Spotlight: Econ Op-eds in Summary

Week ended 15th July '20

In Summary

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

1. Building buffers
By: Daily FT

- As worries of another spike of COVID-19 cases grow, the biggest challenge before the Government is figuring out how to handle the economic fallout from a slower than expected recovery. This is especially true in the context of Sri Lanka's recently weakened public finances.

- The latest Mid-Year Fiscal Position report shows this weakening clearly, with revenue declining 20.3% and expenditure only falling 3.2% in the first four months of the year. The budget deficit for the year, therefore, could be at least 8% according to the Finance Ministry, and even higher according to analysts.

- The need to add both monetary and fiscal stimulus to recover the economy after COVID-19 adds more to this problem. Even if the situation recovers, inflationary pressures and further fiscal pressures could prove damaging. Therefore, the upcoming budget document will be more important than before.

As worries of another spike of COVID-19 cases grow, the biggest challenge before the Government is figuring out how to handle the economic fallout from a slower than expected recovery. Given the state of Sri Lanka's public finances, this will provide to be an effort that will require long-term plans.

The latest Mid-Year Fiscal Position Report 2020, released earlier this month, indicated that fiscal performance is likely to be under severe stress during the remainder of the year, given the local and global shocks of the COVID-19 pandemic. There are also fears of a second wave, and Sri Lanka's debt metrics call for strong fiscal management not just in the second half of the year but also in 2021, depending on how the economic recovery moves forward.

Total Government revenue declined considerably by 20.3% to Rs. 476.7 bn during the first four months of 2020, compared to Rs. 598.1 bn recorded in the same period of 2019. Tax revenue declined significantly by 25.9% to Rs. 408.5 bn in the first four months of 2020, compared to Rs. 551.5 bn in the same period of 2019.

Total Government expenditure fell by 3.2% to Rs. 930.9 bn in the first four months of 2020, compared to Rs. 961.9 bn in the same period of 2019. However, recurrent expenditure increased by 9.3% to Rs. 820.7 bn in the first four months of 2020, compared to Rs. 750.5 bn in the same period of 2019.

Given Sri Lanka's comparatively large public sector and dominance of State Owned Enterprises, it is difficult to stem recurrent expenditure. The additional COVID-19 social welfare demands made on the Budget, such as the Rs. 5,000 hand-out done by the Government for two months during the curfew, has also placed more stress on public finances. These were necessary and part of the Government's responsibility, but they also ran contrary to the fiscal consolidation measures and other reforms that would have kept Sri Lanka's Budget on a more sustainable path.

This is why it is essential to implement reforms in a timely manner, and at the start of a Government's term, rather than delaying them till the end and leaving them mostly undone.

The Finance Ministry had earlier estimated the Budget deficit could be 8% for 2020, but rating agencies have predicted it can be higher, depending on how slow the domestic economy is to recover. Even though the Government has rolled out stimulus packages, using largely monetary policy to assist the private sector to deal with the outcomes of the virus, there are concerns that increasing growth could come with high inflation that could exert fiscal pressure, such as demands for salary increases by the public sector. These are weighty issues that will need to be addressed by both the Executive and the next Parliament.

Undoubtedly, the biggest task for the new Parliament is the next Budget. This will be a more-than-usually important document, because it will have to set the policy agenda for the Government's next four years, make sense of at least two Votes on Account formulated by the Finance Ministry, and set out how Sri Lanka is going to address its fiscal consolidation needs. The Government has already started discussions with India on a $ 1 bn SWAP arrangement, and it is hoped that it can carry out its plans to meet debt repayments as planned. But next year could prove even more challenging.

For the full article - Refer the Daily FT

2. Strengthening exports essential for economy
By: Dr. Nimal Sanderatne

- Increasing exports and foreign investment are vital for Sri Lanka's trade dependent economy. An overreaction to the current global economic dislocation by adopting inward-looking economic policies could be damaging for Sri Lanka's trade dependent economy.

- Thus, Sri Lanka should remain a trade dependent export led economy to achieve a higher trajectory of economic growth. The problem however lies in imports exceeding exports by a large amount and thereby straining the country's balance of payments and external financial vulnerability.

- Exports and imports however are two sides of the same coin. It is thus, imperative to enhance the volume of the country's current exports as well as diversify into new export products and markets. Especially enhancing agricultural exports is crucial in the country's export strategy.

Economic rationale

Being a small country with limited resources of raw materials and a restricted domestic market, the potential for growth lies in enhancing exports. If the cost of raw materials increases and their availability restricted, exports of manufactured goods would be hampered. Exports of industrial goods are dependent on free imports of a wide range of raw materials. Therefore, Sri Lanka's export led growth is import dependent.

Trade dependency

The country's trade dependency (exports and imports as a proportion of GDP) was about 35 percent in 2019. While exports were US$ 11 bn, imports were US$ 19 bn. This high trade dependency is characteristic of small countries. The problem however lies in imports exceeding exports by a large amount and thereby straining the country's balance of payments and external financial vulnerability. It is therefore crucial to enhance exports to bridge the trade gap.

Policies

Economic policies must be geared towards the expansion and diversification of exports. A strategy that attempts to reduce the trade gap by curtailing imports is not only limited in scope but could hurt exports that are highly dependent on imports.

This does not mean that some non-essential imports cannot be curtailed or that one should not try to produce within the country imported items or substitutes. Efficient import substitution is a rational economic objective, but production of inefficient high cost inferior goods are a burden on the economy and people.

Post-independence

At the time of independence the country was an export-import economy and a relatively prosperous one in Asia. For a long period of time the country's exports were the three tree crops: tea, rubber and coconut. This dependency was at times the reason for the country's prosperity and at times for the economic difficulties.

At the time of independence, the economy was a relatively prosperous one in Asia, as it had benefitted from the high prices for rubber during the Second World War, when Ceylon became the main supplier of rubber for the allied forces. Soon after the country gained by the outbreak of the Korean war that resulted in rubber prices increasing sharply once again in what became known as the 'Korean boom.'

Adverse terms of trade

In contrast, the late 1950s and 1960s saw depressed prices for the country's exports, on the one hand, and rising prices for the country's large food imports. This deterioration in the terms of trade (prices of imports relative to export prices) led to a foreign exchange crisis in the 1960s and 1970s. This in turn led to inward looking policies that ushered in a period of economic scarcity, severe hardships and low growth.

Policy imperatives

It is imperative to enhance the volume of the country's current exports as well as diversify into new export products and markets. Enhancing agricultural exports is crucial in the country's export strategy. Declining agricultural export earnings is one of the serious weaknesses in exports.

The main causes for this is the decreased production and export surpluses of coconut, tea and rubber. There has also hardly any increase in spice crops. Cashew is perhaps one of the few increases in agricultural exports. Sea food exports has been a significant new export.

Agri export surpluses

The export surpluses of all three principal agricultural exports have declined. Over time plantation agriculture was neglected owing to high taxation, threat of nationalization, state take-over of estates in 1974, and mismanagement of estates. Consequently, estate tea production in particular declined. Tea exports would have fallen sharply if not for the expansion of small holder tea production that is around two thirds of total production. Small holder productivity is about twice that of estates.

Tea estates

Plantations have a high proportion of low productive senile tea. These have to be replanted with vegetative propagated teas (VPP). Unfortunately, there is no incentive for uprooting senile tea plots and replanting. Furthermore, research funding for tea is grossly inadequate and the once prestigious Tea Research Institute (TRI) is weak. There are also serious labour shortages.

Increasing tea production cannot be achieved in a short period of time. There has to be a medium and long term program of replanting that would increase productivity over time.

Rubber

Similarly, the neglect of rubber has resulted in the area cultivated shrinking. The Rubber Master Plan is ineffectively implemented. Rubber has a high potential as the country's rubber is now mostly used for rubber manufactures. The country has made headway in exports of tires, gloves and surgical gloves. It is essential that natural rubber production is increased to enable an expansion of manufactured rubber goods.

Coconut

The reduction of coconut exports is due to the export surplus decreasing due to lower production and increased domestic consumption with the increase in population. The area under coconut cultivation requires to be expanded to enhance coconut production for domestic consumption and exports.

Conclusion

The world is going through an economic dislocation and recession of unprecedented proportions. It is quite natural to overreact to this and envisage a vastly different global economy in the future. In this mode of thinking Sri Lanka's economic policy makers must not forget the character of the country's import-export dependency. Our economic recovery is very much dependent on the global economic recovery which is still not in sight.

We have to adapt our trade dependent economy and face severe hardships till there is a global economic upturn and poise ourselves to benefit from the gains in international trade. The country must continue to pursue economic policies that promote exports to be a fast-growing economy.

For the full article - Refer The Sunday Times