Spotlight: Econ Op-eds in Summary

Week ended 15th September '21

In Summary

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

1. A reset of economic fundamentals in Sri Lanka: Is IMF the only hope?
By: Raj Gonsalkorale

- Sri Lanka is currently facing an insurmountable level of foreign debt, with International Sovereign Bonds (ISBs) accounting for 47% of it. These ISBs carry higher interest rates with shorter maturity periods in comparison to concessional financing offered by multilateral institutions and Sri Lanka would have no choice but to opt for such loans if there isn't a strong economic recovery which takes place, given its stance on avoiding the IMF.

- Mismanagement of economic policies by governments in the past are to blame for the current situation, with the COVID-19 pandemic exacerbating economic problems which already exist. The first step to recover from this situation is to take acknowledge that such an issue exists, and then Sri Lanka should negotiate an IMF bailout, which would offer low interest loans and a grace period.

- The money the IMF lends out is conditional on Sri Lanka agreeing to undergo major structural reforms, which can be painful to bear in the short term. However, negotiating such a program would help boost foreign investor sentiment and bring about political stability, a key driver in bringing in FDI's into the country. This would ultimately pave the way for future economic stability for the generations of successive governments to follow.

Sri Lanka is at the precipice of an economic disaster. The country's foreign debt is suffocating the country, it is its biggest immediate problem, and the problem for the foreseeable future unless urgent and drastic action is taken, now.

The crisis arises due to several factors, the primary factor being the high component of market borrowings in the form of International Sovereign Bonds (ISBs) in the country's foreign debt portfolio. ISBs account for 47% of the debt, as shown by a Central Bank chart.

ISBs are short-term loans attracting high interest rates (around 6%) with no grace periods while loans from international institutions such as the World Bank, Asian Development Bank, IMF, attract low interests and long term repayment terms including grace periods. ISBs are usually not conditional while others like WB, ADB and IMF have conditions that a country has to fulfil to qualify for the loans. Besides the ISBs, the Chinese debt component is stated as 10% of the total debt. These loans are reportedly similar to short term ones as ISBs, and attract a higher interest like ISBs. If this is so, 57% of the loan portfolio is in high interest, short term loans.

In the absence of export income that brings a net inflow to the country after accounting for the import component of exports, a serious drop in tourist earnings, foreign remittances and much anticipated FDIs not materializing, Sri Lanka will not have a choice but to take more loans in the form of ISBs and other high interest, short term loans, to repay loans and interest components that will be falling due.

Skating on thin ice

It is perhaps time that the country came to terms with the fact that we are skating on thin ice and pretending there is no berg at the bottom of the iceberg and only its tip. What is visible in an iceberg, its tip, is only a small part of the entirety of the iceberg, and Sri Lanka's debt problem is that big part of the iceberg which politicians do not wish to see, preferring to see only the tip. The Titanic sank because of the underestimation of the unseen part of the iceberg it collided with. Sri Lanka could be the next Titanic.

In the past, Sri Lanka managed to settle large debt repayments with foreign exchange inflows from exports, tourism and foreign emittances, and also build a small reserve for a rainy day. Today that reserve is down to $ 2.5 bn, while our accumulated debt is around $ 35 bn without counting the interest component of this debt.

The spin that is given to Sri Lanka's economic woes reminds one of very commonly used Australian and New Zealand expression, "She'll be right, mate". This is a frequently used idiom in Australian and New Zealand culture that expresses the belief that "whatever is wrong will right itself with time". In recent years, the term has taken on a less than flattering connotation, with "a she'll-be-right attitude" referring to a willingness to accept a low-quality or makeshift situation rather than seek a more desirable solution. This definitely rings a bell with regard to the situation in Sri Lanka. Postponing the inevitable, and administering stop gap measures seem to be the modus operandi that seems to be a common thread that links all politicians.

Economy in dire straits

Internal mismanagement over the years, the economic situation in the rest of the world on account of the pandemic, and not having a clear direction for now, and the next 10-20 years, have all contributed to this artificial situation.

The President and the rest of the country must come to terms with the fact that she, meaning the Sri Lankan economy is not all right. That is the first thing that must happen. The Sri Lankan economy, its structural fundamentals, and its financial situation is in a perilous state and that is a kind word to use to describe an extremely dire situation. The country has a short-term policy of virtually robbing Peter to pay Paul, and scraping money from any quarter in order to settle foreign debt, and fund essential imports in order to survive.

Steps to take

Firstly, the economic fundamentals and the foreign policy of the country, which have a relationship to global political relationships, have to be questioned, assessed, and reset where necessary. In a sense, one should question which side of the bread slice is buttered, meaning, if the country's future is to be based primarily on export earnings, then questions like, where do we export now, where does the biggest future potential lie and whether our foreign policy is conducive to sustain and grow export markets needs to be questioned.

It is understood that Sri Lanka's primary export markets are to Western nations and the country has a trade balance in Sri Lanka's favour when it comes to these countries. On the other hand, China, a country very supportive of Sri Lanka at all times, reportedly has a substantial trade balance in their (China's) favour. While efforts need to be made to address this situation, it should surely be important to examine whether Sri Lanka's foreign policy is conducive or not to support the overall future direction of export markets and earnings.

The width and depth of Chinese economic associations with a multiple number of developing countries is substantial and is a reality that needs to be known and faced. Sri Lanka is well aware of this, and the extent of their portfolio of direct and indirect loan facilities, and equity participation is probably not known in its entirety by the public.

Sri Lanka however cannot go down the path it has been traversing for a considerable period of time, and it needs to diversify its own equity and loan facility portfolios with international bodies and countries who are their primary export markets. China too should become an investor in Sri Lanka and importer of products and services from Sri Lanka and not just a lender.

In relation to exports, it is not clear whether what is being reported as export earnings are presented as net export earnings after accounting for the import component of the exported item/s. A gross export earning is like a mirage particularly where there is a very high import component. The long term future benefits will naturally accrue only if the import component decreases in order to give the exporter and the country a higher earning component. This is where a value adding export industry is needed and earnings increased either by using more and more local inputs, or where the exported value has a substantially higher margin over the imported component.

While Sri Lanka has been moving in this direction, this needs to be the policy that underpins the export industry. Tax incentives perhaps should be enhanced for export industries that have a substantial local cost component and/or where the value adding component is high. Much has been written about the need somehow to recommence tourism as soon as possible, and also to recommence overseas travel for workers employed overseas. Both income earners are critical for the country’s survival and it is hoped both will commence soon. However, both have an international dependency and therefore the status of the pandemic in other countries.

While it is an understandable reaction when faced with a devastating pandemic that has caused economic havoc throughout the world, to curtail imports and conserve foreign exchange, it is a very short term measure as many economists have pointed out.

Time for a bailout

From all accounts of expert economists, it appears that Sri Lanka needs a bailout with long-term, low interest loans, with a grace period to tide over the current economic situation that is going to prevail at least for another two to three years, if not more. The IMF is the only obvious institution that comes to mind to obtain such a bailout as that is more or less their core business.

Of course, any such bailout will be conditional on Sri Lanka agreeing to major structural reforms. Some of these will be painful in the immediate to short term, but they will be less painful than the repercussions of an economic collapse or a marginal existence with ad hoc borrowings to sustain the country.

A weak economy will impact on the popularity and the credibility of a government and it will provide ample opportunities for Opposition parties to destabilise the Government. Political stability, the one key criteria that foreign investors will look for when they make decisions about investing in Sri Lanka, will be gravely impacted, and the much anticipated Foreign Direct Investments (FDIs) will be hard to come by.

All above economic worries will destabilise the rupee even further from its present status. Today, the market rate that commercial banks pay to purchase US Dollars outside of the

Central Bank rate is said to be between Rs. 230 to Rs. 240 for one US Dollar although the Central Bank rate is Rs. 202. This dichotomy is real, and it is not a fantasy according to reports from Sri Lanka. Many suspect that the real value of the Sri Lanka value is far worse and if allowed to float, it will sink Sri Lanka.

The current de facto devaluation is bound to exacerbate unless the country's economy is stabilised, and its economic fundamentals are reset in such a manner that it can prepare the country for its next many generations and for them not to live a lie perpetrated on them by successive governments.

For the full article – Refer Daily FT

2. Policy changes vital for export growth in a challenging environment
By Nimal Sanderatne

- Extreme low levels of foreign reserves, high foreign debt, increasing import expenditure and negligeable levels of tourism earnings are forcing the government to continue the activities related to the export industry despite the risk posed by the ongoing pandemic, as export earnings now play a major role in the country facing external crisis.

- However, in order to further develop the export industry, a change in mindset is crucial. The country will need to adopt economic reforms and enhance export competitiveness. These reforms include providing incentives for export industry as well as addressing the difficulties that exporters have to face. Import restrictions have a negative effect towards export growth as it has limited raw materials that are much needed for the export growth.

- To do so, the current issues such as the possible withdrawal of GSP plus needs to be handled diplomatically. Further the current breeches of WTO agreements must be corrected, by informing the WTO of import policies and getting their permission for their waiver. Alongside these measures export growth requires a whole thrust of policies that would ensure competitiveness in price and quality in international markets.

"Export or perish." Never has this economic advice been more relevant and appropriate to Sri Lanka than today.

Challenging environment

Amidst the raging spread of COVID-19 and the extended lockdown, the Government is doing its best to ensure that the country's export capacity is not hampered. However, a sustainable growth in exports requires a change in mind set that will adopt economic reforms that will enhance export competiveness.

COVID restrictions

The need to ensure that the country's export growth is not hampered by the spread of COVID-19 and the restrictions placed by lockdowns and on travel is self-evident. In as much as it is vital that production is not hindered by the prevailing conditions, it is imperative that trade policies are reformed to encourage and provide incentives for sustained export growth. The plethora of difficulties and disincentives for export growth must be addressed.

Importance of exports

Export growth has gained a special importance owing to the low level of the country's reserves, foreign debt repayments, increasing import expenditure and negligible tourist earnings.

In fact, even with a satisfactory performance of exports, it would be difficult to cope with the current requirements of foreign currency. While foreign assistance is vital to cope with the current economic difficulties, economic reforms are needed to develop an export competitive economy.

Containing COVID

As the international experience has demonstrated containing COVID is enormously difficult. Furthermore, it requires a vast amount of foreign expenditure on medical equipment and vaccines.

Import expenditure

Sri Lanka can hardly meet its essential import expenditure. Foreign reserves have dropped to a perilously less than US$ 3 bn. Furthermore, COVID is reducing economic output.

Export manufactures

This is especially so with respect to the danger of COVID controls restricting export manufactures. The loss of production in economic activities implies the loss of employment and incomes. This has already happened and unemployment and poverty has increased significantly.

Developed countries can afford to shut down their economies to some extent and ensure the livelihoods of their people by providing income support for livelihoods. They could also forego production of goods and services as they have financial resources and foreign currency reserves.

Sri Lanka's economy

The Sri Lankan economy does not have these resources. The public finances are in a parlous state with the entire revenue being absorbed by debt servicing and salaries of public servants.

Lockdown

The perilous state of the Sri Lankan economy makes lockdowns a danger to the livelihoods of people and the stability of the economy. The fragile state of the country's foreign currency reserves makes it expedient to ensure the production of the country's exports.

Critical issue

The critical issue is that the lockdown to contain COVID should not jeopardize vital economic activities such as export production. Hence a lockdown while "essential economic activities" were permitted. These included export manufactures and suppliers of essential items such as food, medicines and services such as banking. Only time will tell whether such a lockdown will contain COVID-19.

Threats

Threats to the country's export growth do not come from COVID alone. The difficulties posed by COVID will pass away in the fullness of time. However, the spectrum of disincentives and difficulties that exporters have to face need to be addressed.

These include the possible withdrawal of the GSP plus concession. The Government must understand and appreciate that its withdrawal will confer serious disadvantages disincentives to several categories of exports. These include apparel, sea fish, ceramics and other industrial exports.

Diplomacy

More conciliatory and diplomatic approaches are needed to resolve this threat.

In the first instance the several breeches in the WTO agreements must be corrected. This includes the need to inform the WTO of import policies and get permission for their waiver. A more conciliatory approach to the issues of human rights rather than further violations is needed to convince the international community of the country's respect for human rights.

Import policies

Apart from the breeches of WTO regulations, the current import controls pose serious difficulties. There are shortages of raw materials and inputs and uncertainties in their availability and increasing costs. There is a dire need to reform trade policies.

Performance

Despite the challenging environment, fortunately, or fortuitously, export manufacturing has displayed a strong resilience amidst difficult conditions of the spreading COVID and country-wide lockdowns. Export have increased in the first half of the year, and in the months of June and July this year, exports reached US$ 1 bn.

Longer view

Sri Lanka has been, is and will be an export-import economy. Like other small countries, our survival and prosperity depends on the growth of our exports. This in turn requires economic policies that are conducive to making the country's economic environment and policies conducive to export competitiveness.

The first step is a change in the mind-set that the country's economic future lies in import substitution. There must be significant economic and trade reforms to make the country's exports competitive internationally.

Trade policy reform

The rationale for trade reforms appear to be little understood. In fact, even the economic truism that exports and imports are two sides of a coin is hardly understood by well-meaning policy makers. They are also blind to the fact that successful exporting countries are those with the least tariffs on imports. Singapore is the prime example.

Recapitulation

Increasing exports is imperative. At the best of times, the country's export performance is vital for the external finances, employment, incomes and livelihoods of a significant proportion of the population. In the present economic bind when reserves are below US$ 3 bn, the economy cannot bear an increasing trade deficit.

Further, reduction of imports is not feasible. In fact, import restrictions have affected exports adversely as exports have high import content.

While the containment of COVID is a necessary condition, it is not sufficient. In as much as possible COVID restrictions and lockdowns should not hamper production of export manufacture. That alone would not suffice. Trade policies have to be conducive for export expansion.

Import restrictions should not deprive import of raw materials for industry as it appears to be the case at present. High direct and indirect tariffs or para-tariffs should not increase costs of imported raw materials that would increase costs of manufactures and reduce their international competitiveness.

Final word

Export growth requires a whole thrust of policies that would ensure competitiveness in price and quality in international markets. Ensuring the least disruption of industry by the current COVID restrictions alone will not suffice.

For the full article – Refer The Sunday Times