# Spotlight: Econ Op-eds in Summary

Week ended 7th July '21

## In Summary

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

**1. Forex crisis, plea for calmness in national interest, and need for getting IMF-driven bailout**
**By: Dr. W.A Wijewardena**

- The Central Bank Governor recently reiterated the government's ability to pay off it's foreign debt obligations in the coming years, dismissing negative claims made by media outlets. According to the governor, the Central Bank is in discussion with bilateral partners to obtain additional funding while awaiting the disbursement of IMFs SDR allocations in order to reduce pressure on foreign reserves. The statement also showed reluctance to obtain financing facilities from the IMF.

- Sri Lanka had had to be bailed out by the IMF on numerous occasions, the first of it being in 1988, when reserves fell to critically low levels. In 2008, Sri Lanka went to the IMF yet again, as additional foreign currency was needed to repay off weapons being used in the war. To deal with this, roadshows were conducted to try to attract additional funding given low foreign reserves, however, this option did not prove to be successful.

- The government's current strategy of Modern Monetary Theory has resulted in speculation on the exchange rate, increasing pressure for depreciation, with the Monetary Board being responsible in preventing such instability in the currency. The current dismal economic situation is nothing new for the country, having experienced it in the past. But these past experiences should serve as a learning experience to prevent a calamity from occurring.

**Plea for calmness in national interest**

In the wake of Sri Lanka's foreign exchange crisis graduating from 'acute' to 'severely acute', the Central Bank Governor Deshamanya Professor W.D. Lakshman has appealed for calmness which everyone should do in his view in national interest.

Reiterating the Government's commitment to meet all foreign exchange liabilities on time, he has blamed the speculators, political elements, and the media for the current mishap: "We have also observed that some segments of the Sri Lankan community motivated by political reasons have continued to fuel adverse speculation about the future path of the exchange rate and the ability of the Government to service its obligations. Such self-serving speculations are unwarranted and are harmful to the general public as well as to the business community themselves.

"These speculative comments have naturally created some unnecessary short-term imbalance in the foreign exchange market between inflows and outflows. However, it must be noted that the Government and the Central Bank have ensured that trade is not unduly disrupted, and intermediate and capital goods imports are given priority in the process of imports. Total import values have remained considerably high at a monthly average of $ 1.7 billion during March, April and May 2021. High import values in these months show that importers, particularly of essential goods, have not been overly inconvenienced as the published media reports claim."

**Practice of blaming others for the mishaps in the economy**

This is not the first time Governor Lakshman has blamed market participants for the continuous downturn in the economy. Calling critics as purveyors of doom and gloom who do not understand the alternative economic policy being pursued by the Government of President Gotabaya Rajapaksa, he had confidently said that the Government had the economy well in hand. The fallacy in his charge was presented by this writer in an article in this series.

**Market going in panic mode defies CB fixed rates**

After his plea for calmness, the market became chaotic and panicked. When commercial banks had failed to meet the customers' demand for foreign currency at the exchange rates announced by the Central Bank, a parallel curb market had sprung up to fill the vacuum. The exchange rate announced by the Central Bank was Rs. 202 per US dollar. But in the curb market it went up to Rs. 215 to 220 per US dollar defying the intention of the Bank to maintain the rate at the low level.

A day later, it is reported that it has fallen to Rs. 225 to 226 level and still there are no sellers dollars in the black market at those rates. Markets do not act in national interest as Governor Lakshman has wished. They would act in collective market interest wiping out losses and gains and eventually reaching a new market position which economists call 'market equilibrium'. The role of the Central Bank is to facilitate this process by conducting prudent policies. Hence, plea for acting in national interest cannot substitute prudent policy stances.

**Crisis is not unexpected**

The present severely acute crisis was not totally unanticipated. It was a gradual deterioration from around 2013 and independent economic analysts had warned the governments in power about its dire consequences. This writer in an article in this series warned the new President Gotabaya Rajapaksa about the impending external sector crisis as follows: "As revealed by the Central Bank statistics, in the next 12-month period, the total foreign debt servicing commitments comprising both the repayment of the principal and the payment of interest will amount to $ 6 billion. This is made up of the Government's commitments amounting to $ 4.8 billion and those of the private sector by about $ 1.2 billion.

"The country's liquid foreign exchange balances after taking out the illiquid gold reserves at end-November 2019 had been some $ 6.5 billion and if it is used for debt payments, its foreign exchange reserves would fall to a critically low level. Thus, Gota's problem is slightly different from those of the private sector borrowers."

"The latter may be having rupee funds to meet its commitments and its problem is lack dollars in the country. Gota's problem is that he has neither rupees nor dollars to do so. Hence, he has no alternative but to borrow abroad to fill his coffers and use those proceeds to repay his loan commitments. This strategy, known as loan recycling and used by all the previous successive governments, would provide only a temporary solution to the country. It adds to Gota's, woes and, if continued unabated, those of any future administration to come to power as well".

**Money printing by following MMT philosophy**

However, instead of heeding to this warning, the Government and the Central Bank continued with the adoption of the prescribed by a breakaway economic school calling itself Modern Monetary Theorists. In terms of this policy stance, there is nothing wrong in financing the Government budget by getting the banking sector to create new money, known as money printing in common parlance, because that new money by increasing the total demand in the economy will pave way for economic prosperity.

Accordingly, the total money stock in the country which the Central Bank defines as M2b increased during December 2019 and May 2021 by Rs. 2,409 billion or 32% from Rs. 7,624 billion to Rs. 10,033 billion. The Government's borrowing from the banking sector during this period exceeded this growth and it amounted to Rs. 2,683 billion. This number was made up of Rs. 693 billion by the Central Bank and Rs. 1,993 billion by commercial banks. Hence, the Government was wholly responsible for the total money creation in the economy during this period. This is Modern Monetary Theory at work.

**Stabilising the exchange rate through arm-twisting methods**

Now there is no escape and this excessive creation of money has caused the country's foreign reserves to fall putting pressure on the exchange rate to depreciate in the market. The Central Bank on its side sought to hold on to the exchange rate by supplying dollars from the country's foreign reserves to the market. When this was no longer possible, it tried to adopt an unconventional tactic that could be called 'immoral suasion' or arm-twisting of the forex dealers in commercial banks.

Accordingly, banks had to keep their selling rate of dollars at Rs. 202 per US dollar. This gave rise to panic in the market and the much-maligned speculation on the exchange rate by some market participants. After sowing the seeds for speculation, it is now unwarranted for the Central Bank to blame the speculators.

**Decline in foreign reserves**

The result has been a sharp decline in the foreign reserves of the country. At end 2019, the usable official foreign reserves after adjusting for the gold balance amounted to $ 7 billion. This has fallen to $ 3.6 billion at end May 2021. Given an import bill of $ 18 billion during the next 12-month period, this is sufficient to finance only 2.4 months of imports of the country. Accordingly, the usable official foreign reserves have fallen to a critically low level today.

The Central Bank expects to boost these reserves by adopting two strategies. One is going for some temporary arrangements with China, India, and Bangladesh by exchanging Sri Lanka rupees for Chinese Yuan in the case of China and for dollars in the case of India and Bangladesh, an arrangement known as a SWAP facility. The other is getting some $ 800 million from the International Monetary Fund or IMF when it makes a new allocation of its book currency called Special Drawing Rights or SDRs.

This plan of boosting reserves could not convince the market participants, and the result was the overnight development of a curb market with a high exchange rate at around Rs. 225 and Rs. 226 per US dollar.

**Previous occasions in which Sri Lanka was bailed out by IMF**

There had been two previous occasions when Sri Lanka's foreign reserves had fallen to such critically low levels. One was in 1988 when the country had been at the height of the JVP insurrection. The other was in 2008 when the war with LTTE has escalated to a point of no return. On both occasions, Sri Lanka was rescued by IMF and the lessons learned from those exercises could be a guidance to Governor Lakshman.

**Bailout in 1988**

In 1988, Sri Lanka's foreign reserves fell to $ 277 million which was sufficient for financing only 1.2 months of the imports of the country for the next 12 months. Governor Warnasena Rasaputra, supported by Treasury Secretary W.M. Thilakaratna and coordinated by Sri Lanka's Alternative Executive Director at the Fund A.S. Jayawardena, went for a Structural Adjustment Facility of SDR 156 million with IMF. It was a tough negotiation for Governor Rasaputra who had served as Sri Lanka's Alternative Executive Director at the Fund before he became the Governor in 1978.

All resources in the Economic Research Department of the Central Bank were directed toward this exercise. It was a back-and-forth negotiation agreeing and disagreeing and finally coming to a consensus. IMF approved the facility in March that year and Sri Lanka made the first drawing toward the end of the year. This facility created confidence in Sri Lanka among the foreign investors, and from 1990 onward, the country was able to record surpluses in the balance of payments adding to its foreign reserves. A catastrophe was thus avoided by the timely action of Governor Rasaputra.

**Multipronged approach in 2008**

In 2008, foreign reserves fell to $ 2,560 million which was sufficient to finance only two months of the estimated imports of the country for the next 12 months. The country was at war and the armed forces were fighting it in the field. Quite different from this war, there was a separate financial war being fought by Governor Ajith Nivard Cabraal and Treasury Secretary Sumith Abeysinghe.

That war involved securing the necessary foreign exchange to pay for weapons being used by armed forces which were in the fields. China had supplied weapons to Sri Lanka on three months' credit. The Bank of Ceylon which had opened letters of credit or LCs on behalf of the Ministry of Defence had to meet the LC obligations once the bills matured. For that, the Central Bank had to provide foreign exchange to BOC, but it did not have enough foreign exchange in its reserves.

**A strenuous road show**

I recall Governor Cabraal making several initiatives to bolster the depleting foreign exchange reserves. One was to make Sri Lanka's maiden International Sovereign Bond or ISB issue of $500 million. Since it was Sri Lanka's first-time entry to the ISB market, the country had to conduct a series of road shows in major international financial centres to lure prospective investors. Governor Cabraal led a team of high officials consisting of those from the Central Bank, Ministry of Finance, People's Bank and the Bank of Ceylon and visited financial centres like Singapore, Hong Kong, Tokyo, Frankfurt, London, New York and Los Angeles. Altogether he addressed close to 50 road show meetings and the exercise was a success.

The other was to send teams of Central Bank officers to visit main countries in which Sri Lankan Diaspora was living to coax them to invest in Sri Lanka government securities in foreign currencies. Accordingly, different teams were sent to the Middle East, Europe, London, USA and Oceania. I led the team that visited this last place, Oceania. We met Sri Lankan Diaspora in Melbourne, Sydney, Canberra, and Wellington. But these missions were not a success since Sri Lankan Diaspora was not so patriotic as Governor Cabraal had expected.

**Bailout by IMF**

In these circumstances, the only source for Sri Lanka was IMF. Governor Cabraal supported by Treasury Secretary Sumith Abeysinghe and coordinated by Dharma Dheerasinghe from the Fund started negotiations with IMF. There were hiccups in the process. When things began to fall into the right path, IMF was hesitant in approving the facility. I recall India coming to Sri Lanka's help at that point. Indian Finance Minister Pranab Mukerji who was the Governor of the IMF's Board of Governors representing the Constituency that included Sri Lanka gave an ultimatum to the Fund. He declared that if IMF did not approve of this facility, India would provide these funds to Sri Lanka. It did the trick and IMF approved of an Extended Credit Facility of SDR 1,653 million for Sri Lanka in September 2009. This action boosted the country's foreign reserves to $ 5,357 million by end 2009 and $ 7,197 million a year later.

**Need for saner action**

It is the responsibility of the Monetary Board to protect the rupee domestically and internationally. On previous occasions, the Board stood valiantly to perform this duty by being flexible in its stance. As I have reported above, even the Treasury secretaries who are Government officials supported these prudent policies fully. There are three independent board members who represent people and not the Government. They have a duty by the nation to perform. If they fail, there is an irrecoverable loss to Sri Lanka rupee.

The above episodes have been related to emphasise that the present crisis is not the only occasion where Sri Lanka had undergone such crises. On both occasions, the respective Governors did not appeal to the sentiments of national interest of people but took concrete action to face the problem head on. I hope this would serve as a learning experience for all those who are at the top of the Central Bank today.

For the full article – Refer Daily FT

**2. Inappropriate economic policies in a weak state of the economy**
**By Nimal Sanderatne**

- The recent economic policies which would adversely affect agriculture seems to be adding on to Sri Lanka's economic woes. These policies will directly depress incomes, increase prices of consumer goods, decrease food availability as well as aggravate poverty and starvation. It would further divert the country away from self-sufficiency in food production.

- The recent fertilizer ban is expected to reduce local food production and export crops such as tea, ultimately affecting the country's export earnings. Food imports will rise as local production would be insufficient to meet the demand increasing the import costs. All while the GSP plus concession by the EU is at risk.

- There is no argument that organic food is best for health as well as the environment. However, totally relying on organic food will lead to severe food shortages. Sri Lanka could promote organic food for a niche market with a higher price, but in order to avoid severe shortages, Sri Lanka will have to rely on chemical fertilizer. Partial organic and inorganic farming is most suitable under given circumstances.

The country is heading towards a severe economic crisis. External finances are perilously low; foreign debt repayments are large; weak public finances severely limit the capacity of the government to take adequate measures to alleviate the escalating poverty by providing income support and prevent starvation or stimulate economic growth.

These fragile financial conditions are compounded by inappropriate policies. The sudden banning of chemical fertiliser is a clear example of this. It will reduce agricultural output, increase import expenditure, reduce export earnings and decrease incomes of farmers and agricultural workers. Food prices are likely to soar. Large-scale hunger and starvation is likely if there aren't adequate food imports.

**Policies**

Inappropriate economic policies and ineffective administration have depressed incomes, increased prices of essential consumer items, decreased food availability and accessibility and aggravated poverty and starvation.

**Fertiliser ban**

In this economic context, the banning of fertiliser has added fuel to the burning economic crises. Undoubtedly the economy is heading towards a crisis of severe proportions where hunger and starvation would reach huge proportions.

**Food production**

The banning of chemical fertiliser will reduce food production by more than half that of last year, deny incomes to a large proportion of the rural community engaged in farming or dependent on it. Rural poverty would be widespread.

**Export crops**

The lack of fertilizer, weedicides and pesticides for tea cultivation would decrease tea production on estates and smallholdings and tea export earnings would decrease. This would deprive smallholders who produce 80 percent of tea their livelihoods.

**Food imports**

The sharp fall in rice and food production would necessitate the import of a large quantity of rice in an international grain market where grain prices are nearly 50 percent higher than a year ago. The fact that the Government is calling for tenders to import 150,000 metric tons of rice is evidence of the shortfall in production and the need for imports. Wheat imports too have increased this year.

**Cause**

The root cause for this predicament is the expected shortfall in rice production this Yala due to the lack of fertiliser. If the Maha paddy cultivation that begins around September too is deprived of fertiliser, there would be a huge reduction in paddy production.

**Impact**

The impact of the ban on chemical fertilisers is to reduce food and export crop production drastically, deprive farmers of their livelihoods, increase the incidence of poverty and hunger, increase import expenditure and reduce export earnings.

**Export earnings**

The reduction in agricultural export earnings at a time when manufactured exports are under threat of a withdrawal of the GSP plus concession by the EU is catastrophic. Although a Government spokesman is confident that the withdrawal of GSP plus would not matter, export manufacturers consider it a severe threat. The Apparel Exporters Association has said that it will affect the country's exports severely. Furthermore, if other countries that are main markets for our manufactured exports also withdraw concessions, the country's exports would be seriously jeopardised.

### Misconception

The apparent divergence of views on the adoption of organic agriculture is a misconception. Everyone agrees that organic agriculture is superior to cultivation with chemical fertilisers, insecticides and pesticides. Organic agriculture is good for the environment, organic food is healthier and less harmful to health. Agronomists and other scientists do not disagree on this.

It is also true that small extents of land are successfully cultivated organically. These crops are sold at a much higher prices, locally as well as exported to niche markets. About 21 percent of world agriculture is organic.

### Organic agriculture

The critical issue is that organic agriculture cannot produce adequate food to feed the world population. No country in the world has a large proportion of its land under organic agriculture.

Bhutan that tried to convert to organic agriculture reverted to conventional agriculture. About a third of their agriculture is organic cultivation. The US, Australia, Switzerland, China and India have large extents under organic cultivation. Yet most of their produce is not organic.

### Paddy production

It is estimated that production of our staple rice will fall by over half. This implies that the country that is more or less self-sufficient in rice in a normal year would need to import about 250,000 metric tons. And that would not be organically cultivated rice.

The paddy output this Yala and in Maha 2021/22 would be much lower as we are hardly prepared for extensive organic cultivation. Next Maha may be a season of hardly any cultivation of paddy.

### Tea

The fall in production of tea and other export crops mean a drastic reduction of export earnings that we can ill-afford. Smallholder cultivation would be the worst affected and most damaging to exports.

### External finances

When the need of the hour is to strengthen our external reserves by increasing exports and decreasing imports, the banning of chemical fertiliser, pesticides and insecticides would increase imports and reduce exports. That in a nutshell is the paramount issue.

### Retrospective reflection

In the 1950s, the country imported over one half of the requirements of food. This included rice, wheat flour, sugar, poultry and a wide variety of foods like lentils (dhal), chilies and other condiments.

Particularly significant is the fact that Sri Lanka imported over one-half of the country's rice requirements to feed a population of about seven million. Last year, as in recent years, the country was self-sufficient in rice. Rice production was adequate to feed a population of 22 million.

This self-sufficiency in rice was achieved by both an expansion in the area cultivated by expanding irrigation and most significantly, by more than a twofold increase in rice yields.

Rice yields that were about 40 bushels per acre in the 1950s are about 100 bushels per acre in the dry zone. This over two-fold increase in yields was achieved by adopting high yielding varieties (HYV) like IR8 and appropriate fertilisers.

**Green revolution**

In the 1960's when there was widespread global hunger a scientific revolution in agriculture well known as the "Green Revolution" paved the way to a doubling and trebling of rice, wheat and maize yields. The adoption of these high yielding seed varieties enabled Sri Lanka to feed her 22 million people. We are on a path to reverse this achievement and return to a large rice importing nation at a time when we do not have the resources to import rice.

**Last word**

Finally, all the above factors considered, the ban on fertilisers, will aggravate the country's perilous finances into a deeper crisis and drive the people into hunger and starvation.

For full article – Refer The Sunday Times