Spotlight: Econ Op-eds in Summary

Week ended 8th January ‘20

In Summary

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

1. Gota’s economic war: Ferocity of the enemy makes the challenge frightening
By: W.A. Wijewardena

- President Gotabaya Rajapaksa inherited an economy that has been weakening since 2013. Economic growth for 2019 might even fall below 3%, and except for the manufacturing sector, all other parts of the economy have been slowing down. Tourism and remittances, 2 key parts of the country’s foreign income, have even declined in the past year.

- Another major concern will the country’s large debt obligations, which total up to US$ 6 bn in 2020. However, due to the country’s foreign reserves being relatively weak, and the need for the administration to spend on popular measures in an attempt to secure a two-thirds majority in the upcoming parliamentary election, further borrowings might end up being the only solution to 2020’s debt levels.

- Strengthening the country’s growth will therefore need to be a key policy focus for the new administration. Given that most local sectors have reached a saturation point, the development and use of new technologies will be essential to achieving success. The country can partner with foreign universities and companies similar to what East Asian economies have done. However, Sri Lanka cannot afford to lose any time, and measures to stabilize the economy need to be carried out very soon.

Falling growth rate

The growth rate in the third quarter of 2019 has been 2.7%, a little up above the previous quarter’s rate of 1.6% but pretty much less than the growth of 3.5% recorded in the corresponding quarter of the previous year. Thus, in the first three quarters of 2019, the real economic growth has been at a dismal 2.7%.

Accordingly, the year is likely to end up in a rate of less than 3% as has been predicted by international agencies. If Gota is to meet the targets set in his manifesto, the growth rate should practically double to 6.5%. This is indeed a Herculean task for any economic planner.

The fragile external sector

The supporting drivers of economic growth have also been very weak. Exports in the first 10 months of 2019 have been virtually stagnant, recording a growth of only 0.8%. In the services sector, the main driver of growth – tourism – has not recovered from the depth to which it had fallen after the Easter bombings. In fact, its earnings have fallen by 21% in the first 10 months. Remittances which had been the single-most important relief for the country’s fragile external sector in the past have declined by 6% during the same period.

Both agriculture and services have been at a very low level of performance. The industrial performance has been a little better, but it cannot single-handedly rescue the economy.

Hence, Gota must adopt a multi-pronged approach to expand agriculture, services, tourism exports, and remittances simultaneously if the economy is to remain on course with the planned targets.

The external debt overhang

The country's external debt overhang is looming frighteningly over Gota's administration. That has been the cumulative effect of borrowing abroad to finance local investments in the absence of adequate local savings and investing in sectors that have contributed poorly to the country's foreign exchange earnings.

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 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.

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.

The need for using scarce money prudently

He has to seek Parliamentary majority in a general election in a few months' time. Accordingly, at a time when the Treasury was limping with a huge cash shortage, he has offered a costly tax cut to citizens and jobs for 100,000 Samurdhi kids. The first would drain the Treasury of a promised revenue flow of about Rs. 600 billion and the latter would impose an unexpected cost of Rs. 42 billion on his already fragile budget numbers. The government does not have money for this and, hence, the available moneys will have to be spent prudently.

A 'write-off-four months' ahead

If the voting pattern at the recently concluded Presidential Election is repeated, his government has a good chance of securing a simple majority in Parliament. But what is being fought for now is not just the simple majority but a two-third majority. The latter is needed by him to amend the Constitution and revert to the governance structure that prevailed prior to 2015.

To attain that goal, his government has to postpone all the unpopular economic reforms that are necessary to come out of the present economic malaise. Hence, the economic war has to be temporarily kept aside until the conclusion of the scheduled Parliamentary Elections. Since Sri Lanka has no time to waste, that temporary recess will surely be fatal to the country's economic rebuilding exercise.

Inadequate capacity for developing technology

Sri Lanka has a limited scope for creating economic prosperity for its people through historically prominent growth drivers like subsistence agriculture, three tree crops comprising tea, rubber and coconut, apparels and telecommunication services. All these sectors have now reached their saturation point with the available technology. Hence, any further development leading to increased additional wealth creation known as value addition in these sectors requires the adoption of advanced technologies.

Given Sri Lanka's inadequate capacity for developing such advanced technologies in-house, the attainment of this goal is necessarily a medium to long term objective. Hence, in the initial stage of economic development, Sri Lanka needs to use technologies developed elsewhere.

A good example in the present era is Sri Lanka's competitor in most respects, Vietnam. That country which was nowhere in the global trade map some 30 years ago is the home for large technology-based manufacturers like Nike, Samsung, IBM, Intel, Fujitsu, and HP today. According to the World Bank data, Vietnam's high-tech exports in 2017 had been 41% of its manufactured exports. The comparable figure for Sri Lanka had been just 1%.

To attract high technology in the initial period of economic expansion, the strategy adopted by both South Korea and Singapore could serve as guidance to Sri Lanka.

South Korea's technology policy

It consisted of two aspects: one was to develop new technology through research and development and improve the technologies adapted from other countries. The other was to facilitate the use of technology for going for new products and improving the existing production practices. To develop technology in-house, new research institutes were setup, while encouraging the existing universities to undertake new research and development programs.

Singapore's going for a Western Oasis

In Singapore, Prime Minister Lee Kuan Yew forced all Singaporean universities to get affiliated with universities of repute in USA and improve curricula and research capability based on such collaboration. As a result, the National University of Singapore which was relatively unknown in early 1960s got itself elevated to the 22nd position in global ranking by 2018. In addition to developing in-house capacity for technological advancement, Lee adopted a policy of attracting FDIs with high technology to the country.

To enable the expatriates from the Western world to come and work in Singapore, a conscious policy to convert the country to a Western Oasis was adopted. In this policy, Singapore improved its environment, healthcare facilities, education and transport to be on par with any developed country so that the expatriates felt as if they were working in their own countries. This was a miraculous development and today, Singapore's high-tech exports amount to about 52% of the manufactured exports, according to the World Bank data.

Industry 4.0

Gota's problem is that Sri Lanka is still in the Second Industrial Revolution or Industry 2.0 or 2IR in which production processes are only partly mechanised. He has to make a leapfrogging from Industry 2.0 to Industry 4.0 bypassing Industry 3.0 or 3IR. This is challenging, but not impossible provided he adopts an appropriate policy package to wean the local businesses to the use of emerging technologies.

For the full article – Refer Daily FT

2. Infrastructure: Enabling economic growth
By: Lahiru Karunathilaka

- Infrastructure development is vital in achieving inclusive economic growth. Many such projects are subjected to economic challenges. Despite alarming debt levels, most such projects will have to rely on borrowed funds. While infrastructure investments provide employment and increase long term production capacity it can cause pressures on trade balance through increased import expenditures.

- Establishing a national unit with a long-term vision for infrastructure investment is vital to prioritise infrastructure projects. The persistent budget deficits and loss-making state-owned enterprises have limited capacity for capital expenditures of the government. This indicates that public sector reforms reducing government expenditure is required in releasing finances for infrastructure investment.

- A national infrastructure unit will improve productivity and affordability in designing infrastructure projects. This can reinforce social progress and create the required regulatory background with relevant power and interconnectivity. Also, such a unit should have audit functions with adequate resources to maintain integrity. Thus, having a national strategy with an efficient regulatory design on infrastructure is key.

Getting it right

Infrastructure investment and development is one of the top priorities for governments globally. It is imperative for poverty reduction, social progress and inclusive economic growth.

Infrastructure: fiscal policy and a governance challenge

Having said that, almost every Government including Sri Lanka are under pressure to improve their fiscal positions. Poor governance is a major reason why such projects often fail to meet their objectives, budget and time frame. Political influence may impair the decision-making in terms of identifying and prioritising. Coordination across level of Government is difficult despite the fact that majority of the public investments were made at ministry level.

Followed by the adverse weather conditions and sluggish economic recovery, the economy of Sri Lanka continued grow at a decreasing rate. (YoY growth of 3.2% in real terms).

Debt to GDP levels are already alarming, future infrastructure investment requirement will without doubt rely on borrowed funds. This will push the countries Debt to GDP level up and bring the macroeconomic stability at a risk. Also, this situation will highlight the policy weakness, gaps in our development priorities and weak economic forecast.

In light of the widening trade deficit (specifically due to import of consumer goods, vehicles and fuel) coupled with the decreasing domestic currency position, the current account balance of Sri Lanka has been deteriorating over time.

Widening Balance of Payment, Trade Account and Foreign Debt Service will have a twin effect on the currency. As such infrastructure investments will drive the economy by;

Directly in the short term through employment and purchasing inputs from other sectors and related multipliers. On this point we should be vigilant on large-scale projects since most of the input we have to import. Such investment would increase import expenditure and pressure the trade balance and balance of payments.

Indirectly in the long term, through raising the production capacity of the economy by reducing transportation and other costs allowing a more efficient use of inputs. For these reasons having a national vision for infrastructure investment is needed.

Country has to ensure that there is a prioritisation of investment in infrastructure and to ensure that infrastructure projects lead to higher GDP. Investment in energy would increase the production capacity of the country and help export and manufacturing industries by bringing the production overhead competitive. Investment in social infrastructure, such as education and youth development can support long term economic growth by improving countries labour productivity and level skills.

During recent past years, Sri Lanka was maintaining a budget deficit in the range of 5.3% to 5.7% (except for 2015).

Domestic and foreign interest repayments accounts for more than 31% of total Government expenditure (5.9% of GDP) whereas personal emoluments are high as 24% of the total expenditure (4.5% of GDP). Accordingly, in light of the reducing Government income, increasing interest payments and increasing personal emoluments, the said budget deficit was maintained mainly through the pull back of capital expenditure.

Furthermore, Sri Lanka has around 422 State-Owned Enterprises which contributes 13.3% of the GDP (2018). Out of the total SOEs, 54 has been identified as 'Strategically Important State-Owned Business Enterprises' (SOBEs).

During 2018, 16 SOBEs recorded net loss of Rs. 157 bn. This is 1.25% of the country's GDP.

Above facts indicates that the additional expenditure on infrastructure investment must be found by reducing public expenditure in non-productive areas and through public sector reforms. Institute of policy studies in Sri Lanka states that "the priority for fiscal policy is to release financing for infrastructure investment and reconstruction spending". This entails that a mix of far-reaching economic, institutional and policy reforms accompany a reorientation of public finances.

What should we do to get it right

Establish a national infrastructure unit with a long-term strategic vision that will address the country's needs. Ideally this unit should be enacted by the Parliament which will create an enabling environment and accountable for the public.

This will enable strategies to serve multiple objectives such as growth productivity and affordability along with identification of interrelation across sectors (Housing infrastructure should support by the right investment in transport).

Such a vision can reinforce social progress hence increase the social mobility of the country. For example, introducing basic infrastructure such as solar power, pipe born water and increasing the quality and the capacity of the schools in the country will have manifold social benefits.

Efficient regulatory design

This will mainly address by having an infrastructure unit enacted by the Parliament which will create an enabling environment with relevant power and interconnectivity. Projects often involve many policy areas, several layers of legislation and regulation, and different levels of Government.

Make the project bankable/investor appealing

Managing any threats to integrity and governance is a key aspect on this regard. Range of stages and stakeholders involved make infrastructure projects highly vulnerable to corruption. The projects have to ensure audit functions have built in and adequate capacity and resources to provide timely and reliable audits. For governments, there can also be competing priorities. Developing countries may put rapid economic growth ahead of environmental and social protection. Evaluating innovative finance options is key during a time when Sri Lanka is facing fiscal challenges. Trade off occurs between infrastructure development and macroeconomic stability. Models such as Public Private Partnerships and infrastructure REIT's may be an option to explore.

The above models need material amount of reforms to be take place in the legal and regulatory system. This is why having a national strategy and an efficient regulatory design on infrastructure is key. Finally, 'Make it Smart', studies done by economics intelligent unit shows building information modelling (BIM), sensors, and big data will be increasingly important tools which will improve the monitoring of the asset performance and improve the planning of new assets. This can also increase the environmental sustainability of existing assets (making assets future-proof) while cutting costs associated with maintenance.

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