Spotlight: Econ Op-eds in Summary

Week ended 06th May '20

In Summary

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

1. Economic implications of COVID-19
By: Dr. Sarath Rajapatirana

- The Sri Lankan economy was already in a weak position when the COVID-19 pandemic struck the economy. As such, we can expect a substantial economic impact of the spread of virus, both directly and indirectly, the latter being more important than the former.

- In such a condition, while the measures proposed are appropriate to address the short run situation created by COVID-19, especially on the consumption side, complete shut-downs of the economy can result in more longer-term impacts both economically and socially.

- As such, the country should now start focusing on policies which could support the economy in the long run. For this purpose, the government should make sure that its role is not overplayed and more price focused measures are used to manage the economy.

The initial conditions

When COVID-19 struck we were already in an economically weak position. Our GDP growth rate was 2.6% in the first half of 2019 with the impact of COVID-19, a recovery to our average growth rate (average for three decades of 4%) will be difficult to be achieved in the coming three to five years without substantial reforms and large inflows, particularly FDI.

- Earnings from tourism are substantially low after the 2019 Easter Sunday bombings. The immediate future for tourism does not look good.
- Our exports have not risen enough to help with the current account in the balance of payments.
- Meanwhile our foreign exchange reserves have remained low at around $ 7.0 bn including a part of borrowed funds.
- Finally, we have to meet large debt repayments around $ 16.0 bn in the coming four years 2020-2023.

Economic impact of COVID-19

We can expect a substantial economic impact of the spread of virus, both directly and indirectly, the latter being more important than the former.

Direct impact:

- to date labour is in virtual quarantine.
- Measures to prevent the spread of the virus will cost funds that have not been budgeted before. And,
- the relief measures will cost more.

The direct cost of the virus on the economy arises from the reduction in output given that production in all the sectors has virtually come to a full stop, only to increase in areas where the curfew has been withdrawn. But most workers are from the highly populous three areas of Colombo, Gampaha and Kalutara and are still in their homes.

In terms of national income – wages, profits and interest incomes will remain low in the near term. This makes for much needed policies for recovery. While we deal with the emergency, we have to think beyond the near term for proper policies. Measures taken for this emergency situation will have effects on the medium term and long term.

Government programs to mitigate impact of COVID-19

The Government has proposed a full list of relief measures. These include:

(a) Grace periods for the payment of income tax. And VAT, for driving licence renewals, paying water bills, and assessment of taxes less than Rs. 15,000, monthly credit card bills of less than 50,000 given and extension of until 30 April.

(b) Suspend leasing loan payments of three-wheelers for six months.

(c) No recovery of loan payments from Government and private sector employees until 30 May.

(d) Suspension of repayments of personal loans less than Rs. 1 mn.

(e) Rs. 20,000 allowance to be paid to graduates chosen to follow training.

(f) Agrahara insurance benefits for health workers involved in prevention activities and civil security personnel are to be doubled.

(g) Six-month debt moratorium to be granted to tourism and apparel SMEs.

(h) Bank of Ceylon, People's Bank, National Saving Bank, EPF and Employees Trust Fund are to jointly invest in Treasury bills and bonds to stabilize money market at 7% interest rate.

It is noteworthy that none of these measures are based on the price system. Most are based on directions, orders and quantitative measures.

Additional measures to provide relief include

(j) Maximum of 15% interest rate on credit card domestic transactions up to Rs. 50,000 and a 50% reduction in minimum monthly charges.

(k) All bank branches are to remain open during non-curfew hours.

(l) Ports, Customs and other regulatory bodies to issue essential food, fertiliser, pharmaceuticals and fuel to relevant individual continuously.

(m) Samurdhi beneficiaries and Samurdhi card holders be offered interest-free advances or Rs. 10,000 through Samurdhi Banks.

(n) Samurdhi Authority to issue title certificates to low income families immediately to issue nutritious food items.

(o) Exempting Sathosa and Cooperative Store from VAT and other taxes.

(p) A special account opened at BOC at the Presidential Fund to provide relief to health and social care. Rs. 100 mn allocated. Provide rice, dhal and salt on a weekly basis. Tax and foreign exchange restrictions waived for domestic and foreign donors to contribute to the fund.

Other countries like Chile have a system of income transfers based on detailed family and income data. A recent initiative by our Government to provide ration cards to those who are very poor and not recipients of Samurdhi will be helpful. But in the medium to long term we need to reform Samurdhi programme and target benefits to the deserving.

Meanwhile, the CBSL introducing import controls through credit restrictions which will create medium and long term distortions in the economy and lead to higher inflation. With these policies it signals a greater reliance on quantitative measures rather than use prices to manage the economy including a competitive exchange rate. When the price system is not used the quantities have to be allocated by an authority or a "czar" that breeds irrational allocations.

Conclusions

The measures proposed by the President are appropriate to address the short run situation created by COVID-19, especially on the consumption side. But complete shut-downs such as the closing of the private pharmacies is counterproductive to the maintenance of health standards of those who need daily doses of medicine like those who have diabetes, chronic heart disease and asthma. It was found feasible to relax control such as allowing private pharmacies to open.

However, since we are starting from an already weak initial conditions, the task is not easy. And, carries the danger of over-playing the hand of controlling the economy and extending the role of the Government in the economy. And, at times underplaying it, given that implementation of relief measure including income transfers depend heavily on the public service. It is not known to act efficiently and quickly.

Overplaying the hand of the Government carries with it the danger of bestowing additional and permanent power to the Government. We have seen the results of that experiment in the 1970-1977 period, with income ceilings, near 100% import controls restrictions on the transport of paddy. This overplaying of the hand of the Government led to disastrous results during that period. GDP growth rate fell, as did employment followed by a sharp reduction in living standards.

CBSL would do well to avoid direct quantitative measures to influence the volume of credit. It will reduce the flexibility of the economy to deal with the COVID-19 shock and signal its preference for quantitative measures including the management of reserves specially avoiding flexible and competitive exchange rates.

Direct measures could lead to a non-competitive economy, especially harmful for our export growth. Banning imports directly will create a bias against exports. We have to depend on incentive reforms to raise our GDP growth rate by raising productivity of the economy. What has been done in the short run may be necessary. But it is not sufficient to ensure medium- and long-term growth.

For the full article - Refer the Daily FT

2. Assessment of COVID-19 lockdown impact on household economy and an income-support package proposal
By: Harsha De Silva

- The nationwide lockdown as part of the containment measures for COVID-19 has resulted in severe economic implications for low income earners in Sri Lanka. This exacerbated a pre-existing situation where the bottom 50% of households found it difficult to make ends meet prior to the lockdown.

- The lockdown will also affect both demand and supply sides of the economy, with the impact varying by industry. Further, the reduction in income at the household level will be more than proportionate to the reduction in expenditure, necessitating income support to the most vulnerable segments. Given certain assumptions, the estimate of income support required could reach LKR 45.5 bn or USD 233 mn.

- This is well within the emergency facilities open to Sri Lanka through multilateral agencies, as well as debt concessions that may be open to Sri Lanka. However, the duration of the support is contingent on the economic recovery. Part of this amount can be financed by the government directly, while the balance can be via concessionary loans through the domestic financial system.

Many Sri Lankan households were in trouble before COVID-19 hit

Most families in Sri Lanka are struggling to make ends meet prior to COVID-19. What the pandemic has done is exacerbate the already difficult situation.

The latest available (2016) Household Income and Expenditure Survey (HIES) of the Department of Census and Statistics (DCS) indicates that 50% of households; that is the bottom five deciles earning up to an upper limit of Rs. 43,500 a month (in 2016) could not, on average, make ends meet with their regular income. For example, the lowest income decile was, on average, short almost by Rs. 10,000 a month (difference between mean expenditure of Rs. 19,561 and mean income Rs. 9,916) while the fifth decile, was on average short by about Rs. 1,000 a month. It is only the highest income decile who seem to have a significant amount left over after household expenses. And this is not surprising as the richest 20% enjoy 51% of total household income while the poorest 20% only gets 5%.

Households income and expenditure patterns and their indebtedness

Another important issue to be considered is the level of indebtedness of our household economy. According to the same study, 60% of Sri Lankan households were in debt; urban at 50, rural at 61 and estate at 73% respectively.

The 2019 CBSL Annual Report indicates overall increase in public sector salaries for the last two years was 4.9%, for private sector wages boards 3.5% and for informal private sector the increase was 19.4%. But expenses would have also increased inline.

In nominal terms, using consumer price inflation (CPI) for 2018 and 2019 would give us a sense of LKR figures that is meaningful in terms of calculating necessary relief measures. Assuming CPI at 5% for each year since mid-2017 we could adjust all figures by 15% to reflect nominal prices (income, expenditure, debt, etc.) to reflect the current mid-2020 situation.

Impact of the COVID-19 lockdown on households

First, consider the income side of the equation. According to the 4th Quarter Labour Force Survey of 2019 of the DCS, just over 8.2 m Sri Lankans were in employment; 2.2 m in agriculture, 2.2 m in industry and 3.8 m in services.

Another meaningful way to segment the labour force is that, of the 8.2 m employed only about three million receive a monthly salary while 2.6 m get remunerated based on the success of their self-employment venture, and 1.7 m are daily wage workers such as labourers, construction workers, daily domestic helpers and so on. Of the 8.2 m, 600,000 do not get paid.

Lockdown impacts both supply and demand

On the supply side, factories, hotels, shops and offices are closed due to lockdowns and self-employed and daily wage workers are unable to engage in their trade as markets are closed and transport is restricted. On the demand side people are at home so there are no customers, no tourists, no shoppers and no passengers.

During the lock down it is true that some market exchanges are taking place online with physical delivery offline; The extent of such activity has not been measured, but at the moment such would be marginal, in terms of the huge negative impact of the physical lock down. Valid questions are being raised with regard to the cost-benefit of the long lockdown.

The varying negative impact by type of employment and income

The only category that will not be impacted in terms of income are the 1.2 m State employees. Of the 1.8 m remaining monthly salary earners in the private sector, some in essential services particularly in health care would not be impacted. It is likely that most others would have some negative impact on their monthly earnings; ranging from a very heavy toll in tourism related jobs to marginal toll in strong financial institutions.

The impact on the 220,000 business owners who employ others will be relative to exposure to the worst affected to least affected sectors they are operating in. Similarly for small entrepreneurs and the self-employed. But given the large number of persons who are self-employed; 2.6 m, the impact on the household economy would be severe.

In the short term, the most significant negative impact will be on daily wage earners. These are the 1.7 m men and women who are suddenly without any income.

The impact on expenditure

Food expenditure will vary in terms of income; low income homes will spend on essentials that cannot be reduced or substituted while high income homes will have the option to reduce and substitute.

The biggest non-food component of rent or mortgage payment will be fixed and so will be the loan or lease repayment to finance companies or banks unless enjoying a moratorium. Other fixed expenses will remain; such as healthcare. Expenses on transport will fall but communication will rise with the higher usage of data. Expenses on durables, as well as on personal care products, clothes and lifestyle and other impulse products and services will reduce.

The reduction in expenditure will not be directly correlated to income. So, for most households the reduction in expenditure will be far less than the reduction in income; this will be particularly true for the low-income homes.

Monetary value of the loss to households

Given certain assumptions on non-monetary income at the national level and reduction in expenditure (that can change with more updated data), if approximately 525,000 families are assumed for each household decile the total amount to be given out as income-support to all needy households will be Rs. 45.5 Bn.

If adjusted for inflation the amount would be Rs. 52,325 Mn. However, the actual amount will vary based on how much of this amount may be granted and for how many months same is provided. The duration of support cannot be estimated with the available data and will depend on how long the lockdown will remain and what the rate of normalisation will be. That will become clear in the coming days.

A comparison of the proposed income-support package in terms of Government revenue and expenditure

In terms of share of revenue of the Government for 2019, Rs. 45.5 Bn. is 2.6% of 2019 tax revenue of Rs. 1,735 m. From an expenditure perspective, Rs. 45.5 Bn. works out to 1.6% of the total recurrent and capital expenditure amounting to Rs. 2,932 Bn. or 2.0% of the recurrent amount for 2019 which was Rs. 2,301 Bn. Looked at it in another way, Rs. 45 b is 6.6% of the total salary bill of the public sector in 2019 amounting to Rs. 686 Bn.

At the current exchange rate this amount is roughly USD 233 Mn. and well within the expected USD 800 Mn. from IMF's Rapid Credit Facility for COVID-19 budgetary support or the USD 300 Mn. ADB budgetary support loan, both of which are to be at concessional terms. The World Bank has already granted a long-term soft loan of USD 128 Mn. specifically for COVID-19 related expenditure. In addition, G20 nations have called for debt suspension for low income countries and even though Sri Lanka has graduated, but yet in transition, the Government could also utilise part of the expected USD 1,200 Mn that would be saved in 2020.

It is the responsibility of the Government to find the best option

Part of this amount, say for daily wage workers and some amount of micro-scale self-employed persons could be direct income-support by the Government. The rest of the self-employed entrepreneurs, can be financed via the commercial banking system as long-term concessionary finance guaranteed to some extent by the Government. In terms of delivery of the income-support package, the direct Government support should be almost immediate and could be handed out in either weekly or by-weekly instalments whereas the other component could be a monthly program.

For the full article – Refer the Daily FT