade deficits

With these projection scenarios, the trade deficits would be about US$ 4 Bn in 2020 and decrease to about US$ 2 Bn in 2021.

Balance of payments

With these outcomes in the trade balance, the overall BOP balance is likely to be in surplus by about US$ 2 Bn this year despite negligible earnings from tourism and about US$ 1 Bn next year. However, workers' remittances are likely to be about US$ 6 Bn compared to last year's US$ 6.7 Bn and fall sharply next year.

Capital inflows

The balance of payments could however be strengthened by capital movements or official transfers such as aid, loans from multilateral agencies like the IMF, World Bank and ADB and loans and financial arrangements like swaps in the coming months. These would enhance the reserves but loans would increase our foreign debt.

For the full article - Refer The Sunday Times