Spotlight: Econ Op-eds in Summary

Week ended 09th February '22

In Summary

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

1. Current food inflation in Sri Lanka Causes and consequences
By Dr. Faheema Saheed

- There has been continuous rise in food inflation globally. High food inflation has negative consequences for the people living in poverty and to middle income groups who earns a fixed income as most of their income is spent on food.

- Sri Lanka's food inflation was mainly attributed to a rise in global community prices, dependency on imports, currency depreciation, dollar shortage as well as supply chain disruptions and high transport costs. However, there are other factors such as hoarding by producers and traders as well as production disruptions due government ban on agro chemicals which have exacerbated the impacts.

- To solve the issue, an effective food management strategy is required. The Rupee value needs to stabilize, and targeted intervention should be prioritized over price control. Further encouraging people to earn foreign currency, promote domestic production, give incentives to growers, and encourage substitutes for imported items must be explored.

Rising food prices have been a global phenomenon in the recent past. In the globalized world food prices have become an important determinant factor of domestic inflation. Food inflation has been in the spotlight recently in the wake of food price hikes on a global scale. Sri Lanka has recorded the highest increase in the food inflation index at a rate of 22.1% in December 2021 which stood at 17.5% in November 2021. It was 25% in January 2022 causing alarm among the consumers in the country.

Sri Lanka as well as many other countries calculate food inflation as a part of overall inflation. The contribution to the overall inflation by food in Sri Lanka stands out at a rate of 7% in December 2021. Also, Sri Lanka is ranked 4th place in terms of food inflation in Asia and 12th place in the world. High and persistent food inflation has emerged as a major concern of the Sri Lankan economy.

Though COVID contributed to rising prices through supply chain disruptions, Sri Lanka experienced the food price hike even before the pandemic situation.

High food inflation has negative consequences for people living below the poverty line as well as the middle-income group with a fixed source of income. Food inflation is outpacing the income levels of the households, exacerbating income disparities. Soaring food prices hit the consumers and it is highly regressive on the poor. Poverty and dominance of food in the consumption basket is more pronounced as the poor have to spend a relatively higher share of their disposable income on food. Food price dynamics have a noticeable influence in the economic stability and wellbeing as high poverty and malnutrition directly affects the welfare of households. Even non-food expenditure such as education, housing, health is compromised at the cost of food which in turn creates socio-economic pressure.

Sri Lanka's food market consists of two sources:

- Domestic supply
- Imports

Food inflation is partly due to supply Side disruptions locally and globally. A major component of the inflation is driven by supply side factors and supply shocks which carry over the effect of low growth in food production. A rise in global commodity prices drastically affects Sri Lanka's dependency on imports. Import curbs, currency depreciation and dollar shortage too are driving the prices high. The cash strapped country is grappling with a shortage of essentials due to the lack of dollars to finance imports and to shore up the foreign exchange reserves.

Sri Lanka is a net food and fuel importing country. The exchange rate has a positive impact on the prices of food imports and import of intermediate inputs. Rising oil prices, international food prices and high transport costs also inflated the domestic food prices as external factors.

Global factors alone cannot explain Sri Lankan food inflation. Internal factors such as shortfall of agricultural production, labor shortages, increase in production costs, cyclical factors like natural calamities, monsoon onset, food demand, disruption of distribution, government policies are some of the cost push effects of food prices.

Money supply has a significant positive relationship with food inflation in the long run. Demand-pull effects from rapid monetary expansion with lower interest rates and money printing in the economy impacted the food inflation in the recent past, as a lagged effect of the loose monetary policy.

Food inflation is partly due to supply side disruptions locally and globally. A major component of the inflation is driven by supply side factors and supply shocks which is a carry-over effect of disruption in food production.

The market structure is also a factor which contributed to the recent food inflation as traders speculate decisions due to uncertainty in the continued supply of imports. Import restriction on essential consumer goods due to dollar shortages added up to the rise in the food crisis. Recently hoarding by producers and traders impacted on price increase as speculation creates artificial shortages and domestic supply shortfall. Since there are no substitutes, prices keep increasing. Recent agricultural policy shifts too had an impact on the food crisis. Production disruptions and food shortage was accelerated by government's ban on agro-chemicals, while switching to organic fertilizer in a short period.

The food inflation issue deserves immediate attention and decisive actions. Sri Lanka needs to have an effective food management strategy to deal with the current crisis situation. Cascading effects of the negative impact may otherwise lead to labor unrest and long-term socio-economic issues as well.

Effective stabilization policies are imperative. Sri Lanka has to resolve external sector issues and explore options to stabilize the rupee value. Though some countries are trying to increase policy rates to arrest inflation it should not affect the growth rates. The government should anchor fiscal plans directed towards growth objectives and sustainability. Enhancing investments by creating confidence can help in averting the food crisis.

Targeted intervention should be prioritized over price controls. Targeting vulnerable groups and accelerating short to medium term policy solutions should be implemented by the government to address this problem. Short-term measures to encourage people to tap some of the unconventional avenues, to earn foreign exchange, start development projects by tapping the global market, infrastructure development, promote domestic production, provide selective extra incentives to growers, identify special zones for off season cultivation and food storage and preservation strategies, ensure availability of farm inputs, rationally fine tune import duties, encourage substitutes for imported items are some of the areas to be focused. Structural issues for food price hikes too should be identified and addressed.

For full article – Refer Daily FT

2. The consequences of sovereign default
By: Devaka Gunawardena, Ahilan Kadirgamar

- In recent history, sovereign defaults have become a rarer occurrence due to groups of international creditors becoming smaller, the accessibility of IMF programs for countries with debt issues and a focus on countries for a production-based economy. However, international capital markets play an important role in rolling over and refinancing debt, as well as provide access to trade credit for debtor countries.

- A sovereign default can result in ripple effects across the economy, including a stock market crash, capital flight and a collapse in pension funds. Furthermore, importers and exporters could lose access to trade credit and wide-spread panic could lead to a bank run. The state would then be prompted to impose capital controls resulting in the country losing its ability to attract investments giving way for unemployment to rise, with general demand in the economy falling.

- Sri Lanka needs to undergo strong reforms to ensure its survival, including prioritizing essential imports, investments in domestic food production and the distribution of subsidies for it. Moving to an IMF program in general, involves a country giving up control of its policies. For Sri Lanka, this would also mean a removal of import restrictions currently in place alongside other measures.

Sri Lanka may be on the verge of defaulting on its sovereign debt. Some economists are even proposing default as the way forward. To understand the consequences of default for the country, we engage with a scholar who provides a novel perspective. London School of Economics academic Jerome Roos' book, 'Why Not Default: The Political Economy of Sovereign Debt' (Princeton University Press, 2019), presents an important set of ideas about what default potentially means for countries that face sovereign debt crises.

Using historical and comparative examples, Roos outlines the critical mechanisms by which countries either avoid default or embark on an alternative path by choosing default. More generally, as Roos argues, "It has become clear that future scholarship on sovereign debt—and on global finance more generally—can no longer bypass its social and political dimensions".

Roos begins his book by exploring, from a theoretical point of view, why countries in general tend to avoid default, in contrast to the previous historical epoch, before the 1980s, when default was a much more frequent occurrence. As he argues, because of its increased structural power, finance capital has a tremendous degree of leverage over the policies of debtor countries. As he puts it, "We can define structural power as the capacity to withhold something upon which another depends". Debtor countries rely not only on access to international capital markets to try and rollover debt, but also basic facilities such as trade credit. Accordingly, Roos' point is that finance capital defines the rules of the game, making it significantly more likely that debtor countries will comply with restructuring, as opposed to trying to chart an independent course by defaulting.

Roos identifies three main reasons for why cases of default in recent history are extremely rare:

1) the immense concentration of international creditors,
2) the interlocking of lenders of last resort, especially the IMF, with debtor governments, and, as he puts it,
3) "the growing dependence of the capitalist state—and the capitalist economy more generally—on private credit".

Roos' point is that the third factor especially entrenches the shared interests of the elites in the creditor and debtor countries. Elites within debtor countries themselves ensure compliance with the terms of a bailout agreement because they are most likely to lose out in a default scenario in which the government rejects austerity as a condition of debt restructuring. Moreover, these forces are more likely to obtain a better deal regarding terms of credit than a progressive pro-default coalition that opposes austerity (p.15).

Default and devastation

Roos concludes that any long-term transformation of the global debt structure would require "mass social mobilisations" within countries in the global North and South. He also mentions in brief other potential strategies that debtor governments themselves can adopt, such as exemptions for pensioners and other smaller categories of investors, to shield them from the full effects of default.

But, as Roos makes clear from the outset, default can be a devastating process. We quote him at length below to describe the dynamics following default:

"The spillover costs of default would initially spread through the transmission belt of the financial sector, with a default on foreign creditors likely to provoke capital flight, a stock market crash, and a collapse of domestic banks and pension funds. But given the centrality of finance to contemporary capitalism, the consequences would quickly ripple throughout the wider economy, risking massive social dislocation in the process.

"Exporters and importers would no longer be able to obtain trade credit, causing shortages of crucial consumables and industrial inputs; depositors would fear the safety and value of their savings and would likely instigate a bank run and mass capital flight, making the imposition of unpopular capital controls all but inevitable; producers would no longer be able to attract foreign or domestic investment and would start laying off workers in droves; households would see unemployment skyrocket while no longer being able to obtain credit for consumption, as a result of which aggregate demand would dry up—in sum, the bankruptcy of the state would risk provoking the bankruptcy of large parts of the domestic economy, with devastating social consequences (at least in the short term) and potentially grave implications for the government's capacity to legitimise itself in the eyes of its citizens."

Thus, even to consider default, the debtor government must be incredibly clear-eyed about the risks. It must be capable of managing massive short-term disruption. This approach also assumes that the government has a plan to successfully transform the country's economy in the long run, to move away from continued dependence on debt.

Politics of default in Sri Lanka

The differences between the examples outlined above, especially Argentina, and Sri Lanka should be clear. Whereas in the case of the former, default was proposed by a left-leaning government that came to power through massive popular mobilisation opposing austerity, default is now being bandied about as a solution by our mostly right-wing economic experts, ostensibly as a way of keeping "food on the table."

The reality, however, is that not only are these experts unwilling to tolerate a rupture with austerity, but they also do not see default as implying divergence from continued dependence on debt. In fact, the debate among experts themselves right now is what is ultimately the fastest way for Sri Lanka to regain access to international capital markets!

Finally, they have not evinced the slightest bit of awareness of the vast range of challenges that would make default, and debt restructuring in general, a brutal process for Sri Lanka in the current moment. For example, as Roos himself puts it, many trends in the global economy had to converge in favour of Argentina for the country to navigate the challenges of default, such as the growth of its trade surplus because of a boom in commodity exports.

In contrast, Sri Lanka is staring down the barrel of the gun with the US Federal Reserve likely to raise interest rates soon. These maneuvers within the heart of global capitalism will further isolate Sri Lanka from external capital and put massive pressure on the country's Government to conform to an agreement that favours creditors above all else.

While our experts talk about putting food on the table, the reality is that they aren't even considering, much less publicising, the real structural reforms that would be necessary to ensure ordinary people's survival. As mentioned elsewhere, these include cutting down on the import bill by prioritising essential imports, distributing subsidies to cover the effective increase in food prices, and investing in domestic food production.

Progressive positions

Although Roos considers what would make a progressive pro-default coalition successful, we can invert the focus of his argument. We must consider the range of factors that would likely make debt restructuring, either before or after default, a far more painful process for ordinary Sri Lankans under the current circumstances. Progressives seriously pondering default, or debt restructuring in general, must comprehend the array of forces stacked against Sri Lanka. They must reckon with the political implications of an IMF-led reform process that this choice would engender.

Despite whatever progressive veneer the IMF may now try to adopt, the reality is that a bailout agreement would rule out import restrictions. The latter contravene the core ideological assumptions of that institution. One doesn't need to be a starry-eyed leftist to realise that the IMF is shaped by the interests of powerful creditor countries. And as Roos also points out, what is ultimately at stake in any default or debt restructuring is the degree of democratic control a country has over its own policies.

By embedding itself further within the IMF-creditor nexus, Sri Lanka would be sacrificing whatever little control it has left, and accepting whatever solution is proposed by the powers that be. In this context, the current Government is proceeding along the parallel path of subordinating itself to regional and global powers. It is mulling over the strategic assets it can pawn, while attempting to manage the political fallout.

In contrast, if we are serious about getting out of this mess altogether, we must be honest about our goals and realistic about the strategies to achieve them, especially considering the extent to which Sri Lanka's economy continues to be characterised by overwhelming dependence on the external sector. Only a comprehensive alternative to both the Government's dilettantish policies and austerity-driven debt restructuring—whether before or after default—will enable Sri Lanka to regain control of its economy, thereby ensuring that its people can survive the current economic crisis and thrive in the long run. At the heart of the political question about default and restructuring debt is who takes on the social and economic burden of decades of extraction through sovereign debt by global finance capital and its comprador elite in Sri Lanka. Our firm commitment is that it should not be the working people. How about you?

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