Spotlight: Econ Op-eds in Summary

Week ended 11th August '21

In Summary

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

1. Why are we fighting shy about going to the IMF?
By: Dinesh Weerakkody

- The IMF recently bailed out debt-ridden Congo, showcasing their ability to help other nations service their debt. However other countries who offer debt relief, can be doing so to further their own economic or political goals. Sri Lanka would not have requested funding from other countries if the pandemic hadn't impacted tourism as heavily as it did.

- A major measure taken this year to align with the IMF's stated goal of maintaining financial stability, is the current SDR allocation of $650 bn, the largest ever allocation by the Fund. $275 bn of this is set to be allocated to emerging and developing economies, with Sri Lanka expecting to receive approximately $800 mn in SDR's.

- Currently IMF programs are likely to have more favourable conditions than in the past, given that the Fund is under strain to help developing nations rebuild their economies. Sri Lanka must take advantage of the concessional support the IMF offers and must avoid shunning them for ideological reasons given its BOP challenges and high debt service requirements.

According to Reuters, the IMF recently approved a bailout worth nearly $ 449 million for OPEC member Congo Republic, giving a clear message to other nations struggling under the weight of large commercial debts and reeling from the impact of the pandemic, to seek their assistance for forex relief.

Congo's economy is worth around $ 50 billion in GDP terms and its debt levels have ballooned to 120% of GDP by 2020. This is despite having oil and being part of the OPEC.

China or the US cannot, or don't have the appetite to, bail out developing economies like Congo, as they are not in the business of financing and reconstruction of economies, unlike the IMF, or ADB or WB. If they could, they would do so, for political and economic reasons. Both countries want to support success stories with their investments to tell their citizens about their global achievements. On the other hand countries like Sri Lanka would not have gone to India or China to borrow money and to Bangladesh for forex relief if the pandemic did not hit the tourism industry so hard.

Unlike Congo, in the case of Sri Lanka, Secretary to the President Dr. P.B. Jayasundera says: "Sri Lanka has no immediate plan to seek financing from the International Monetary Fund (IMF)". He succinctly pointed out in a recent interview published in a local newspaper that 'going to the IMF would not bring tourism or exports back'. He certainly has a point, but tourism will take two more years to recover and exports will take more time to scale up. If this is his opinion that must be now the Government's official position.

This is not the time to shun the IMF. Due to the pandemic all citizens, businesses, farmers suffer hugely and this makes the economy and the lives of the poor vulnerable. The IMF's mandate, ratified by Sri Lanka as a member, is to create financial stability and be the lender of last resort.

According to EconomyNext, Sri Lanka could get up to $ 800 mn from the International Monetary Fund as a part of a new allocation of Special Drawing Rights, a reserve asset created by the IMF in 1969 to supplement the official reserves of its member countries.

New opportunity

On 2 August, the IMF Board according to IMF news approved a general allocation of Special Drawing Rights (SDRs) equivalent to $ 650 bn about SDR 456 bn, to boost global liquidity.

IMF Managing Director Kristalina Georgieva said: "This is the largest SDR allocation in the history of the IMF and a shot in the arm for the global economy at a time of unprecedented crisis. The SDR allocation will benefit all members, address the long-term global need for reserves, build confidence, and foster the resilience and stability of the global economy. It will particularly help our most vulnerable member countries struggling to cope with the impact of the COVID-19 crisis."

According to the IMF, the general allocation of SDRs will become effective on 23 August and the newly-created SDRs will be credited to IMF member countries in proportion to their existing quotas in the Fund.

Further, according to the IMF, about $ 275 bn (about SDR 193 bn) of the new allocation will go to emerging markets and developing countries, including low-income countries.

Georgieva went a step further when she said: "We will also continue to engage actively with our membership to identify viable options for voluntary channeling of SDRs from wealthier to poorer and more vulnerable member countries to support their pandemic recovery and achieve resilient and sustainable growth."

Concerns

Whilst there are genuine concerns about going to the IMF on the basis that the IMF imposes stringent conditions such as pushing hard for structural reforms and move clinically to fix the exchange rate resulting in an increase in the cost of living. However, unlike before, the agency is under immense pressure to help vulnerable countries in their economic recovery efforts. Therefore, seeking IMF support during this pandemic will be much more favorable for the Government than before.

We may need their support given that many international investors have moved out of developing countries and tourism has virtually disappeared and will only return only when the pandemic is contained and the majority of the population is vaccinated. This has given rise to exchange rate vulnerability, BOP challenges and debt servicing pressures for developing countries.

Many of these countries were financially viable and growing over 4% prior to the pandemic, but unfortunately now facing unsustainable debt payments due to huge commercial borrowings. The rating agencies who liberally issue opinions have also joined the bandwagon to make life difficult for many of these countries. Ironically, in the pandemic their opinions have influenced the credit flows in a big way.

For the IMF it is a remaking of history once again in the aftermath of a pandemic. The IMF was established in 1944 in the aftermath of the Great Depression of the 1930s to support countries to recover and to create financial stability globally. Therefore, Georgieva has said publicly: "We will continue to engage actively with our membership to identify viable options for voluntary channeling of SDRs from wealthier to poorer and more vulnerable member countries to support their pandemic recovery and achieve resilient and sustainable growth,"

This is Sri Lanka's opportunity to get concessional support and we should not miss the bus for ideological reasons. The country is far more important.

For the full article – Refer The Daily FT

2. Replenishing low foreign reserves and strengthening external finances
By Nimal Sanderatne

- Sri Lanka is having high hopes that the country's external financial vulnerability can be resolved after the recent loan payment. Government hopes to build up the foreign reserves using inflows of currency swaps, the IMF SDR grant and earnings from services in upcoming months. However as import expenditure increases, levels of reserves will deteriorate during the rest of this year as well as next year.

- Although the government is expecting short-term inflows, these are temporary measures and doesn't address the problem that lies with the disequilibrium in external finances. Even though EDB has been able to increase exports, imports have been increased at a higher rate. It is likely to experience widening trade deficit due adverse policies such as restrictions on fertilizer during the second half of the year.

- Even with many restrictions and obstacles, it is significant how manufactured exports have made a solid and gradual revival. Given the present situation of external finances of the country, the only viable solution is the reduction of the trade deficit through increased exports and achieving a balance surplus through earnings from services such as ICT and worker's remittances

There is euphoria in the government after the loan repayment of US$ one billion on July 27, the due date for repayment. The country's record of not defaulting on loan repayments has been maintained. Now, there is an air of confidence that the country's external financial vulnerability would be resolved. How will the external reserves be replenished immediately and strengthened in the long term?

Replenishing reserves

The Government is quite confident that the foreign reserves that have fallen to a mere US$ three billion would be replenished to a satisfactory level later this year. They are expected to grow owing to an inflow of currency swaps, an IMF grant and higher earnings from services in the coming months of the year.

However, analysts point out that the precarious level of reserves will continue during the rest of the year and aggravate in 2022, when further repayments of debt are due and import expenditure would increase.

Currency swaps

The reserves are expected to be replenished by two currency swaps from India and Bangladesh, a "line of Yuan credit" of US$ 150 billion with China and a SDR allocation of about US$ 780 million that is expected from the International Monetary Fund (IMF).

The currency swaps are a temporary cushioning of the reserves and have to be repaid. The Chinese credit line is useful to import from China. The IMF allocation is a grant.

The currency swap of US$ 500 million from India and US$ 250 from Bangladesh are short term facilities that appear uncertain. The Chinese Yuan loan is only useful to purchase goods from China.

Useful palliatives

Currency swaps, loans and other financial arrangements are palliatives rather than solutions Nevertheless, these are useful means of tiding over the current foreign currency crisis though not a solution to the problem.

Solution

The reduction of the trade deficit by stringent import controls is inadequate. Increased merchandise export earnings and enhanced earnings from services are essential to reduce the island's external financial vulnerability. Most of the expected funds are short term relief measures.

The plain truth is that the country has to earn foreign exchange by exports of goods and services in excess of funds spent on importing them. In brief, we must attempt to narrow the trade deficit and, if possible, achieve a balance of payments surplus as done in 2019, when the trade deficit of US$ eight billion was offset by earnings from services and capital inflows.

In 2020, in spite of stringent import controls that reduced imports and narrowed the trade deficit to US$ six billion, the balance of payments was in deficit by as much as US$ 2.3 billion.

Higher earnings

Increased remittances, higher earnings from ICT services and an increase in tourist earnings in the fourth quarter of this year are expected to enhance the reserves to an adequate level. The icing on the cake is the finding of several "high value" gems. They have been valued at US$ 100 to US$ 200 million rather than in the billions. The gems, though very valuable to finders, are not of much value to the nation's foreign reserves. Yet, in the dire situation we are in, like little drops of water, that fill the mighty ocean, they can add to our poor reserves. However, there are also reports that they are of low value. These inflows are expected to enhance the foreign reserves by the end of the year.

Past experience

The fact that the country has had only four or five years in which there was a trade surplus, is a clear indication of structural problems. The last trade surplus, albeit a small one, was 44 years ago in 1977 when it was achieved with stringent import controls, scarcities of essentials severe hardships to livelihoods and low economic growth.

Fundamental reason

The fundamental reason for the persistent trade deficits is the failure to increase exports while imports have increased substantially. Imports have been nearly twice the value of export earnings in many years. Even in 2020 when the trade deficit was brought down to only US$ six billion, imports were US$ Sixteen billion compared to exports of only US$ ten billion.

Trade balance in 2021

What are the prospects for the trade balance this year?

This year's trade deficit is likely to be much higher than last year's US$ six billion owing to increased imports despite stringent import controls and a fairly good export performance in the first half of the year.

Exports

The Export Development Board (EDB) disclosed export earnings in the first half of the year to be US$ 5.6 billion. It has projected merchandise exports to reach US$ 12 billion. Despite this, the trade deficit is expected to widen owing to much higher import expenditure.

Sri Lanka's merchandise exports of US$ 5.56 billion in the first half of this year was an increase of 27.5 percent over the first half of 2020 of US$ 4.36 billion. This improvement was achieved, despite the severe third wave of COVID-19, many restrictions and obstacles. The manufactured exports were responding to the gradual revival of international demand.

Imports

Paradoxically, the adverse impact on the balance of trade this year has been the increasing import expenditure in spite of restrictions on imports. The second half of this year is likely to witness a widening of the trade deficit owing to increasing import expenditure on food, fuel essential raw materials and reduced agricultural exports. Restrictions on fertiliser imports to counteract this, would aggravate the balance of trade by shortfalls in food production.

Balance of payments

In this context of a widening trade deficit, the earnings from services is of paramount importance, as in previous years. The pertinent question is whether worker's remittances, earnings from ICT services and net capital inflows would exceed the trade deficit to yield a balance of payments surplus.

Summary

The foreign reserves of US$ three billion at the end of last month is a dangerously low level as import requirements for the rest of the year are high. The expected currency swaps and IMF grant may help the country tide over the immediate difficulties. They are necessary palliatives in the current situation but not a solution to the fundamental disequilibrium in external finances.

Conclusion

The only viable solution to the external finances of the country is the reduction of the trade deficit by increased exports and achieving a balance of payments surplus through enhanced earnings from services.

For the full article – Refer The Sunday Times

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