Spotlight: Econ Op-eds in Summary

Week ended 29th September '21

In Summary

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

1. Sri Lanka's foreign debt payment challenges in '22
By: Dinesh Weerakkody

- In July, Sri Lanka met its repayment obligation of US$ 1 bn keeping intact its reputation for honouring sovereign debt. Despite this, several downgrades had resulted in pushing the cost of dollar debt higher. Thus, most of the debt is currently financed locally and this is set to rise further given the prolonging of the pandemic with the country unlikely to revert to pre-pandemic levels till mid-2023.

- One of the main challenges moving forward is the growing import bill, with analysts expecting a widening of the trade deficit given a surge in pharmaceutical and oil imports. The government faces strong external sector pressure in 2022, with multiple sovereign bond repayments falling next year with certain analysts estimating debt service obligations to be as large as $7 bn.

- Although Sri Lanka has received multiple swaps in the past, some of these swaps may not be convertible to USD, adding further pressure to the country's reserve position. As it is unlikely that the country will be granted a debt cancellation, it must seek debt moratoriums which would offer concessional financing and other forms of fiscal management support to help navigate the way forward.

In spite of the negative opinion on Sri Lanka's ability to repay foreign debt by rating agencies and somewhat stemming from a fiscal crisis largely precipitated by COVID-19, the country repaid the US$ 1 bn bond by the deadline and a further US$ 400-500 mn in other commitments, keeping intact its reputation for honouring sovereign debt.

Despite that, Moody's Investors Service downgraded Sri Lanka's current rating CCC+ to negative, citing its assessment of the country's increasingly fragile external liquidity position and the risk of default. Unfortunately for the country, undue concerns about the repayment ability are pushing the cost of Lanka's dollar debt higher.

Fitch Ratings, expect general Government debt to GDP to keep rising under their baseline to 108% by 2022 from 101% in 2020.

Meanwhile, 60% of the total debt is local and 40% is foreign. The local component is set to rise further given that the pandemic is far from over. So despite the substantial macroeconomic stimulus, Sri Lanka according to economists is unlikely to soon revert to pre-pandemic levels till mid-2023, let alone recoup 2020-'21 economic losses.

Foreign currency debt

According to CBSL data, total foreign debt was US$ 49 bn; US$ 31 bn is Government borrowings. Foreign borrowings have dropped from a high of US$ 55 bn to US$ 49 bn by

’21, showing a clear preference for local debt, given that the Government has good control of domestic interest rates. The single biggest challenge however now would be to keep inflation in check.

The challenge in the next few months of the year is largely to pay for the imports. According to CBSL data the trade deficit in 2020 was US$ 6 bn. The trade deficit in the first half of 2021 was US$ 4 bn. Analysts expect this to widen significantly due to a surge in oil and pharmaceutical imports.

Our reserves are currently down to around US$ 3.5 bn. The IMF SDR allocation of US$ 780 mn helped to boost our gross reserves. The reserves should enable Sri Lanka to meet its remaining debt maturities and interest through the rest of this year.

The big challenge for Sri Lanka in 2022 will be servicing of debt and interest and funding the trade deficit. The Government has to honour the next sovereign bond – a US$ 1 bn bond in July 2022. The Government has said repeatedly that it will dip into its foreign exchange reserves to bridge any shortfall in repaying the foreign bonds and that it will not default at any cost. This confidence can certainly be challenged in 2022.

Balancing the books in 2022

LRA, a local rating agency now back in business, estimates that Sri Lanka will close the year at around US$ 3.352 bn. They estimate the Government will mobilise a total of US$ 4.107 bn for ’21.

For the Government, meeting foreign-currency debt-servicing needs for 2022 should be its immediate concern. Two big payments according to reports need to be honoured in 2022 – a US$ 500 mn bond in January, followed by US$ 1 bn of debt maturing in July. It is estimated a total of US$ 5 bn will be required to service debt obligations (principal + interest) and other commitments in 2022. Some analysts put this figure at US$ 7 bn.

The uncertain factors for 2022 will be the remittances remaining at current levels and Foreign Direct Investments picking up. It is important the rains don’t fail us, giving rise to an increased fuel bill to power the non-hydropower electricity generation and an increase in food imports to meet the drop in harvests.

Therefore, the Government would need to get tough on imports. Vehicle imports and luxury goods will have to be curtailed significantly to manage the trade deficit in 2022 and the politicians and the public will certainly have to tighten their belts further to ride over the economic challenges in 2022.

Way forward

The bilateral currency SWAPs (US$ 1,350 bn) whilst they serves their purpose – 80% of our foreign debt is in USD – some of the SWAPs may not be convertible to USD, adding further pressure to the reserves, given the debt overhang. Therefore, a professional approach would be required to manage our finances going forward given our deteriorating debt trajectory.

International debt instruments have also changed over time, this means we need people who understand them to structure them. There are also many blended finance and innovative climate finance options available. It is very unlikely for any debt cancellation for developing countries. Therefore, we need to seek debt moratoriums and more flexible and concessional forms of financing, and other forms of fiscal management support.

The way forward for the country is clear, and well-lit; the Government needs to walk forward with a clear purpose.

For the full article – Refer Daily FT

2. GSP+ withdrawal How will it impact Sri Lanka's economy
By Asanka Wijesinghe and Eleesha Munasinghe

- Sri Lanka's preferential access to the European Union (EU) market faces fresh challenges after the European Parliament's special resolution adopted in June 2021, calling for an assessment on "whether there is sufficient reason, as a last resort, to initiate a procedure for the temporary withdrawal of Sri Lanka's GSP+ status."

- A possible withdrawal of GSP + will reduce export income by around US$ 627 mn, with the apparel, tobacco, seafood and rubber sectors being affected the most. While the apparel sector is relatively resilient to a loss of preference as it's utilization ration was low in 2019, the recovering seafood sector could face much larger blow.

- Even though less dependence on the EU market and more diversification is needed, Sri Lanka should work to secure the GSP+ resolving the current political issues and focus on fully utilising GSP+ preference in the short run. In the long run, as GSP+ is contingent upon income level, Sri Lanka will lose it someday, and as such, Sri Lanka should take steps to enter into reciprocal trade agreements with the EU and other high-end markets.

Sri Lanka's preferential access to the vital European Union (EU) market faces fresh challenges after the European Parliament's special resolution adopted in June 2021. The resolution calls for an assessment on "whether there is sufficient reason, as a last resort, to initiate a procedure for the temporary withdrawal of Sri Lanka's GSP+ status."

The GSP+ is a non-reciprocal trading arrangement whereby Sri Lanka does not have to lower tariffs in return but is required to implement certain non-trade related conventions to benefit from preferential access.

The GSP+ arrangement slashes import duties to zero for vulnerable low and lower-middle-income countries that implement 27 international conventions related to human rights, labour rights, environment protection, and good governance.

This article assesses the impact of a hypothetical withdrawal of GSP+ on Sri Lanka's exports to the EU: the largest single trading bloc, with the United Kingdom (UK), accounting for 30% of Sri Lanka's exports.

The impact

A possible withdrawal of GSP+ will increase the tariffs for Sri Lankan products up to the Most Favored Nation (MFN) tariffs. Consequently, products coming from Sri Lanka will be more expensive in the EU market, directly reducing the export demand from Sri Lanka.

However, Sri Lanka's competitors that continue to benefit from the EU's GSP will face zero preferential tariffs. Thus, in addition to the trade destruction effect, with the relative price of goods from Sri Lanka being higher, the trade will be diverted to those competitors. Assuming the UK will follow the EU lead, and Sri Lanka will face the lower bound of relevant MFN tariffs, partial equilibrium estimates show that Sri Lanka's exports to the EU will fall by US$ 627 mn. (The simulations are done taking 2019 as the base year)

The worst-hit sectors are apparel (HS 61 and HS 62), tobacco (HS 24), seafood (HS 03), and rubber (HS 40) sectors. The combined loss for the apparel sector will be as much as

US$ 494 mn, and it is 79% of the total estimated trade loss. In addition, the seafood sector is deemed to lose US$ 20 mn or 17% of the sector's 2019 exports to the EU. Thus, losing preference to a vital market will be hard for the recovering seafood industry.

There are two caveats of an ex-ante impact assessment of this kind.

- The first is that the analysis is based on assumed elasticities. However, the assumptions are not overly restrictive.
- The second is that all the eligible exports from Sri Lanka do not utilize the GSP+ facility. Thus, the actual impact will be contingent upon the utilization ratio.

However, after Sri Lanka regained GSP+ preference in 2017, the utilization ratio increased, reaching 61.8% in 2019, improving from 55.1% in 2017. Therefore, the increasing utilization ratio makes the potential impact still significant.

Notably, there is a variation of the utilization rate within the HS chapters. The apparel sector will be relatively resilient to a loss of preference as its utilization ratio was 52% in 2019. However, a loss of preference will halt any industry drive that aims to increase the utilization rate and then expand the market share in the EU.

Further, the 2010 loss of GSP+ inflicted high costs to the industry. As seafood, rubber products, and footwear sectors utilize more than 90% of GSP+ preference, those sectors will be more vulnerable to the shock. Indeed, the difference between GSP+ preferential tariff and MFN tariff for seafood is higher -zero versus 7.5% respectively - aggravating the impact.

Future steps

The losses from GSP+ preference will be significant and heterogeneous across sectors. The GSP+ also opens the door for EU investments as outsourcing production to preference receivers is beneficial to the EU. In addition, sectoral losses may spillover to the overall economy exacerbating poverty and income inequality.

Less dependence on the EU market is a widely suggested strategy. Diversification is indeed beneficial when it is done for economic reasons. However, ad-hoc moves to diversify to escape from unresolved political issues will not do much good. The EU market is a high-end export destination for Sri Lanka. The quality improvements, product standards, and consumer preferences positively challenge the Sri Lankan exporters to improve product quality and competitiveness.

Additionally, a non-reciprocal preference for various products incentivizes product diversification away from traditional exports into more complex products like electronic equipment, including semiconductors (HS chapter 85). Therefore, while Sri Lanka should work to secure the GSP+ resolving the current issues and focus on fully utilising GSP+ preference in the short run. In the long run, as GSP+ is contingent upon income level, Sri Lanka will lose it someday, and as such should enter into reciprocal trade agreements with the EU and other high-end markets, including the US.

For the full article – Refer Daily FT

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