Spotlight: Econ Op-eds in Summary

Week ended 04th August '21

In Summary

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

1. IMF or not: What other options are available for Sri Lanka?
By: Dr. W.A Wijewardena

- **The government on numerous occasions have iterated that the government will not seek economic assistance under an IMF program. Past experiences had shown that governments have inevitably resorted to IMF assistance, despite refusing to approach them in the past. Delays in approaching the IMF will only worsen the country's economic woes.**

- **The Budget 2022 is set to be 'business friendly', 'market friendly', and 'state friendly'. However, the focus on any one of these objectives will result in an adverse impact on another due to trade-offs caused by policy choices. Implementing sound policies, similar to Singapore, on their own accord is what would help the government avoid an IMF program while still maintaining economic prosperity.**

- **The policy choices made by the government of Singapore included the implementation of a currency board, which prevented excess money printing and helped align political objectives with economic objectives, helping Singapore maintain a stable budget position. A key takeaway for Sri Lanka from this experience is the maintenance of fiscal and monetary discipline as the current economic climate poses a significant challenge in the preparation of Budget 2022.**

Closing the door to IMF

Central Bank Governor Deshamanya Professor W.D. Lakshman, in an interview on Derana's Hyde Park last week, reiterated the stand of the present Government that it will not seek any bailout from IMF.

This was one day after Sri Lanka kept its unblemished record of meeting all foreign debt obligations on time by paying in full the International Sovereign Bonds or ISBs of $ 1,000 million that matured on 27 July 2021. This was done by using the existing foreign reserves of the country and minimising the dollar outflow by arranging with the local banks to reflow their maturity proceeds to Sri Lanka Development Bonds that are to be issued on a future date.

State Minister of Finance Ajith Nivard Cabraal, a former Governor of the Bank himself, congratulated the Government on keeping its promise untarnished. He expressed his sympathy for those who are deemed to have incurred a loss by overreacting to rating agencies and analysts' reports. He too had previously maintained in an answer to a question raised in Parliament that Sri Lanka could resolve its debt issues without the support of IMF.

Recently, in an interview with Sunday Times, the de facto policy chief of the Gotabaya Rajapaksa Administration, President's Secretary Dr. P.B. Jayasundara too had reiterated that going to IMF was not the solution.

Strangely, the new Finance Minister Basil Rajapaksa has been silent on this issue, perhaps keeping his options open. But as it is, the Gotabaya Rajapaksa administration appears to be firm on the stand of not seeking IMF support to rescue Sri Lanka's economy badly battered by worsening macroeconomic conditions exacerbated by the outbreak of the COVID-19 pandemic. Despite many suggestions by analysts, including this writer, the Government will seek to implement its own home-grown policies to rescue the economy without the support of IMF at this crucial hour.

Delaying the move to IMF will be costly

However, the experience in the past has shown that many policymakers and top politicians who had spoken valiantly against any type of IMF support had finally yielded to the pressures of the market and changed their stance. The most recent example was that after the Good Governance government was set up in 2015, its Finance Minister Ravi Karunanayake refused to seek IMF support to resolve the growing balance of payments problem of the country. Instead, he claimed that a Belgian investor had agreed to supply Sri Lanka with a deposit of $ 3 billion. He did not change his stance, nor did his Government, when it was pointed out that such an inflow may be fake and smelled of an instance of money laundering.

When the Government decided to go to the IMF, it was too late, and the rescue package was delivered only by July 2016. Because of this late adoption, it could not deliver the expected results. As a result, President Gotabaya Rajapaksa inherited a problem economy that demanded tough measures for effective resolution. Hence, when a country is facing an acute balance of payments problem, a delayed decision for a rescue package is extremely costly and the late delivery of support would not bring in the desired results.

Wittingly or unwittingly, the present Government too has fallen into this trap. If it one day decides to go to IMF, it will be too late. Hence, the present Government does not have a choice but to go along with its own plan of resolving the country's balance of payments issue. That will involve, as Governor Lakshman had eloquently pronounced all the time, going ahead with the much-publicised alternative policy stance.

A Finance Minister on a tight rope

This is the formidable challenge faced by the new Finance Minister Basil Rajapaksa. His choice is like the paradox faced by the proverbial villager who was given an impossible choice: if he stayed in a place on route to house, he would die; if he went home, his wife would die. That was because, unknown to him, a cobra had lodged itself in his travel bag and whatever he did, it was an unbearable cost which either party had to take. Similarly, there is a cobra that had entered the coffers of the Treasury making the choice which finance minister had to make an impossible one. This will make the preparation of the Budget 2022, his maiden budget, a choice involving imposing enormous costs on some section in society.

The impossible three tasks of the new Finance Minister

President's Secretary Dr. P.B. Jayasundara had given a clue about it in an interview with the website EconomyNext. Claiming that the new Finance Minister will make a 'dramatic change' in his Budget 2022, he had said that the Minister is a practical person plus 'market-friendly, state-friendly, and business-friendly' too.

In terms of economics, a person cannot be friendly to these three competing sectors at the same time. For instance, a state-friendly person must expand the state sector at the expense of the market and the business. A market-friendly person can be to some extent business friendly if the business sector follows the market rules. If business is anti-market, both the market and the business clash with each other. Surely a market-friendly person cannot be state-friendly at the same time unless the state is prepared to follow the market rather than lead the market.

This was how the open economy with a human face preached by Chandrika Bandaranaike or the social market economy of Ranil Wickremesinghe failed in attaining their goals. If all the three goals are pursued, it is an iterative process. The algorithmic formula requires the policymaker to follow one ignoring the other two and then return to the ignored goals one after the other. But once they return to the ignored goals, they are no longer in the previous condition. Once they are fixed and the policymaker returns to the original priority, it is also changed beyond redemption.

If a balancing act is required, it is like an acrobat walking on a tight rope holding three burdens at the same time in his two hands. If he tilts to one side, say to the state sector, he will fall. Similarly, if he tilts to the market side, he will also fall. The same is true if he tilts to the business sector. Hence, the Budget 2022, it appears, instead of bringing a dramatic change, will drive the new Finance Minister to an inescapable trap.

Singapore story

Can a country rescue itself without an IMF program? It can, provided it will introduce an economy-wide reform and restructuring program on its own. Singapore has set a good example for this.

Singapore joined both the IMF and the World Bank in 1966 one year after it got separated from Malaysia. Singapore's Finance Minister at the time, Lim Kim San, while presenting the Bretton Woods Agreement Act in Parliament, justified seeking IMF membership on three grounds. They were: boosting Singapore's capacity to manage its balance of payments, instilling confidence of the global community in its monetary policies, and gaining access to continued IMF technical expertise and advice on Singapore's economy.

Further, joining IMF was a prerequisite for joining the World Bank which might extend some development loans to infant Singapore. But apart from the technical advice, Singapore did not go for an IMF program. There was no necessity for such a program either. That was because Singapore continued to implement the needed reform programs on its own.

No free lunches

How Singapore implemented the reform programs has been explained by its first Finance Minister Dr. Goh Keng Swee in an article written for the silver jubilee commemoration publication of its Currency Board. Explaining why Singapore chose to continue with the Currency Board system, though it was a relic of the colonial rule, Goh says that Singapore's old guard felt the necessity to establish discipline among its ruling politicians. Unlike a central bank, a currency board cannot print money for financing the government expenditure programs because it has to maintain an equivalent amount in foreign exchange when it issues currency. If the country does not earn fresh foreign exchange, it cannot print new money.

Similarly, if the country loses foreign exchange, an equivalent amount of currency already released will be withdrawn from circulation. Hence, there was an incentive for the ruling politicians to implement schemes to earn fresh foreign exchange. Dismissing the extant popular view that central bank printed money could generate prosperity, Goh says that the old guard did not buy that idea. According to them, the central bank money cannot bring in prosperity. Prosperity is generated by hard work done by all citizens, students in schools, undergraduates in universities and technical colleges, and workers in workplaces.

By adopting this type of a policy stance, Singapore's old guard wanted to give messages to three types of people: its future politicians, citizens and people in the rest of the world. The message to its future politicians was that if they needed to have vote catching expenditure programs, they should bring that money from homes and not the money printed by the central bank. The Singaporeans were warned that if they needed better public services, they should be prepared to pay for them and not expect free lunches.

The message to the people in the rest of the world was the important one. It simply said that they could leave their savings with Singapore and the country would invest them prudently so that they would be paid an attractive rate of return, while ensuring the safe return of the principal.

No alternative for prudence

Accordingly, Singapore adopted a prudent budgetary policy and monetary policy throughout its post-independent history. From 1965 to 1973, the budget was balanced, from 1974 to 1987, a slight deficit, and thereafter, a budget surplus. Its monetary policy was so restrictive that its inflation rate was lower than that of its main trading partner, USA.

Hence, the Singapore dollar which was exchanged for S$ 3.32 per US$ in 1960 continued to appreciate in the market ending at S$ 1.35 per US$ by end-July 2021. In the external sector, Singapore had a slight trade deficit from 1965 to 1982, but a growing trade surplus thereafter. Its current account was in deficit from 1965 to 1987 and was in surplus since then. As Singapore managed its finances well, there was no necessity for seeking IMF funding.

Sri Lanka: Cut revenue and then print money

Sri Lanka which shuns IMF now can learn a few lessons from Singapore. Maintaining fiscal and monetary discipline is an important element in these lessons. On the fiscal front, the discipline should come from the elimination of free lunches by getting the users to pay, on one side, and enhancing the Government's taxation capability, on the other. While the first element is now being tried out, the second has been largely ignored. This is evident from the loss of a massive amount of revenue by offering an unsolicited tax concession to income and value-added tax payers.

The loss of the Government revenue in 2020 compared to its achievement in 2019 amounted to some Rs. 519 bn or 3.5% of GDP. According to the developments so far, the loss of revenue in 2021 will amount to some Rs. 450 bn or 3% of the estimated GDP. To compensate for the loss in revenue, the Government has resorted to borrowing from the banking sector that is made up of both the central bank and commercial banks. During the period from December 2019 to June 2021, its borrowings from the banking sector had amounted to Rs. 2,854 bn.

This would have led to a massive increase in the money stock had it not been for the outflow of money from the country by way of a decline in its foreign assets. But the money stock during this period has increased by Rs. 2,541 billion or 33%. Sri Lanka cannot continue with this type of fiscal and monetary indiscipline and hope to manage its own affairs without the IMF.

This is the formidable challenge faced by the new Finance Minister when he prepares the Budget for 2022.

For the full article – Refer Daily FT

2. Denying IMF support is no solution for Sri Lanka's economic woes
By Prof. Sirimevan Colombage

- At present Sri Lanka is facing multiple economic challenges. The budget deficit that exceeds 11% of GDP as well public debt service commitments as much as 142% of government revenue have exacerbated the issues. With decreasing foreign reserves and upcoming foreign debt commitments exceeding current foreign reserves, most appropriate decision for Sri Lanka would be to seek assistance from the IMF.

- Governments' top officials have clearly stated that there is no immediate plan to seek financing from the IMF, arguing that an IMF facility will not assure immediate economic recovery or boost exports and tourism. However, in general IMF programs go beyond lending as it helps a country in long term economic stability with policy reforms. These ensure stability of in the monetary system and help attract foreign investment in the long run.

- The IMF expects the borrowing country to voluntarily agree on implementation of conditions that ensure macroeconomic stability. These are mainly in relation to the fiscal sector and the balance of payments. The government, however, strongly believes that there are alternate ways to address economic issues faced by the country and will seek these alternatives. Ultimately, it is the policymakers' decision to decide whether to choose the IMF or continue to borrow avoiding policy reforms.

Sri Lanka is currently facing multiple economic challenges amidst the COVID-19 pandemic. The budget deficit, which exceeded 11% of GDP last year due to tax cuts, has aggravated macroeconomic imbalances. Given the revenue constraints, it has become extremely difficult to meet public debt service commitments which absorb as much as 142% of total Government revenue annually. This necessitates further borrowings to roll over the maturing debt.

In the absence of adequate foreign loan inflows, the Government is now compelled to resort to domestic borrowings, mainly bank from the banking sector, causing faster growth of money supply by 22% over the last 12 months.

The resulting increased liquidity exerts considerable demand pressures on imports and inflation, weakening the rupee against foreign currencies. The country's foreign reserves are down to $ 3.5 billion (excluding gold), as against the foreign debt commitments amounting $ 6.8 billion to be met within the next 12 months.

Support from the IMF is the prudent option

In this difficult situation, the most appropriate policy option available to the authorities would be to launch a cohesive policy framework aimed at reducing macroeconomic imbalances in the short and medium-terms with the assistance from the International Monetary Fund (IMF). Such an arrangement would provide sufficient breathing space to implement the adjustment policies that are essential to restore economic stability and to facilitate economic growth.

Although Sri Lanka, as a member country, has the right to seek assistance from the IMF to overcome the economic catastrophe, the Government continues to decline such approach.

Denial of IMF support

Presidential Secretary Dr. P.B. Jayasundera in a recent interview categorically stated that the Government has no immediate plan to seek financing from the IMF. He says that an arrangement with the IMF will not help to boost the country's exports or tourism. Any borrowing, including IMF programme, is good if there are immediate prospects for economic recovery, he says. But if the borrowing programme is not assuring economic recovery, it is important to work out areas where such assurance will come, he insists.

That assurance will come from investment, not from borrowing, according to Dr. Jayasundera. He further states that a project portfolio around $ 3 billion is available from the World Bank and the Asian Development Bank covering sectors such as water, irrigation, highways, education and health with utilization spanning three to four years. If these projects are fast tracked removing the bottlenecks, the disbursements are a money flow, he said.

State Minister Ajith Nivard Cabraal and Central Bank Governor Prof. W.D. Lakshman too have reiterated in recent forums that the Government has an alternative approach to resolve the current economic problems without resorting to the IMF. However, such alternative approach is yet to be unveiled.

IMF programmes go beyond lending

As pointed out by Dr. Jayasundera, it is true that entering into an agreement with the IMF will not help to raise exports or to attract more tourists immediately. But that should not be a reason for rejecting any agreement with the IMF, since its mission has a broader scope than merely lending to member countries, in contrast to project loans disbursed by the World Bank (WB) or the Asian Development Bank (ADB).

The IMF, which is known as the world's "financial crisis firefighter," offers loans or bailouts to member countries that are encountering balance of payments difficulties. As the apex global financial body, it is the mission of the IMF to ensure stability of the international monetary system – the system of exchange rates and international payments that enables countries and their citizens to transact with each other.

Once economic stability is achieved through an IMF reform package, the economy would be conducive to attract foreign investment and thereby to boost exports and economic growth. Also, the country would be an attractive destination for tourists.

IMF conditionalities

The IMF's lending conditions are designed not only to execute its loan facilities, but also to ensure that the borrowing country will adopt the policy reforms that are needed to restore macroeconomic stability, particularly with regard to the fiscal sector and balance of payments. In practice, the borrowing country has to voluntarily agree to implement the conditionalities without any insistence by the IMF.

Thus, IMF assistance is subject to borrowing country's obligation to implement certain conditionalities aimed at improving Government finances and external payments. These conditionalities, known as "structural adjustment policies", include balancing the budget, removing price controls and State subsidies, privatising State-Owned Enterprises, liberalising foreign trade and exchange systems, adopting flexible interest and exchange rates and removing barriers to foreign capital flows.

This is the difference between the IMF and other lending agencies that offer project loans without any conditions aiming at rectifying macroeconomic imbalances such as the budget deficit. Similarly, loans can be obtained from a particular country, say from China, India or Bangladesh, without any structural adjustments. This applies to foreign borrowings raised in global capital markets through International Sovereign Bonds or Sri Lanka Development Bonds which do not carry any reform pledges.

Housekeeping essential

Globally, the IMF is accused of imposing strict conditions on poor borrowing countries. But it may be noted here that such conditions are imposed for the sake of overcoming the macroeconomic imbalances encountered by the borrowing country itself. It is a kind of "housekeeping" that helps a debt-ridden country to escape the debt trap. This is what is needed at the moment in the case of Sri Lanka which is caught in a debt trap.

Given the stringent conditionalities attached to IMF facilities, the Sri Lankan Government has been increasingly resorting to non-conditional loans raised from individual countries and global capital markets. This has led to the accumulation of the debt stock rapidly over the last 15 years without adhering to any structural adjustments to achieve macroeconomic stability, particularly fiscal discipline aimed at reducing the budget deficit.

Undisclosed alternative approach

In a recent TV interview, Central Bank Governor Prof. Lakshman mentioned that the advice given to the Government by various people in newspapers almost on a daily basis is that obtaining assistance from the IMF is the only solution. But, according to him. there were times we resolved problems of this nature without IMF interventions He further stated that none of the 16 IMF programs implemented in Sri Lanka over the last 40 years or so helped us to get out of the problems and to attain a sustainable growth.

Prof. Lakshman mentioned that there are alternative ways of resolving the economic setback. But as usual he did not disclose any such alternative path to address the critical problems that the country is facing today – heavy loan commitments, export shortfall, foreign exchange shortage, import restrictions and depleting foreign reserves.

Instead, he said that certain elements contained in the Presidential election manifesto, which was later adopted as the Government's economic policy, are being implemented at present. They include emphasis on the domestic production economy and exports, restrictions on non-essential imports, reliance on non-debt investment and reduction of foreign debt component.

I wish to emphasise here that the failure of the past IMF programmes in Sri Lanka was largely due to the non-adherence to such policy packages by the successive Governments for political reasons. Most of the structural adjustments contained in those programmes were abandoned halfway, as they contradicted with the populist policies such as consumer subsidies and public sector employment which have been used to win elections by the successive Governments. A good example is the premature suspension of the three-year Extended Fund Facility (2016-2019) programme with the IMF in 2019.

Hence, it is not reasonable to say that the IMF programmes were unsuccessful entirely due to their weaknesses.

Debt rollover

State Minister Cabraal claims that the prompt settlement of $ 1 billion worth of International Sovereign Bonds on the due date (27 July) has proved that all the doomsayers and sceptics, both globally and locally, are wrong. He mentioned that multiple measures have been implemented to first stabilize the economy and stimulate thereafter, and to preserve foreign currency reserves.

He states that the Government was negotiating over $ 2 billion in foreign funding in the short term via bilateral and multilateral arrangements. They include currency swaps of $ 400 million with the Reserve Bank of India and $ 200 million with the Central Bank of Bangladesh, $ 200 million from the China Development Bank, $ 780 million via enhanced Special Drawing Rights (SDR) from the IMF, as well as a syndicated loan of $ 700 million.

It should be noted that all those foreign exchange inflows, with the exception of IMF's SDR allocation, are loans. Raising foreign loans to service the existing debt in such manner without making implementing any policy reforms to ensure fiscal discipline further aggravates the country's debt vulnerability.

IMF lending to deal with COVID-19

In responding to the urgent financial needs following the COVID-19, the IMF has doubled the amount of funds available through two lending programmes – the Rapid Financing Instrument and the Rapid Credit Facility.

The Fund has lent out to more than 100 member countries under those facilities. Sri Lanka, however, is yet to seek such assistance.

Escaping the debt trap

Formidable policy reforms aiming at fiscal discipline are imperative to relieve Sri Lanka from the debt trap. Continuous borrowing from sources other the IMF has become the preferred choice of the country's top policymakers to avoid painful structural reforms that may hurt the voter base.

As the saying goes, there is no such thing as a free lunch. So, it is left to the policymakers to decide whether to avoid policy reforms by continuous borrowings or to escape the debt trap by adopting a stabilisation policy framework so as to phase out the borrowing spree.

For the full article – Refer Daily FT