Spotlight: Econ Op-eds in Summary

Week ended 16th October '19

In Summary

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

1. Formidable economic challenges in 2020
By: Nimal Sanderatne

- The economic future of the country in 2020 is likely to be fraught with risks. The impact of political considerations, and the need for candidates in both presidential and parliamentary elections to win voters, are likely to both put economic considerations aside and add more fuel to the underlying economic troubles of the country.

- The key problem facing Sri Lanka's economy, is the country's high debt profile. With total public debt above 80% of GDP and foreign debt above 60% of GDP, the country's external financial position is filled with vulnerability. Fiscal pressures from elections are only likely to aggravate this, raising the cost of servicing the country's debt.

- All this is likely to play into Sri Lanka's slowing economic growth. Compared to an average annual growth of 4.5% in the post-independence period, the post-2015 years have seen average growth rates of less than 4%. With the continued impacts of political uncertainty, the Easter Sunday attacks, and a failure to revive investor confidence, this is likely to severely impact the future growth of Sri Lanka.

Next President

In any event, the responsibility of running the economy will not be with the next President. Since the President will not hold a single portfolio under the amended constitution, resolving the massive economic problems will be the responsibility of the present UNP government and the government that will be formed after the 2020 parliamentary elections.

Pre-occupation

The pre-occupation of presidential candidates is the election. They could make any promises to gain popular support irrespective of their capacity to fulfil them. For most part, the extravagant public expenditure in the runup to the two forthcoming elections and promises would aggravate the economic problems rather than alleviate them. This would continue into next year owing to the parliamentary elections.

Economic woes

The three most critical economic problems are
1. the servicing of the large public debt that distorts fiscal priorities and destabilises the economy
2. the growing foreign debt and meeting its debt servicing costs
3. the tardy growth of the economy.

The resolution of these problems requires a strong commitment to good economic policies that the political situation does not allow as good economics is bad politics in the short run.

Public debt

The most difficult problem faced by the country is its domestic and foreign debt. The total public debt — domestic and foreign — is around 80 percent of GDP and is evenly divided between the two. A debt to GDP ratio of 60 percent is acceptable, but when it exceeds this threshold, it is a sign of grave financial instability.

There are serious implications and consequences of the high indebtedness. One significant impact of this is that the government does not have the financial capacity to invest in the country's economic and social development.

The inadequacy of revenue to meet even current expenditure, debt servicing costs of the public debt that exceeds revenue and the burden of servicing a foreign debt of US$ 54 billion are almost insurmountable problems. The continuous high fiscal deficits lead to inflation, lesser export competitiveness and slower economic growth.

Foreign debt

The foreign debt has increased over the years to reach about US$ 54 billion, which is over 60 percent of GDP. The debt servicing cost (repayment of capital and interest) is as much as about 45 percent of export earnings.

The country's massive foreign debt and its high servicing costs are serious external vulnerabilities. The debt servicing costs have been met by further borrowing. Consequently the foreign debt and its servicing costs have been increasing. Persistent large trade deficits and small balance of payments surpluses have hardly contributed to the repayment of foreign debt.

Recent governments have repaid debt obligations by further borrowing and enhanced the foreign debt burden and external vulnerabilities. Consequently the foreign debt and its servicing costs have been increasing. Persistent large trade deficits and small balance of payments surpluses have hardly contributed to the repayment of foreign debt.

Slow growth

The slow economic growth since 2015 is a serious concern. In the five year period (2015-2019), the economy grew by less than 4 percent compared to an annual average of about 4.5 percent in the post-independence period. Economic growth is estimated at only 2.7 percent this year.

The failure of the regime to inspire investor confidence, political instability created by the conflict within the government leading to the constitutional crisis in October 2018, the obstructionist activities of the political opposition and trade unions, the incapacity to implement policies and the setback to the economy by the Easter Sunday terrorist attack and ethnic violence are reasons for this tardy economic growth.

Concluding reflection

Politics is inextricably connected with economics. It is an axiom that good economics is bad politics in the short run. On the other hand, good economics is good politics in the long run. Political compulsions are preventing the nation from achieving its economic potential.

[For the full article – Refer The Sunday Times]

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2. Bankrupt Sri Lanka Incorporated Prospective rescuers should come up with a common policy
By: W.A. Wijewardena

- Presently, the annual debt repayment obligations of Sri Lanka are almost equal to the total Government revenue. To complicate the economic situation, the growth of the economy has been falling for the past few years making it difficult to repay the debt. In such an environment, two methods of debt repayment are widely considered.

- First of such methods is to borrow from cheaper sources and repay the existing debt. However, this has an issue given that this could only be applied to maturing debt of the Government and not the public sector, since such arrangements for the public sector require extensive negotiations and penalties to be paid at times. The alternative is for the central bank to print money and lend to the government to settle the debt.

- One issue with this method is its assumption that debt can be settled permanently by the transfer of mere financial funds to creditors. Another concern is how the government would repay the central bank thereafter. In lights of these concerns, Sri Lanka needs to run a surplus in the budget and strengthen the country's foreign exchange earning capacity by promoting exports.

The case of a bankrupt company

What do you think of a private company which is indebted to the hilt, does not earn enough to repay its debt and experiences a low sales growth which is declining year after year? Surely, it is a problem company needing quick fixing.

If its capital has completely been eaten up, it is said to be a bankrupt company which, as those in the market would say, is in the red. To convert it into green, capital has to be brought in from outside, while its operations are restructured. If this is not done, the private company will go under and has to stop operations before the authorities would force it to close shops.

Sri Lanka Incorporated: Fast moving toward bankruptcy?

Now consider the parallel between this company and Sri Lanka.

- The total public debt incurred by its Central Government is about 83% of the country's total output (GDP).
- When the Central Government's borrowings from the Central Bank and State banks are also added, the total debt increases to 85% of GDP. That number includes only the foreign borrowings of the Central Government.
- In addition, private sector entities also have made foreign borrowings amounting to some US$ 21 bn. When that number is also added to the Central Government borrowings to represent the total country borrowings, it rises to 100% of GDP in 2018.

Sri Lanka was able to reduce the share of these borrowings from a peak of 116% of GDP in 2002 to 77% in 2010. But since then, they have been rising ominously mainly due to the increases in foreign debt contracted by both the Central Government and the private sector.

To complicate the ominous economic situation, economic growth has been falling continuously from 9% in 2012 to 3% in 2018. The growth projections for 2019 have been even below 3% with no hope of economic recovery during the next three-year period.

Expanding the debt profile in a slow real growth era

Unlike a private company in a similar situation, Sri Lanka is not yet a bankrupt country that should go into compulsory liquidation.

With its single digit inflation of around 4%, its Government can still repay domestic debt by either borrowing from the domestic economy or by printing new money. The country can still access foreign commercial markets to raise foreign exchange funds to repay its foreign debt. However, the country's debt profile is changing for the worse year after year pushing it to the edge. Presently, annual debt repayment obligations are almost equal to the total Government revenue. In the next few years, it will exceed the revenue levels making it necessary for the country to borrow in larger volumes and repay its debt.

This debt recycling has a limit since no country can continue to expand its debt profile unless it has comfortable real economic growth to back such borrowings. In this connection, the danger signs have already been shown by the low economic growth in the recent past with no prospect for economic recovery in the next few years.

Hence, without further borrowing, the country cannot maintain its unblemished track record of meeting all foreign debt obligations in time. The casualties in this backdrop are ever-rising foreign debt, depleted foreign reserves, falling exchange rate, stalling economic growth and finally accelerating inflation.

The blame-game should stop forthwith

Hence, the ominous debt profile is the public enemy number one looming over Sri Lankans today. The political parties have been on a 'blame game' accusing each other for the critical state in the country.

The most commonly used debt-burden indicator is the amount of public debt falling on a single individual in the country. By quoting this number, they are in the habit of awarding a clean certificate to themselves, while accusing their political rivals.

However, if any political party is desirous of earning this clean certificate, there is a fundamental qualification which it should have acquired. That is, when that political party had been in power, the government budgets its finance ministers had presented should have been either:

- Balanced budgets, where they have not added new debt to the debt profile. OR
- Surplus budgets, where they have indeed repaid some of the previous debt thereby contributing to shrinkage of the total debt.

The bold example by M.D.H. Jayawardena

During 1954 to 1956 then Finance Minister, M.D.H. Jayawardena was able to maintain surplus budgets of 0.5% and 2.2% of GDP in 1954 and 1955, respectively.

The macroeconomic achievements during this short period were for the better.

- The total public debt fell from 27% of GDP in 1953 to 21% by 1955.
- Government's borrowings from the Central Bank and commercial banks on a net basis, that is, after setting off Government deposits from borrowings, declined from Rs. 455 mn in 1953 to Rs. 186 mn in 1955.
- The beneficial effects on inflation and economic growth were remarkable during this period. Inflation rate, measured in terms of the Colombo Consumers' Price Index, fell from 1.6% in 1953 to a negative 0.5-0.6% in 1954 and 1955 and continued to be in the negative range even in 1956 before accelerating to 2.6% in 1957.
- Economic growth accelerated from 2% in 1953 to 6% in 1955. In the subsequent four-year period, growth fell again on average to 1.6% per annum.
- Sri Lanka had a comfortable surplus in the balance of payments or BOP amounting to about $ 60 mn in each of the two years. Since then, Sri Lanka's BOP turned to be negative, depleting foreign reserves, putting pressure on the fixed exchange rate to be devalued by the Government and forcing the authorities to impose the most stringent import and exchange controls on the citizens.

Proposing to settle debt by borrowing more

The solutions that the presidential candidates have suggested pose two issues. One issue relates to the strategy of borrowing funds from a cheaper source and repaying the existing foreign debt. Such an approach can be applied only in the case of the maturing debt owed by the Government and not by the private sector borrowers.

Sri Lanka's private sector also owes some $ 21 bn to diverse creditors and any early repayment arrangement has to be made by individual borrowers having negotiated with individual creditors. A President representing a country cannot do this. It is worthwhile to note that, with regard to the maturing debt, this approach is exactly similar to the debt recycling being done by Government debt authorities.

What is ignored by all the parties is that it does not take the country out of debt. It simply makes the country more indebted trapping it in a bigger debt burden, since it now has to borrow money even for paying interest on the existing debt.

Debt should be repaid via real sacrifices

The second issue arises from a misunderstanding that a country can get out of debt without making a real sacrifice. Though debt is denominated in money form, it is not money that is lent. A lender has to save a part of his real earnings to give out as a loan by sacrificing his current consumption in favour of consumption to be made in the future.

For instance, if I borrow one rupee, I do not simply borrow it in money form. The person who lent me that one rupee has to sacrifice his real consumption equal to one rupee. When that one rupee is transferred to me, I have the ability to command over a basket of real goods and services worth of one rupee. Hence, when I repay it and pay interest on it, I transfer to my creditor a basket of real goods and services worth of one rupee and the interest component applicable to it. Hence, debt repayments are not mere financial repayments but transfers of real goods and services to creditors by borrowers.

Suggestion that Central Bank should print money and repay Government debt

Based upon the belief that debt repayment is a mere financial repayment some believe that the Sri Lankan Government can settle all its domestic debt if the Central Bank prints Rs. 1 tn and lends to the Government. After the Government has paid all its debt, the Central Bank can adopt a tight monetary policy and take that money back to prevent it from causing inflation.

This however has two defects.

- One is that it still has the issue of how the Government will repay its debt to the Central Bank.
- The other is its wrong assumption that debt can be settled permanently by the transfer of mere financial funds to creditors.

The way out is only by real sacrifices

Thus, a government which intent on resolving the country's debt problem permanently should follow only one policy option. That is to run a surplus in the budget and start repaying the existing debt. But this will address only the domestic debt of the Government. About the foreign debt owed by both the Government and the private sector, the proper course is to strengthen the country's foreign exchange earning capacity by promoting export of merchandise goods and services.

For the full article - Refer Daily FT

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3. Human capital agenda for Sri Lanka
By: Dinesh Weerakkody

- While education is often taken to be a direct road to development, the truth of the matter isn't as simple. A more important question is making sure more and better jobs get created in an economy, so that proper specialization can develop and drive a country towards positive economic activity.

- Education remains a key component of this, but countries like Sri Lanka need to look at a range of factors in making sure education results in proper growth of the economy. Focusing on the growth of new sectors and establishing vibrant professionals need to be key components of this goal.

- Beyond education, the requirements of supply chains and other networks within an industry need to be considered. This will include strengthening labour laws and reforms and ensuring policy movements are in line with the country's future requirements. This will be crucial to ensuring the country develops its human capital in order to avoid being stuck as a middle-income country.

A question that is often asked is, what is the real connection between education, innovation and economic development? If you take a simple human capital view of economic development, it's fairly straightforward: if you invest in people's education, then incomes will develop. But that presupposes that people are going to get jobs and that there's something that's actually driving the development.

The more important question is, how do jobs actually get created? How do countries take on new technologies and become effective producers? In this kind of argument it's not just thinking about supplying the education, it's saying that knowing where the possibilities for an economy to specialise and develop are going to be important in thinking about how economic development takes place.

It is not a simple universal model, where invest more in education, positive things will come out – but if you take a particular country, you can look at what capacity it already has in terms of education and training systems, its industrial system, the existing network between firms and the capacity of the state to support them, but also what positions it could possibly take up within the global system.

Focused investments

Therefore Sri Lanka needs to look at a range of different factors rather than just invest more and more into education hoping the market will take care of the mismatch between the quality of high-skilled labour demanded and supplied and also provide the required new jobs for those coming out of the education system.

There is no doubt higher education is a key element of developing new innovations and thereby help GDP growth to accelerate. But another important role of higher education is around developing professionals. Professionals play a key role in picture: key factors critical for our future success meeting health, education, agricultural and water goals: engineers, doctors, nurses, teachers – the whole range of professionals who are vital for development. Therefore producing the right professionals for our future success, is key.

Also there is a need for greater competition between education providers in a marketplace to bring about higher and higher quality of content for a lower and lower overall cost. Given that investing in education and leaving it to the markets will only do so much. We need a new way of looking at the relationship between higher education, economic development and employment.

The widely adopted human capital view is that higher education increases skill and knowledge and results in higher income.

In practice however, geography, sectors, available skills and education systems and networks of companies, value chains, employment patterns and policy frameworks associated with each sector are equally important factors that are often ignored.

We have spent decade upon decade surrounded by a system that is, for all practical purposes, a "one-size-fits-all" system. Because quality improvements at that level affects employment creation and also for those young highly -skilled workers to get "better paying jobs".

The education to employment continuum and the requirement for compulsory education of 13 years and the required Labour and education reforms need to kick in fast to ensure our workforce is future ready and get us out of the middle income trap (MIT – the middle-income trap refers to the phenomenon where rapidly growing economies stagnate at middle-income levels and fail to transition into a high-income economy) and for the creation and professionalisation of talent pools for specific industries.

For the full article – Refer Daily FT