Spotlight: Econ Op-eds in Summary

Week ended 03rd November '21

In Summary

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

1. Food shortages soaring prices and lack of fertilisers threaten livelihoods By Nimal Sanderatne

- The country's economic problems have been worsening during the course of the year, with foreign reserves falling drastically, while the continuing widening of the trade deficit and deterioration of the balance of payments, threatening a further depletion of the foreign currency reserves.
- Rising import expenditure is expected to be a severe burden in 2022 owing to higher imports of food, fuel and other essentials whose international prices are increasing, as domestic food production reduces due to ill-advised policy decisions, which are now being reversed rightfully, following a social upheaval.
- Most of the economic difficulties Sri Lanka faces today is a result of structural weakness in the economy, and adoption of ill-advised macroeconomic policies. Thus, drastic economic reforms and international financial assistance is required for the recovery of the economy from its current status.

Sri Lanka's battered economy is facing several social and political upheavals that have been brought about by

- the deteriorating economic conditions,
- ill-advised economic policies,
- the mismanagement of the economy and,
- the unscientific and impractical policy to suddenly switch to organic agriculture.

Food shortages soaring prices and lack of fertilisers threaten livelihoods, while foreign reserves decrease to critical levels. These problems are likely to intensify in the next two months and in 2022.

Reasons

While the economic difficulties, especially the severe foreign currency difficulties, are underlying reasons for the shortages and price hikes of food and essentials, the mismanagement of the economy by inappropriate and faulty monetary, fiscal, trade and exchange rate management policies have aggravated these problems.

Organic agriculture

The sudden switch to organic fertilisers has threatened crop production and the livelihoods of farmers and caused mass protests country-wide. The inevitable reduction in crop production would strain the external finances further owing to increased imports of food and reduced tea and rubber exports.

Not only COVID

Many have attributed the economic crisis to COVID. The attribution of the economic crisis, especially the external financial crunch, to COVID is only partially correct. It is only correct to the extent that there was additional expenditure on COVID, a disruption in export manufacturing for a few months and a halt to tourism.

Tourist earnings

Undoubtedly, tourism that was expected to revive had another severe setback owing to the global pandemic. Tourist earnings of US$ 4 Bn in 2018, before the Easter Sunday bombings in April 2019, were severely disrupted by the global spread of the COVID pandemic. The second wave of COVID in the country and international restrictions on travel denied the country a significant inflow of foreign currency as earnings from tourism dried up to a negligible amount in 2020 and 2021.

Benefits

In contrast, there were other compensatory benefits. The rock bottom petroleum prices (US$ 30 per barrel) reduced import expenditure and decreased the trade deficit to only US$ 6 Bn. The expected reduction in exports was for only a couple of months. After a brief setback, manufactured exports bounced back to pre-COVID proportion by a diversification of export items.

In fact, one silver lining amidst the dark and gloomy economic scenario has been the growth in manufactured exports to around US$ 1 Bn a month.

It is therefore clear that COVID was not the villain of our economic problems. Paradoxically, it is the post-COVID global economic recovery that is increasing our import costs and widening the trade deficit.

Faulty policies

The economic difficulties and the consequent social upheavals have been brought about by the adoption of ill-advised macroeconomic and unscientific policies. The pursuance of so called alternate economic policies that were a disaster in 1970-77 and the New Monetary Theory (NMT) has been reasons for the accentuation of the country's economic plight.

Social upheaval

The unscientific and hasty introduction of an unrealistic organic agriculture has unleashed mammoth protests by the rural community that is a huge political set back to the Government. The modification or reversal of this policy in response to these protests is increasingly evident. In addition, organic 2ertilizer imports from China have led to controversies and even some diplomatic displeasure with China.

Reversal

We are currently witnessing the reversal of the decision to convert the country's entire agriculture to organic cultivation in various disguises and face saving rhetoric. Though late, it is a move in the right direction. However, the disruption of agriculture by the lack of fertiliser and agrochemicals will be inevitable in the first half of the year. Hopefully there would be a revival in agricultural output later next year with the availability of fertilisers, pesticides and fungicides.

Recapitulation

The country's economic problems have been worsening during the course of the year. Foreign reserves that were US$ 4.5 Bn at the beginning of the year have fallen below US$ 2.5 Bn. The continuing widening of the trade deficit and deterioration of the balance of payments implies a further depletion of the foreign currency reserves.

Import expenditure is likely to increase owing to higher imports of food, fuel and other essentials whose international prices are increasing. The escalating international prices and higher import requirements owing to lower domestic food production will be a severe burden in 2022.

The plea by the government that the economic difficulties were owing to the global COVID pandemic is incorrect. Most of the economic difficulties were due to structural weakness in the economy, and adoption of ill-advised macroeconomic and unscientific policies. The prime example of this is the attempt to switch to organic fertiliser. This has increased import needs and reduced agricultural export earnings next year. These adverse impacts will be revealed much more during the course of next year when the trade deficit will widen further.

Conclusion

The economic recovery of the country can be achieved only by drastic reforms and international financial assistance. The stubborn resistance to make drastic changes in economic policies will only lead to further deterioration of economic and social conditions. The road ahead is wrought with more problems and economic hardships.

For the full article – Refer The Sunday Times

2. Continuation of GSP+ vital to maintain export momentum
By Economic Intelligence Unit, Ceylon Chamber of Commerce

- EU is Sri Lanka's largest export market, where Sri Lanka had been benefiting from the lower tariffs under the GSP+ scheme offered by the region for many years. The European Parliament recently adopted a resolution requesting the European Commission to temporarily stop providing this benefit to Sri Lanka.

- Such loss of the GSP+ privileges could significantly impact key export industries such as apparel, processed food products, seafood, toys and porcelain. It is evident from the situation these export sectors faced following a similar withdrawal in 2010, where competitors such as Vietnam, Cambodia and Pakistan were able to increase their exports to EU significantly while Sri Lanka's exports loss its market share.

- Thus, it is in the best interest of these sectors as well as the Sri Lankan economy as a whole that the key stakeholders negotiate with the European Commission in order to keep Sri Lanka from loosing its competitiveness in both the EU market and possibly the UK market.

What is EU GSP?

The Generalized System of Preference schemes of the European Union (EU GSP scheme) is a unilateral trade arrangement implemented by the EU where developing countries are allowed to pay less or no duties on their exports to the EU. EU GSP has been in operation for over 50 years since its introduction in 1971 (born out of the UN Conference on Trade and Development (UNCTAD)'s request for developed countries to help developing countries integrate into the world economy). There are three main variants (arrangements) of the EU GSP scheme;

- Standard (General) GSP: for low and lower-middle income countries. This means a partial or full removal of customs duties on two third of tariff lines.

- Special Incentive Arrangement for Sustainable Development and Good Governance, GSP Plus (GSP+): It slashes these same tariffs to 0% for vulnerable low and lower-middle income countries that implement 27 international conventions related to human rights, labour rights, protection of the environment and good governance.

- Everything but Arms (EBA): The special arrangement for least developed countries (LDCs), providing them with duty-free, quota-free access for all products except arms and ammunition.

GSP+ therefore offers incentives in the form of duty reductions on exports as a reward to developing countries for their commitment to upholding the 27 core international conventions on human and labour rights, sustainable development and good governance. In addition, the country must also be considered 'vulnerable' under two conditions;

- the country is not competitive in the EU market (the import-share ratio is less than 6.5% of EU's total GSP imports) and

- the country does not have a diversified export base (seven products account for over 75% of that country's total GSP imports to EU).

Eligible country exports to EU under the EU GSP scheme must also be compliant with the Rules of Origin (RoO) criteria (as set out in the GSP scheme) in order to be eligible for the tariff reduction. There are currently eight GSP Plus beneficiaries in the EU GSP scheme- Sri Lanka, Armenia, Bolivia, Cape Verde, Kyrgyzstan, Mongolia, Pakistan, and the Philippines.

Why is GSP+ scheme important for Sri Lanka?

EU is Sri Lanka's largest export market accounting for US$ 3.1 Bn and a share of 31.6% of total exports. EU is also the largest market for Sri Lanka's leading export product, apparel, accounting for 42% of Sri Lanka's apparel exports (two-year average: 2019 and 2020.). Sri Lanka's export trade with the EU improved significantly from US$ 1.76 Bn in 2004 to a peak of US$ 3.56 Bn in 2011.

Export performance since then has been below the US$ 3.45 Bn mark struggling to reach the level attained in 2011 due to withdrawal of the GSP+ facility in 2010 and ban on fisheries exports in 2015. In the first eight months of 2021, export to EU including UK has increased by 26% compared to the same period in 2020 in line with the overall export growth of 23%.

Sri Lanka's GSP+ benefits were temporarily withdrawn in August 2010 due to non-effective implementation of certain human rights conventions. As a result, Sri Lanka operated under the GSP scheme for little over a six-year period, until the GSP+ facility was regained in May 2017.

Regaining GSP+ was an important victory for the country, as at that time Sri Lankan exports have been performing poorly. During 2015 and 2016, exports declined year-on-year for 17 months straight (March 2015 to July 2016). The additional tariff advantage greatly strengthened Sri Lankan exports' relative competitive position in the EU.

Sectors like apparels, processed food products, seafood, toy products, porcelain and ceramic ware, are some of the main sectors that benefited under GSP+. The additional tariff concession gained by these sectors varied; in many

- apparel categories duties are cut from 9.6% to zero,
- seafood sector from 18.5% to zero,
- fresh and processed fruits and vegetable sector from 12.5% to zero
- porcelain and ceramic ware sector from 8.4% to zero
- toy products sector from 1.2% to zero.

While it is difficult to provide a full analysis of what was lost due to withdrawal of GSP+ in 2010, looking at how Sri Lanka's competitors fared in the EU market, provides a perspective on how Sri Lanka lost out to Asian apparel exporters.

According to the International Trade Centre, Vietnam, Pakistan and Cambodia all trailed Sri Lanka in 2009, with EU exports at US$ 2.1 Bn, US$ 1.5 Bn and US$ 1.09 Bn respectively, against Sri Lanka's US$ 2.3 Bn. By 2015, however, Vietnam's apparel exports to the EU had risen to US$ 3.9 Bn, Pakistan's to US$ 2.9 Bn and Cambodia's to US$ 3.7 Bn, with Sri Lanka trailing at US$ 2.4 Bn. Apparel, ceramic, porcelain, crafts, gem and jewelry are some products which lost market grip as a result of the withdrawal of GSP+ in 2010.

Further the EU GSP also provides an opportunity to engage in regional cumulation to gain advantage of Rules of Origin. Regional cumulation encourages regional co-operation amongst those countries which are both GSP beneficiaries and members of a regional grouping recognized by the EU. Inputs from other countries are considered as originating in the exporting country. There are two main types of regional cumulation that can benefit Sri Lanka:

SAARC Regional Cumulation

SAARC was recognized by EU with effect from 31st October 2000 as a regional grouping to enjoy the benefits of regional cumulation of origin. For example, fabric imported from a SAARC country doesn't have to go through the double transformation process.'

Cross Regional Cumulation – between SAARC and ASEAN

Source material from any ASEAN county and export to EU under GSP subject to a condition that the two cumulating countries produce a joint statement to the EU that they agree to comply to EUs reporting requirements under ROO criteria which will then be accepted and gazette by the EU. For e.g. Source unprocessed tobacco from Indonesia and manufacture cigarette products to be exported to the EU member countries. The normal duty rates applicable for this product category is about 29% and can be brought down to about 8%-9% by making use of these facilities. Non-compliance with ROOs will be dealt with seriously as the EU follows a strict monitoring procedure on compliance to prevent anti-dumping. There has been an instance where bicycles imported from China has been re-assembled in Sri Lanka and re-exported to EU under GSP scheme to avoid 48.5% anti-dumping duty applicable.

Although Sri Lanka has applied for Regional cumulation with countries such as South Korea and Indonesia, there has not been much progress achieved.

The European Parliament Resolution:

The European Parliament Resolution on the situation in Sri Lanka, in particular the arrests under the Prevention of Terrorism Act (2021/2748 (RSP) [Based on details published in the European Parliament website]:

- European Parliament resolution of 10 June 2021 on the situation in Sri Lanka relates to the arrests under the Prevention of Terrorism Act.
- Sri Lanka regained access to generous EU tariff preferences under the GSP+ on 19 May 2017, on the condition that it replaces the PTA and effectively implements 27 international conventions, including on human rights. They call on the Sri Lankan authorities to fulfil their pledge to review and repeal the Act and replace it with anti-terrorism legislation which follows international best practices.
- Members are therefore calling on the European Commission and the European External Action Service to use the GSP+ as a leverage to push for progress on Sri Lanka's human rights obligations. They also want them to carefully assess whether there is sufficient reason, as a last resort, to initiate a procedure for the temporary withdrawal of Sri Lanka's GSP+ status.

Way forward

Based on consultation with key stakeholders, the following key recommendations are made in terms of way forward:

- It is important for policymakers and firms to speak with one voice as divergent statements/views may send mixed signals.
- It is important to continuously engage with the European Commission to understand what possible action can be taken in order to stretch out the period by which a temporary suspension might be implemented in a worst case scenario.
- Under the Withdrawal mechanism of the GSP Regulation, 'Serious and systematic violation of principles laid down in the main human rights and labour rights conventions listed in the GSP Regulation' is a key reason for cancellation of the scheme. Therefore, it is important to study the process and understand the time period involved for such a decision to become fully effective. Presently there are few countries like Cambodia and Pakistan facing similar issues which may provide insights into how this can be handled best at a diplomatic level.
- There is potential for UK to adopt a similar resolution given that the UK mirrors the EU GSP Scheme. Therefore, it is important that the Sri Lankan exports sector use the GSP Plus period as 'breathing space' rather than a 'comfort zone'. Sri Lanka was given a narrow time window to boost competitiveness of our exports to the EU and not be complacent as the country fast approaches 'Upper Middle Income' status (have achieved it once already) and will thereafter not be eligible for GSP Plus or GSP, if the position is maintained for three consecutive years. Therefore, building export success beyond the concessionary scheme is crucial in the long run.

For the full article – Refer Daily FT