Spotlight: Econ Op-eds in Summary

Week ended 21st July '21

In Summary

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

1. Warning signs for Sri Lanka's IT-BPM sector
By: Professor Rohan Samarajiva

- Sri Lanka is currently at risk of losing its competitiveness against other South Asian countries in the IT-BPM sector. The silver lining in this case, is that the sector is less vulnerable to policy mismanagement unlike in the case of agricultural or manufacturing industries and stands to benefit from high-value exports for the country if corrective action is taken.

- The AT Kerney's GLSI index ranks Sri Lanka in the top 25 South Asian countries in the IT-BPM sector. This ranking is strongly supported by its cost competitive advantages against regional peers, although it ranks below Bangladesh in terms of people availability and skills. This is partially attributable to the smaller labour force the country possesses, which has deterred the upscaling of the sector and resulted in investments being redirected to other countries.

- A proposal to rebalance AT Kerney's GLSI index to include a higher weight on digital resonance, if passed, could lead to Sri Lanka plummeting in rank and no longer being considered in the Top 25 Asian countries. Policies which were promised to be implemented a decade ago were unfruitful, and unless strong corrective measures are undertaken, the country will not be able to achieve the $5 bn IT-BPM exports mark.

Although the National Export Strategy identifies the IT-BPM sector as a key industry, progress on improving the sector has been limited, as it lacks a skilled labour force in the field to help upscale the sector.

It was 11 years ago that I wrote a column entitled 'Sri Lanka's ITES: The problem is people' and pointed out that the sector suffered from problems of quantity and quality affecting its critical input. Preparing for a discussion on what we should ask from our tertiary education institutions, I revisited the sources used in that article. It was not a happy picture. Not only had we not made progress, but we are also in danger of falling back.

Software and business process outsourcing are not top of mind these days. Food security and end of Ceylon Tea are. But we should focus on software, knowledge process outsourcing, and associated activities. Banning fertiliser and vehicle imports are temporary patches to the core problem that is besetting Sri Lanka: we do not export enough; our exports are not diversified enough and of high added value.

Exports that rely less on imports

The Government's misguided import restrictions are likely to harm many of our exports. Restrictions or permit-based imports of critical inputs such as fertiliser, weedicides, and insecticides are likely to kill or maim the fast-growing fruit, vegetable and foliage export sectors. Enough has been said about tea.

The textile and garment sector which pulled in $4.4 bn even in the plague year of 2020 and is the largest contributor to exports (44%), is also among the largest importers. In 2020, this sector was responsible for 14.5% of all imports. Add friction to the import process, exports will suffer.

The software and associated industries (described by various acronyms, but let's settle for IT-BPM) require very few imported inputs. It is true that they cannot function without computers and the ability to use cloud service for certain SaaS applications, etc., but they are less vulnerable to changes in government policy than many conventional manufacturing or agricultural industries.

Given the difficulty of reversing the current drift toward disaster, it may be wise to promote exports that are relatively insulated from government policy mismanagement. The IT-BPM sector which has been identified as a priority sector by the National Export Strategy is an obvious candidate. Even that epitome of self-reliance, North Korea, exports coal to China so it can import fuel for the motorcades of the leadership.

The problem is people

The biggest and most critical input for the IT-BPM sector is people. The Global Services Location Index (GSLI) published annually by AT Kearney is a key source of information used by those entering into contracts for services. As Sri Lanka was rising in the rankings, the ICT Agency relied heavily on the Index to talk up Sri Lanka's attractiveness as a place to do business in. Therefore, it is reasonable to examine how Sri Lanka would be perceived by a user of AT Kearney's index.

The good news is that GSLI 2021 includes Sri Lanka in the Top 25. The bad news comes layered. The old bad news and the new. Let's start with the old bad news identified in 2011.

The GSLI ranks 60 countries. Theoretically, service supply can take place anywhere. But let us compare Sri Lanka only to its South and South East Asian peers.

On the key resource of people skills and availability, Sri Lanka is last among its peers, behind even Bangladesh and Pakistan. When I last wrote on this subject, Bangladesh was not even included in the GSLI.

The problematic component in the index includes both quality and quantity. For those who prefer not to look hard truth in the eye, this leaves a possible escape path. Sri Lanka's work force has the skills but being a small country, there just aren't enough people to hire.

It cannot be denied that there is a quantity problem. I have heard enough cases of investment going elsewhere, because Sri Lankan operations have trouble scaling up. Perhaps the pensionable jobs in Government are a part of the problem. Malaysia does not have that big a population, but it does way better on people skills and availability.

But the gap suggests that quality is also a major contributor to our poor performance (more will be said on this below).

Why is Sri Lanka still in the Top 25?

Sri Lanka is still an attractive location for supply of services because it's cheap. Among its South and South East Asian peers, it has the highest score for financial attractiveness. Malaysia and Thailand are ranked third and 10th, despite their financial unattractiveness. Sri Lanka is hanging in almost solely because of its financial attractiveness.

When we were working to attract BPO business to Sri Lanka in 2002-'04, a major concern was that Colombo salaries were unlikely to be competitive with the established locations in Andhra Pradesh, Karnataka and Tamil Nadu. Appears we worried needlessly. In 2009, we were equal to India in financial attractiveness; Philippines was cheaper. While everyone else was raising their prices (and compensating their staff better, one hopes), Sri Lankan companies kept their prices down. As with tourism, Sri Lankan IT-BPM competes on price, not value.

What does the future hold?

International organisations and companies that produce composite indexes for all sorts of things ranging for innovation to ease of doing business, keep tweaking their indicators and weights. This is especially important in rapidly changing fields such as information and communication technology business.

AT Kearney had introduced a new component worth 10% called digital resonance to reflect strengths in digital skills of the labour force, digital outputs, the amount of corporate activity, legal protections of intellectual property, and other elements of business activity. It is their considered judgment that these elements are becoming more important than the old considerations of low costs. They are proposing to increase the weight given to digital resonance from 10% to 60%.

When this is done, the rankings change dramatically. The United States and the United Kingdom displace India and China from first and second places. China drops down only two places to be fourth. India, on the other hand, drops 10 places. Singapore, which was not even in the Top 25, moves up 35 places to occupy third place after the US and UK. Malaysia and Indonesia suffer grievous declines but hang on in the Top 25. And Sri Lanka, which owed its place in the Top 25 to cheapness, drops down into oblivion.

Collectively, we failed to take the necessary remedial actions to the people problems identified a decade ago. Talk about our high literacy and the elegance of the software written by the graduates of the top programs will not take us to $ 5 billion in IT-BPM exports. Unless hard truths are faced and radical remedies are adopted, this too could be another bus we missed.

For the full article – Refer Daily FT

2. How will the economic crisis be resolved?
By Nimal Sanderatne

- The country is at a crucial point with an escalating economic crisis as well as widespread social upheavals. The severe crisis related to external finances, foreign debt repayments and import requirements are decreasing external reserves significantly, adding on to the economic crisis.

- Sri Lanka's fiscal deficit is also widening due to government expenditure on containing Covid. Despite import restrictions, imports are on the rise. However, exports have been satisfactory so far. But external risks lie with work disruptions and risk of losing GSP plus. Lack of fertilizer too threaten a decrease in tea exports.

- Public expects Sri Lanka to go to the IMF. However, seeking assistance from IMF or reversing the ban on fertilizer could be controversial in certain public context. But in the long run government will surely have to focus on more sustainable solutions.

The country is in a multiplicity of inter-related and intertwined crises and widespread social upheavals. Apart from solutions to the specific grievances, drastic changes in economic policies are required to ensure financial and economic stability.

Social unrest

Protests and social upheavals due to severe economic difficulties, unavailability of fertiliser, protests against the charging of fees at the Sir John Kotelawala Defence University and arrests of protestors confront the Government.

Political crises

In addition, a political crisis has been brewing within the ruling coalition and within and among the opposition. These have been amply covered by the media for several weeks. The course that these political developments will take is at present as clear as mud. Whatever direction the political developments take, they will have to be drastic, pragmatic and effective. Otherwise, the country would face an economic catastrophe.

Economic crises

The economic crises facing the country are multi-dimensional. The country is heading towards a severe crisis in external finances. External reserves are perilously low and foreign debt repayments and import requirements are eroding them further.

Farmer incomes are dwindling and consumer prices are rising. Poverty, unemployment and hunger are increasing and weak public finances are limiting the capacity of the Government to even implement its policies to alleviate the escalating poverty by providing income support.

Foreign reserves

The depletion of the foreign reserves to as low as US$ four billion at the end of June with the imminent servicing of the foreign debt of around US$ 1.5 billion in a few days' time, is of immediate concern. The widening of the trade deficit owing to increasing import expenditure is a further threat to the reserves.

Public finances

The parlous state of the public finances with the fiscal deficit rising to an unprecedented 11 percent of GDP, while government expenditure on containing COVID is increasing is destabilizing the economy. Furthermore, the inadequacy of interventions to reduce the plight of the increasing unemployed and destitute are serious economic problems facing the Government.

Increased imports

Despite stringent import restrictions, imports have increased this year. Food and fuel imports have increased and are likely to increase further later this year. Consequently, the trade deficit would widen to much above last year's US$ six billion. One could project it to be around US$ seven to eight billion this year. Consequently, the balance of payments deficit at the end of the year will further erode the foreign reserves.

Imports

Fuel imports are likely to increase sharply owing to escalating international prices from about US$ 45 per barrel to about US$ 70. The recent increases in consumer fuel prices will not reduce fuel imports by much as the demand for these are inelastic. A large consumption of fuel is for thermal generation of electricity and public bus and rail transport.

However, the increase in consumer prices of petroleum products would have a bearing on public finances. The public expectation of a reduction in fuel prices, if implemented, will weaken the public finances further, but have little impact on fuel imports.

Food imports

Food import expenditure is increasing due to international prices of grains increasing. Poor harvests of paddy in Yala this year have compounded the problem necessitating increased imports of rice. If the Maha 2021/22 suffers the same fate, then larger rice imports would be needed.

Exports

Export performance has been fairly satisfactory. In the first half of the year export earnings have been better than of last year. On this basis, one could expect export earnings of about US$ 11 billion for this year.

The downside risks to exports is dislocation of manufacturing owing to work disruption by the spread of COVID, the non-availability of raw materials and the threat of losing the GSP plus status in the EU market and similar trade restrictions by the UK and Canada.

Tea exports

Another likely setback is to tea exports. There could be a sharp decline in tea exports as tea production, especially among tea smallholders, who account for about 75 percent of exports of US$ 1.2 billion. Their tea production is threatened by the unavailability of fertiliser. The resolution of this problem is imperative. Chemical fertilisers, weedicides and insecticides should be permitted for tea cultivation.

Debt repayment

The fears that the Government would not be able to meet its debt repayment obligations of US$ 1.5 billion this month, is unfounded. Its reserves of US$ four billion can meet this obligation. There are expectations of a further swap from India of US$ 1.5 billion, an agreed swap of US$ 250 million from Bangladesh and the IMF grant of SDRs of approximately US$ 780 million expected in August.

The Chinese currency swap of Yuan amounting to about US$ 1.5 million, though not part of the reserves, could be used to pay for Chinese imports. This is an important strength to the balance of payments as China is one of Sri Lanka's main importing countries.

Turning point

These economic conditions have a significant bearing on the political crises and social upheavals. There is considerable uncertainty on what policies the Government would pursue to resolve the country's formidable economic problems. Will the undefined 'alternate economic strategies' take us further and further into an abyss or will the economy be rescued by international assistance?

Radical change

The question uppermost in the minds of most people is whether the appointment of Mr. Basil Rajapaksa as Finance Minister would bring about a radical change in policies that could save the country from the several economic crises facing the country.

There are strong indications that the new Finance Minister would change course and turn to the IMF to rescue the economy. Can the new Finance Minister reverse several key policies to diffuse the widespread demonstrations and protests against many discontents and strengthen the economy with foreign assistance?

Conclusion

The island is in the midst of multidimensional crises. The Government's priority would no doubt be to diffuse the widespread protests in the country. This may well be the priority of the new Finance Minister. However, reversing the President's decision to ban fertiliser, which caused turmoil among the large farming population, will be a severe setback to the President's policy. Similarly, turning to the IMF, which is the most viable solution, too would be a severe affront to him and his economic advisors.

It is not certain whether the new minister is contemplating such policy reversals. Nor is there an indication of what policies he would quell amid the protests and opposition to the Government. Any changes in policies must be aimed at not only dampening protests but bringing relief to people's livelihoods that have been threatened.

Pursuing economic policies that resolve the political and social upheavals, but aggravate the economic conditions, is not feasible in the state of the economy. Conversely, resolving the economic crisis is a prerequisite to addressing several of the other economic and social deprivations.

Final word

The Government will be able to tide over the immediate foreign debt problem, but the resolution of the perilous state of international reserves can only be resolved with a more sustainable solution. Will the Government take a U turn in policy and turn to the IMF to stabilise the economy?

For full article – Refer the Sunday Times