Spotlight: Econ Op-eds in Summary

Week ended 10th November '21

In Summary

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

1. Are there prospects of an improvement in the deepening crisis in external finances?
By Nimal Sanderatne

- Sri Lankas foreign currency reserves have fallen to significantly low levels this year. The external financial crisis may worsen as the trade balance is widening and the prospect of non-debt inflows of capital, such as tourist earnings, foreign direct investment and aid are small. Remittances too have been slowing down owing to the wide divergence in the official exchange rate and the informal market rate.

- An improvement in the reserves could be expected only by foreign assistance in the form of currency swaps, credit lines, aid inflows or other forms of foreign assistance. The Central Bank is optimistic in expecting such assistance, especially a line of credit from Oman to purchase petrol and currency swaps. On the other hand, the Central Bank of Sri Lanka and the Government has ruled out seeking IMF assistance.

- However, most economists and financial analysts have pointed out that the wisest and least cost solution to the country's external financial crisis is to seek the assistance of the International Monetary Fund (IMF).

Deepening crisis

External currency reserves that were US$ 5.2 Bn at the beginning of the year has been declining to only, US$ 3.6 Bn at the end of June, US$ 2.5 Bn at the end August and dip to a perilously low US$ 2 Bn at the end of September.

The depletion of the foreign reserves from US$ 3.5 Bn at the end of June to US$ 2 Bn in September was in spite of, an infusion of US$ 870 Mn from the International Monetary Fund's (IMF) SDR allocation and a currency swap of US$ 250 Mn from Bangladesh in August.

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Trade performance

This declining trend in the external reserves was mainly due to the repayment of debt and the widening trade deficit.

The trade deficit has expanded despite import and foreign exchange restrictions and a good export performance. Import expenditure has been increasing owing to the escalating international oil prices to over US$ 80 per barrel and higher expenditure on essential food imports whose prices have also been increasing.

In contrast, exports have been faring well. Export earnings reached US$ 7.9 Bn by end August: An increase of 22.6% compared to the same period in 2021. In the four months since June, export earnings have been about US$ 1 Bn a month. While export earnings in the first eight months have exceeded last year's earnings in the same period by 23%, import expenditure has increased by nearly 31%.

The implication of this pattern in trade is that the trade deficit will continue to increase as imports of fuel, food and other essentials would increase in the coming months.
Despite stringent import controls, the trade deficit has expanded in the first 10 months of this year. In the first 8 months the trade deficit had reached US$ 5.5 Bn. Based on this trend, the projected trade deficit is about US$ 8 to 9 Bn for 2021.

Balance of payments

With remittances showing a decline in recent months, tourist earnings small and net capital outflows, the balance of payments is likely to have a deficit of US$ 3 to 4 Bn. In the first 8 months of this year, the BOP deficit was US$ 2.4 Bn.

Foreign assistance

From whom will such assistance come? Foreign assistance from whatever source in whatever form is of immediate importance to tide over this crisis. The Central Bank of Sri Lanka is confident of overcoming the crisis with several forms of foreign assistance it expects soon. These would in currency swaps and trade credit.

Summing up

In spite of stringent import restrictions, the trade deficit has widened and the balance of payments deficit has increased. The rupee has depreciated and reserves depleted to a dangerously low level. Foreign financial assistance is crucial to overcome the crisis.

Best solution

Most economists and financial analysts have pointed out that the wisest and least cost solution to the country's external financial crisis is to seek the assistance of the International Monetary Fund (IMF). Its advantages are

- The long term repayment of the loan;
- low interest rate and
- the confidence boost the country would get in the international financial market.

Conditions

The likely conditions that the IMF would lay down would be:

- a market determined exchange rate,
- the liberalisation of imports
- a consistent interest rate policy
- the reduction of the fiscal deficit over a period of time by pruning certain expenditure and by enhancing revenue.

In conclusion

Although the Government and the Central Bank have consistently said they would not go for IMF assistance, they may now realise that there is no better alternative.

Final word

The Central Bank is surely as capable of justifying such a U-turn in policy as it has defended its opposite position with eloquent rhetoric.

For the Full Article – Refer The Sunday Times

2. Sri Lanka is heading for a serious crisis
By Dr. Laksiri Ferndnao

- Sri Lanka is already in a serious crisis in people's living conditions, in the economy, foreign reserves, political system, public administration, foreign relations, and Government's day-to-day decision-making processes.
- What affects the people in general and their living conditions at present is the thumping inflation in essential commodities. This is felt even more given the limited relief measures and stagnant salaries in both the public and private sectors.
- Making matters worse, was the complete ban of chemical fertilizer imports which affected tea and vegetable cultivation. It will also negatively affect the population of rural areas that depend on agriculture.

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Economy and inflation

What affects the people in general and their living conditions at present is the thumping inflation in essential commodities. Even according to the Central Bank, the national inflation rate has gone up from 3.7% in January 2021 to 7.6% in October 2021.

As the Trading Economics website has noted, "Prices advanced at a faster pace for both food products (12.8% vs. 10% in September) and non-food products (5.4% vs. 3.8%)." Taking into account the piling up of hardships on people, Moody's has downgraded Sri Lanka's sovereign rating from Caa1 to Caa2.

People's living difficulties cannot be fully gauged through the official inflation rates. The newspapers and TV interviews with people on the ground have revealed more drastic conditions. Day by day the prices of essentials like rice, tea, milk powder, sugar, bread, coconut, lentils and vegetables have been going up. Men express their anger and women cry referring to their children's and household needs. One reason for the price inflation is the rapid increase of fuel prices. Undoubtedly the world prices are going up, but in Sri Lanka, the gap between the fuel refinery costs and market prices is also high.

Of course many countries have suffered economically during the COVID pandemic. But to alleviate people's suffering during the lockdowns and after, most countries, have taken measures to supply various payments and relief measures. It is understandable that Sri Lanka has serious public finance difficulties. However, most of these difficulties are due to waste and financial mismanagement. The stagnation of salaries in both the public sector and the private sector has also contributed largely to the people's difficulties.

Zigzag policies

There have been this zigzag policies and U-turns particularly between August and October this year. First the Government imposed a state of emergency on essential food items, including rice and sugar, with controlled prices and started to raid the hoarders. Then it created a huge black market and the prices shot up. The Government did not have any control. Then the Government withdrew all the gazette notifications on controlled food prices, and the prices again went up!

Even before, since March 2020, import controls were imposed due to foreign currency shortages. Since then and until last month the Government was going in a 'closed economy' direction. After one year's 'experimentation,' in April this year, Basil Rajapaksa was sworn in as the Minister of Finance to implement a change. It is that change that we are experiencing now! In September this year, Ajith Nivard Cabraal also was appointed as the Governor of the Central Bank changing the previous policies.

The old dichotomic controversy between a 'closed-economy' and an 'open-economy' does not have much meaning today. While an economy should be open as much as possible in market sense and also in investments, the State has a definitive role in holding strategic enterprises like harbours, airports, and the energy sectors. In addition, the State also should offer welfare services to the needy, and encourage people to work hard and contribute to the country's welfare.

Fertilizer crisis

It was in April this year that the President suddenly declared a complete banning of chemical fertilizer importation. There is no question that properly-composed organic fertilizer is better for the environment and people's health. However, that transition requires much time, planning, education to the farmers, and necessary arrangements to produce (or import) reliable organic fertilizer.

The immediate effect was on the tea industry and vegetable cultivation. Then came the Maha paddy cultivation season in September. Without fertilizer, chemical or organic, farmers could not get into the fields. Except in certain areas, the situation is the same today. Although the agriculture contribution to GDP is (under) estimated to be 8%, over 28% of the population depend on agriculture and 82% of the population lives in rural areas.

In President's speech in April, he said, "The annual sum of US$ 400 mn spent on fertilizer imports could be used to uplift the lives of the people." Perhaps realizing the failure to suddenly produce organic fertilizer locally, the Government then decided to import 99,000-tons of 'organic' fertilizer (solid and liquid) from China.

This fertilizer has proved or alleged to be more harmful than the chemical fertilizer! The Government also decided to import 30,000 tons of potassium chloride from Lithuania suddenly, but called it 'organic fertilizer'. Sri Lanka also had to so far import 3.1mn litres of nano liquid fertilizer from India.

Within the last three months, fertilizer costs have rocketed to nearly US$ 150 mn and if calculated with previous imports (Jan-July), definitely exceeding the previous annual cost of fertilizer imports (US$ 400 mn) that the President quoted in April.

For the full article – Refer Daily FT