Spotlight: Econ Op-eds in Summary

Week ended 30th October '19

In Summary

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

1. Will presidential poll ensure political stability and economic growth?
By: Nimal Sanderatne

- The prospect of an economic revival after the presidential election can be dampened by political instability. Despite the vast majority thinking otherwise, the powers of the new president will be limited. The country will be governed by the prime mister and the cabinet. A constitutional crisis between the new president and the prime minister will cripple the economy.

- Continued populist policies targeting the parliamentary elections in 2020 on top of the current election promises will worsen the economic problems. Fiscal slippage due to such political compulsions will erode the macro-economic fundamentals. Stringent fiscal policies and limiting public expenditure is vital. Sooner the parliamentary election is held, better the prospects for an economic recovery.

- Heavy public debt caused by the fiscal slippage will be a severe economic burden. Government revenue is inadequate to meet the debt servicing costs. The current and capital expenses have to be met from further borrowing, limiting funds available for essential expenditures. In such context restoring economic stability is a massive challenge for the next government.

On November 16, a new president will be elected. Will the election usher in political stability or will the post-election period be one of confusion and chaos? Are there prospects of an economic revival?

The worst scenario would be another constitutional crisis. Constitutional experts have pointed out that the new president's powers are severely limited by the 19th Amendment. However, the presidential candidates and vast majority of the electorate consider the presidential election of foremost importance as they appear to believe that the new president will continue to be the chief executive. In fact, the new president will not hold any portfolio. It is the Prime Minister and the cabinet that will govern the country.

If the newly elected president does not accept this constitutional position, the country could be in political chaos similar to the anarchy of October 2018. This would have dire economic consequences. A conflict between the newly elected president and the Prime Minister would cripple the economy.

Bleak prospects

The country cannot go through a period of political instability when the economy is performing poorly. An economic recovery is vital to meet the daunting economic challenges. The prospects of political stability and an environment conducive to economic growth are bleak.

Economic policies

It is the Prime Minister and the government backed by parliament that will have to resolve the formidable economic problems. However, since a parliamentary election is due in 2020, the government is likely to take economic decisions that are politically popular rather than correct. The continuation of populist economic policies will worsen economic problems.

Economic challenges

Whatever the election outcome, whoever forms the next government, it cannot escape the serious economic problems of the country. The next government would have to face the issue of a high foreign debt of US$ 54 bn and difficulties of meeting the repayment obligations.

The weak external finances and external financial vulnerability would be compounded by political instability. The sooner a parliamentary election is held and a stable government established the better the prospects for an economic recovery.

Election rhetoric

The election campaign of most candidates did not disclose an awareness of how they would resolve the very serious economic problems facing the country. Instead, if the election promises made by the elected president are implemented, the economy would be in a worse crisis.

Scarce resources

The Sri Lankan electorate knows fully well that election promises, bar a few, would not be implemented. What the electorate does not know and understand is that resources are limited, in fact very scarce, and that the need of the hour is a resolve to implement stringent fiscal policies and limit public expenditure.

Fiscal slippage

In the run-up to the election, political compulsions of electoral politics have resulted in considerable fiscal slippage that has weakened the macroeconomic fundamentals and undermined macroeconomic stability.

The consequences of the increased fiscal deficit would be, inter alia, an increase in the public debt, inflationary pressures, weakening of the country's export competitiveness and low economic growth.

These consequences of an expansion in the fiscal deficit are serious. They will erode price stability, increase public debt, exert pressures on the exchange rate, affect external trade adversely and people's livelihoods would be affected on top of the adversity caused by the tourism crash that has been experienced. With economic fundamentals being eroded, the country is heading towards an economic crisis.

Political compulsions

The political compulsions of the elections have driven the government to adopt policies that are vote catching. The economy's macroeconomic fundamentals are being seriously eroded by politically motivated economic policies. This is especially so with respect to heavy public expenditure that would expand the fiscal deficit, that would affect the economy adversely both in the short run and longer term.

Neither the electorate nor the candidates are aware that what is needed is fiscal austerity and not fiscal profligacy. A renewed process of fiscal consolidation could begin only with the budget for 2021. The 2020 budget is likely to be a fiscally imprudent one with further handouts, increased public sector employment, salary increases and other politically motivated unproductive expenditure. Therefore, fiscal slippage will worsen before remedial measures could be implemented. The fiscal deficit target of 3.5% of GDP in 2020 is now a distant dream.

Public debt

Both the debt-to-GDP ratio and the fiscal deficit are far too high and burdensome. The debt-to-GDP ratio at the end of 2018 was as much as about 80%. It's further increased this year and its servicing costs are a severe burden. The high debt servicing cost as a proportion of revenue has a crippling effect on the economy.

The inadequacy of revenue to even meet the debt servicing costs is alarming. Debt servicing costs absorbing the entirety of government revenue implies that the government's current and capital expenditure have to be from further borrowing. This is an unhealthy situation like the plight of a household whose total income has to be spent on debt repayments and has to borrow for even its basic consumption needs.

The inadequacy of revenue to meet debt servicing costs means that funds are not available for other essential expenditure. This lack of funds from revenue results in a distortion in priorities in public spending. There is an inadequacy of public expenditure for education, health and development projects. It is in this fiscal context that promises are made to spend money in various ways.

External vulnerability

The increasing debt — both domestic and foreign – is a serious economic concern. The acknowledged threshold for the fiscal deficit is about 3 to 4% of GDP and the debt-to-GDP ratio is expected to be kept at no higher than 60% of GDP. The current position exceeds both these thresholds.

Conclusion

Restoring the eroded business confidence in such macroeconomic background would indeed be difficult. In turn, inadequate economic growth would impact on the employment, incomes and livelihoods.

The adoption of sound economic policies would have to await a new government after the parliamentary elections. Meanwhile, the state of the economy is likely to get worse and the remedial measure more difficult to adopt. Restoring economic stability and enhancing economic growth are massive challenges for the next government.

For the full article – Refer The Sunday Times

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2. Policy certainty and political stability are essential for achieving socio-economic goals
By: Prof. Lalith Samarakoon

- The Sri Lankan economy faces many challenges due to policy and political uncertainty and negative global economic conditions. The deteriorating economic growth needs to be corrected by analyzing the Sri Lankan economy in comparison to Lower Middle Income and Upper Middle Income peer economies.
- Such analysis shows that Sri Lanka could sustain high economic growth by, modernizing the agricultural sector, developing export-oriented industries,

developing new and competitive services sector enterprises and increasing the contribution of trade to growth.

- To facilitate these the government will have to take measures to increase FDIs, increase labour force participation, achieve fiscal consolidation, control debt, leverage private sector investments, develop domestic capital markets and most importantly take advantage of the unique geographical placement of the country.

The Sri Lankan economy faces numerous challenges. While global economic and financial conditions have a material impact on an export-oriented small economy such as Sri Lanka, many of the impediments to economic development have been created by the lack of commitment to make necessary policy changes and their implementation on the part of Sri Lanka. Some of the main challenges and opportunities are briefly discussed below.

Policy uncertainty

The high degree of policy uncertainty is one of the main issues. In regard to most economic matters, Sri Lanka does not have robust and clear policies. This is further exacerbated by frequent, ad-hoc changes to existing policies. To ensure policy certainly, Sri Lanka must create a robust policy making system, draft long-term economic policies, and establish an effective institutional mechanism for their implementation.

Political uncertainty

In the recent years, there have been multiple political events that have led to increased policy uncertainty. Frequent changes in the size and the composition of the Cabinet of Ministers and the oversized Cabinet of Ministers have been noteworthy. This is a real constraint to developing, sustaining and implementing economic, financial and social policies in order to address significant economic problems faced by the country. Decoupling policy formulation and implementation mechanism from the political process as far as feasible can help ensure policy stability to a greater extent.

Global economic conditions

According to the latest World Economic Outlook, global economic growth decelerated from 3.8% in 2007 to 3.6% in 2018 and is projected to moderate to 3.0% in 2019. Growth in advanced economies is important for Sri Lanka because of its export markets. Growth in advanced economics is also projected to decline from 2.3% in 2018 to 1.7% in 2019 and continues to maintain low growth in the medium term.

Sri Lanka's largest export destinations are the European Union countries and the United States and their growth in 2019 is projected to decline to 1.5% and 2.4% respectively. This expected slowdown in global growth coupled with trade tensions between the US, China, European Union and Mexico will likely cause global trade to moderate as well. These global conditions have the potential to affect Sri Lanka's external sector negatively.

Sustained high economic growth

The greatest challenge for Sri Lanka is to stem the deteriorating growth that has been evident in the recent years and to reignite the economy with a concerted effort to reach higher single digit growth in the next decade. This requires a closer analysis of growth dynamics of the Sri Lankan economy taking into account experiences in other lower-middle income (LMI) and upper-middle income (UMI) economies.

Clearly, when Sri Lanka averaged a growth of 4.2% in the 2013-2017 five-year period, South Asia grew at 5.7% and every country in the South Asian region recorded higher average growth than Sri Lanka. While it may not be possible to exactly replicate the growth paths of these high growth Asian economies, their growth experiences clearly suggest opportunities for growth.

Agricultural sector modernization and productivity improvement

The share of the agriculture in the Sri Lankan economy (8%) is smaller compared to LMI countries (11%) and less than half of the agriculture share in LMI countries in Asia (17%). In fact, Sri Lanka's agriculture share is the same as that in UMI countries and UMI countries in Asia. This suggests that the share of the agriculture sector in Sri Lanka has already reached that of UMI countries and there is likely to be little gain in reducing its relative size further. What is needed is modernization of agriculture, and diversification and promotion of export-oriented agriculture in order increase productivity and achieve stable and high growth in the agriculture sector.

Export-oriented industrial development

The share of the industry sector of Sri Lanka (27%) is fairly at par with LMI and UMI countries. However, a comparison with UMI countries in Asia, where the industry share is about 38% of the economy, suggests that Sri Lanka needs to expand industry sector as a growth driver. This requires targeted expansion of existing industries and development of new industries with a special focus on export markets.

Development of new and competitive services sector

The services sector of the Sri Lankan economy exceeds that in LMI economies (53%) and is comparable to the share in UMI economies (57%). However, given Sri Lanka's geographical location and the availability of highly educated workforce, Sri Lanka has great potential to increase the services sector in line with high income economy (HI) average of 64%.

Increasing share of trade in GDP

Sri Lanka's exports are only 22% of the economy whereas it is 35% of LMI countries and 37% in UMI countries. Sri Lanka's exports as a proportion of the economy is less than half that in UMI economies in Asia (53%) suggesting the need to expand exports significantly in order to achieve high growth. Imports as a percent of the economy are 29% and much lower than that of LMI economies (45%) and UMI economies (46%). Reflecting higher imports than exports, net exports contributed -7% to the economy of Sri Lanka in 2017. Although the contribution of net exports is much more negative (-10%) in LMI economies in general, it accounts for only -5% in LMI economies in Asia and -3% in UMI economies. Further, UMI and HI economies in Asia show a positive 7% contribution of net exports suggesting the important role of played by net exports in their economies.

Overall, trade, as a percent of the economy was 51% in Sri Lanka whereas trade has played a much bigger role in LMI economies (80%) and UMI economies (78%). Trade is 99% in UMI economies of Asia which comprise of China, Malaysia and Thailand.

Increased Foreign Direct Investments

In relative terms, FDI was about 3% in Malaysia and Thailand, 6% in Vietnam and 13% in Cambodia. Sri Lanka will need to attract substantially more FDIs in the range of 3% to 6% of GDP in the medium-term in order to increase export-oriented manufacturing industries.

Increasing labour force participation

Sri Lankan's labour force participation of 54% is one of the lowest in the lower-middle and upper-middle income economies in Asia where it is 65%. South Asia in general has lower labour force participation with an average of 58%. Involving more of the economically inactive population, particularly women, in the labour force is a challenge that Sri Lanka to consider in its development strategy.

Fiscal consolidation

In order to achieve a sustained fiscal balance, Sri Lanka needs to increase government revenue and rationalize government expenditure.

Increase in government revenue will critically depend on improved economic growth. However, measures are needed to improve tax administration and collection as a top a priority. As for expenditures, a complete rationalization of government expenditure is required and must involve significance reduction in wasteful and unnecessary government expenditure and allocation of resources to more productive and job-creating initiatives which will contribute to increased economic growth. Beyond the medium-term, the budget deficit needs to be contained at about 3% of GDP.

Debt sustainability

The high level of public debt amounting to 83% of the GDP is not sustainable in the long-run. Given the continued fiscal deficit, the government will be forced to continue to rollover existing debt as they mature and, as a result, reduction of existing debt will be a significant challenge.

Leveraging private sector investments

Sri Lanka needs to re-orient its growth model to leverage private capital for long-term investment projects including infrastructure investments. The fiscal and public debt constrains facing the economy only allow very limited fiscal space for large investments and borrowings by the government. Domestic private sector should be encouraged to partner with foreign investors for large capital investment projects.

Developing domestic capital markets

Sri Lanka's equity and corporate debt markets have to be developed in size and liquidity in order to attract more domestic savings to stock and bond market investments, provide more dynamic and efficient markets to raise funds domestically and increase private sector capital formation for investment projects.

Exploiting geographical location advantages

Sri Lanka as an island centered between the East and the West and located in the East-West maritime route has enormous opportunity to develop into one of the best aviation, port, commercial and services hubs in the region. The Colombo Port City can be developed as a vibrant and dynamic financial centre in the region and Hambantota Harbour, which is a pivotal link in the Chinese Belt and Road Initiative, as an active trans-shipment hub and a port.

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