Spotlight: Econ Op-eds in Summary

Week ended 20th January '21

In Summary

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

1. Financial turnaround, with Indian assistance
By: Tudor Wijenayake

- Sri Lanka needs to settle over $6 bn in foreign loan payments over the current year and urgently requires financing support for current projects undertaken. This support mainly comes from countries including India, China and Japan. The country needs to play a balancing act in terms of maintaining healthy relationships between the aforementioned countries.

- Japanese loans are notable for their low rates of interest and long repayment periods, providing a favourable source of foreign financing for Sri Lanka. With the government however, moving toward more domestic based financing, the frequency of foreign funded projects into Sri Lanka is expected to reduce.

- The other options available, which Sri Lanka seems to be taking more steps towards, are direct financing facilities with China and India. There is around US$ 2.5bn being negotiated in the form of currency SWAPs, while additional investments are also being reported. However, if these do not materialize to the optimistic levels expected, Sri Lanka would be forced to approach the IMF for support instead.

Country's problems and issues

In addition to financial problems given below are some issues currently faced by the country needing solutions.

1. Promises and agreements already made with India and China
2. Balancing relationships with China, India and Japan.
3. East Container Terminal and the future of Colombo Port
4. Critical nature of electricity generation
5. Supply of petroleum and expanding refining capacity

Promises and agreements with India

Trincomalee tank farm

As consented by Prime Minister Ranil Wickremesinghe, an agreement was signed in February 2003 between Indian Oil Corporation (IOC), Sri Lanka Treasury, and Ceylon Petroleum Corporation (CPC) to lease the China Bay oil tank farm in Trincomalee. The oil tanks built by British prior to second world war idled for 70 years. The deal valid for 35 years, extendable for 99 years. According to the lease agreement, annual payment would be $ 100,000 and IOC paid the rental promptly to Treasury. Currently only 15 out of the 99 oil tanks are used by IOC.

Power plants in Trincomalee

Indian Prime Minister Narendra Modi during his visit to Sri Lanka in March 2015 informed that 'India is keen to develop Trincomalee to become a regional petroleum hub'.
Later in 2015, Indian and Sri Lankan governments signed an agreement (MOU) to establish a 500 MW coal-fired power plant in Sampur, Trincomalee. But when President Sirisena met the Indian PM in India in 2016, wished to change the Sampur coal-fired plant for a liquefied natural gas (LNG) power plant.
Accordingly, when SL PM met the Indian PM at New Delhi in April 2017, the heads of State revised the MOU, for building a 500 MW gas power plant, running on imported LNG.

Chinese investments

China was the most favoured country under Mahinda Rajapaksa Government, led to Colombo Port City. The project was suspended in 2015 by Yahapalanaya Government, but recommenced faced with contractual issues. MR Government developed Hambantota port with Chinese assistance, but inability to make required loan payments resulted in handing over the Port for 99 years.

The Colombo South Terminal developed and run by the Chinese Company CICT, owning 80% shares been in operation since August 2013, has heavily contributed in raising the Colombo Port among the top 25 in the world.
But projects constructed by Chinese contractors with Chinese loans especially around Hambantota, give poor economic returns, and contributed heavily to the current foreign exchange mess.

Of the country's electricity requirement, a large percentage is supplied from three Chinese coal power plants in Norochchalai each with 300 MW capacity. But plants break down frequently forcing to purchase thermal power at high costs. High cost of power and pollution concerns requires coal power be replaced by renewables and gas-based power.

With the Government decision to avoid foreign-funded projects, future Chinese projects will reduce. But investments and projects expected in the Port City and Hambantota would see continuous activity by Chinese contractors.

Japanese in Sri Lanka

Japan maintained excellent relations with Sri Lanka since J.R. Jayewardene, then Finance Minister's speech at San Francisco Peace Conference in 1951. After the 1973 riots when the entire world boycotted Sri Lanka, Japan still maintained normal relations.
When RDA commenced Baseline road development, Japanese funded the flyovers over railway crossings. Even today, the massive bridge over Kelani River and the complex of flyovers are funded by Japan.

In 2016, Japan offered to build a 500 MW coal power plant and the Government accepted. Also, when the Government wished to shift from coal to gas, Japan agreed to the change. In July 2017 Cabinet accepted the proposal, but no further progress.
In March 2019, Japan International Cooperation Agency (JICA) signed a loan agreement with SL Government for a loan of 30 billion yen to establish Light Rail Transit System to ease Colombo Malabe traffic. A notable feature of Japanese loans is the long-term payback period with extremely low interest.

Colombo Port

Colombo is among the busiest ports in the world, with a capacity of seven million TEUs. CICT-managed South Terminal with three 18 m deep berths is capable of accommodating the biggest container ships. Privately-owned South Asia Gateway Terminal (SAGT) has 15 m deep three berths. SLPA-owned Jaya Container Terminal (JCT) has two berths also 15 m deep. In addition, two other berths in JCT are 12 and 13 m deep could handle only small ships. But most cranes at JCT are 20-30 years old work far below their capacity.

Colombo Port handles over 75% of Indian export and import containers and India is concerned of their containers being handled by Chinese and are developing their own ports.

Financial crisis

Many do not realise the financial crisis faced by the country. The Government needs to settle over $6 Bn foreign loans next year and similar payments over the following years as well. The Government has declared not to accept foreign project loans. As for local expenditure, Government staff salaries were paid with loans obtained from EPF, ETF and Government banks. Daily FT reported that Central Bank printed a record Rs. 650 Bn in 2020. The treasury warned Government organisations that no additional funds would be allowed beyond the budget allocations. Meanwhile the country's forex reserves fell by $ 306.4 Mn to $ 5,549.3 in November 2020 from a month earlier.

The Government has contacted India, China and Japan help for settling foreign commitments. New Delhi provided $ 400 Mn currency swap in 2020, and SL has requested further $ 1 Bn currency swap with Reserve Bank India and further $1 Bn debt moratorium on loans Sri Lanka owes India. China has pumped in $ 500 m in 2020 out of a $ 1.2 Bn syndicated loan through China Development Bank. Sri Lanka has approached Beijing for further $ 1.5 Bn currency swap. Above shows the critical nature of our relations with India and China.

East Container Terminal

The development of ECT commenced in 2013 and first 400 m of the 1,200 m long jetty was completed and tenders were called for container handling cranes.

During the previous regime the Cabinet accepted extending JCT and importing container handling cranes. Although JCT was not extended, cranes arrived in Colombo that were ordered by the previous Minister. The cranes were unloaded at ECT and SLPA workers demanded ECT should start operations with arrived cranes. When the government was reluctant, SLPA workers stopped work bringing port to standstill as container movement got disrupted. With the general election around the corner, PM had discussions with Trade Unions and the strike ended. ECT commenced operations with the arrived cranes.

When the port workers struck work, also when workers were infected with Corona virus, Port was unable to handle the container traffic resulting ships in queues and bypassing Colombo, indicating the critical handling capacity of Colombo Port.

India to assist Sri Lanka

In addition to joining hands with ECT, India wishes to develop Trincomalee as a regional petroleum hub as proposed by Indian PM on number of occasions.
The country needs several investments urgently, but lack finances to implement. The country expects assistance from friendly countries to overcome payment issues. But extending current payments and new loans would extend payment needs for a foreseeable future. Thus, investments need to be joint ventures.

Developing Trincomalee oil tanks

Oil tanks in Trincomalee numbering 99 were built by British during late 1930s, each with 12,100 metric ton capacity. Only 15 tanks are used by Indian Oil Corporation (IOC). The remaining 84 tanks are unutilised and refurbishment would cost around $ 2 million, yielding 1.2 million metric tons of storage, far in excess of domestic requirement. The refurbished tanks with spacious sea and land would allow establishing South Asia's energy hub, as proposed by Indian PM.

The proposed energy hub would include

a. Crude and refined oil storage
b. An oil refinery
c. LNG import, gasification plant and storage
d. Gas based electricity power generation

The size of each plant could be based on local requirement and export capability. Establishment would allow stabilised fuel supply from world oil price variations, cheaper gas-based electricity, also supplying gas to existing generating plants.

Establishing above projects would be extremely expensive, but Japan has indicated to fund the projects sponsored by India and some were proposed by Japanese earlier. In addition, other prospective investors too could be invited to participate.

All above would-be joint ventures and foreign investments would help to stabilise foreign currency levels and operations would bring in foreign exchange, technical know-how and employment to locals.

Development of Trincomalee would balance involvements between China, India and Japan. In addition, with close corporation of USA with India and Japan, would result USA looking at Sri Lanka in more favourable terms.

For the full article – Refer the Daily FT

2. Budget 2021: Playing ostrich or parading in the Emperor's new clothes?
By: Dr. Anila Dias Bandaranaike

- The government presented its inaugural budget in November 2020. However, analysts studying the numbers pointed out a few flaws including, not having numeric estimates of the revenue impact, key estimates differing between the budget speech and the statistical tables and inconsistencies between the budget proposals and associated numeric targets.

- These drawbacks are significant, given the economic environment that the country is facing in 2021. There is little provided to deal with the upcoming debt crisis, and measures for shoring up revenue are minimal as well. A lot of the estimates were also quite optimistic, and could provide an unrealistic expectation of what 2021 could end up looking like.

- As such, the estimates in budget 2021 were unrealistic and the monetary allocations in Budget 2021 were neither relevant to the government's vision nor Sri Lanka's short-term and long-term priorities. Given the above conditions it is imminent that, during 2021 and beyond, Sri Lanka will remain a country of vast potential and lost opportunities.

The national budget is a financial plan, not a policy statement. Unfortunately, Budget 2021 parts did not add up to a consistent whole. Yet, Sri Lanka's leadership in both public and private domains did not seem to care.

Parliament and corporate response to the 2021 Budget

Budget 2021 was presented in Parliament on 17 November 2020. Several analysts with knowledge, experience, and integrity reported that this budget

1) provided no numeric estimates of the revenue impact of the budget proposals (e.g. revenue lost or gained under each tax revision or concession);
2) had key estimates differing between the budget speech and the statistical tables by Rs. 50-70 bn, (e.g. Rs. 1,961 bn vs. 2,019 bn for revenue, Rs. 3,525 bn vs. 3,594 bn for expenditure); and
3) had glaring inconsistencies between the budget proposals and associated numeric targets (highlighted below).

A new government with Sri Lanka at crossroads

This was the maiden budget of a strong new government, elected with the people's blessings, with greater powers under the 20th Amendment to the Constitution and a two-thirds majority in Parliament. Budget 2021 was a unique opportunity for a strong, capable government to implement difficult reforms to address Sri Lanka's priorities. Alas, they lost this opportunity.

Sri Lanka is at a crossroads in a new global reality created by COVID-19. This reality underlines the fragility of global connectivity and uncertainty of pre-COVID-19 economic activities as we knew them. International and domestic movement of people, goods, and services can no more be taken for granted. Sri Lanka's priorities must adjust to this new reality.

As I see it, Sri Lanka's immediate priorities should be to address:

- a pandemic-related health and welfare crisis; and
- a looming economic and debt crisis

Sri Lanka's long-term priorities should be to reverse:

- People/skills drain of 200-300,000 per year, searching for greener pastures abroad;
- Environmental drain, with rainforests, sanctuaries, mangroves, coasts destroyed for short-term monetary gains; and
- Investment drain, with investment below 30% of GDP and declining.

Budget 2021, oblivious to reality, ignored both pandemic and priorities.

Irrelevant Budget

The Government's policy statement, 'Vistas of Prosperity and Splendour' is embodied in its 10 key principles. As I see it, those principles can be divided into three categories, People, Environment, and International Relations.

<u>People</u>: People centric economic development (6) in a technology based society (7) with a productive citizenry and a vibrant human resource (5) in a disciplined, law abiding and values-based society (10) under a new constitution that fulfils the people's wishes (4) and an administration free from corruption (3), giving priority to national security (1).

<u>Environment</u>: Development of physical resources (8) with sustainable environmental management (9).

<u>International Relations</u>: A friendly, non-aligned, foreign policy (2).

The budget speech hit some good buttons, consistent with their vision and Sri Lanka's current reality – support the rural heartland, agriculture and small entrepreneurs; protect the environment; promote technology and vocational training; raise investment; curtail non-essential imports and expand exports; etc. However, budgetary allocations in the Appropriation Bill told a different story, as follows:

People: The Ministries of Defence (Rs. 355 bn) and Highways (Rs. 330 bn) were allocated 26% of total expenditure (Rs. 2,678 bn), while Health (Rs. 220 bn), during a COVID-19 crisis, Education and related ministries, including pharmaceuticals, distance learning, technical and vocational skills and education reforms, (Rs. 177 bn) together, were allocated only 15% in total.

Most people live in rural communities. Yet, 15 ministries responsible for their key needs—agriculture, fisheries and livestock, irrigation and water supply—together only received an allocation of 10% (Rs. 262 bn) of the total. The major share of Sri Lanka's employment and output (GDP) is with her informal sector, not corporates. In Sri Lanka's labour force, 53% work in the informal sector. They have no social security. 18% work in the public sector and only 29% work in the formal private sector. Yet, significant tax concessions and incentives in the budget prioritised listed or large corporates. The vast majority will continue to pay indirect taxes on their basic consumption, inconsistent with principle 6.

Critical structural reforms to address the mismatch between products of the education system and needs of the labour market, particularly English, mathematical, analytical and technological skills, identified in the policy statement, need funds. Yet, education reforms, vocational training and research and innovation received a paltry Rs. 15 bn (0.5% of total expenditure), despite principles 5 and 7.

Critical structural reforms in the wage structure and labour laws to address employee dissatisfaction and reverse the exodus of professional, skilled and unskilled persons from Sri Lanka need funds. Without budgetary allocations for such reforms, brain and skills drain will continue, contrary to principle (5).

Environment: The entire allocation for the environment (Rs. 9 bn) is below 3% of the Defence or Highways allocations. The environment is facing serious problems due to ill-conceived construction, encroachment, poaching, illicit logging and destruction of national parks, dry zone forest cover, rainforests, mangroves and wetlands. Yala, Wilpattu, Sinharaja, Anawilundawa, Mannar, Moneragala are examples highlighted in mainstream and social media recently. This budget only pays lip service to principles 8 and 9. Soon, we will have nothing to attract tourists in the short term nor for future generations in the long term.

International Relations: This budget has been unable to build confidence with long-term foreign investors (highlighted below) to raise foreign investment, despite principle 2.

In summary, monetary allocations in Budget 2021 were neither relevant to the government's vision nor Sri Lanka's short-term and long-term priorities.

Unrealistic Budget

Budget 2021 estimates and strategies were unrealistic. For example,

1.The Budget's GDP growth estimates were -1.6% for 2020 and +5.5 for 2021. Official GDP statistics released on 15 December recorded a contraction of -5.3% for the first three quarters of 2020. With the COVID-19 second wave, 2020 GDP will obviously contract by more than -5.3 %, highlighting the unrealistic optimism of GDP estimates.

2.The investment estimate was also optimistic. The official release of 2020 2nd Quarter GDP contraction of -15.3% was delayed by three months. Loss of confidence among potential local and foreign investors, by the deliberate withholding of official statistics, cannot be overcome by tax breaks and incentives. Two rating agencies, Fitch and Moody's, downgraded Sri Lanka recently, criticising economic management. Subsequently, the Citi Group went further, actually stating that the Government is "in denial". Serious long-haul investors will want positive signals from rating agencies. Who will invest here now?

3.The estimates for inflation and private sector credit expansion were inconsistent. The State Minister stated that there will be no IMF bailout, while the budget speech stated that bilateral loans and domestic borrowing would meet the deficit. This conveys that government will borrow from captive sources like state banks, EPF and ETF. Till now, with low private credit demand, interest rates have remained low. The estimated optimistic rise in private sector credit by 14.7% (6% in 2020), together with high Government borrowing and low interest rates cannot all three be reconciled. Alternatively, printing money will raise inflation to well over the 5% estimate.

4.Revenue was overestimated in relation to actual data up to October. With the tax breaks and tax holidays given, from where will this huge revenue appear in this current climate?

5.Budget 2021 made no effort to trim public sector expenditure, contradicting the policy statement. The deficit will likely be higher than estimated due to higher recurrent expenditure and debt repayments, unless investment is cut below budget, as has been done in the past.

6.The unrealistic economic strategies proposed for import substitution and export and investment promotion, respectively, were tried and failed in the Bandaranaike Government of '70-77 and the Jayawardena Government of '77-'90. Can old rhetoric promoting failed ideas succeed 30-50 years later?

In summary, Budget 2021 numbers were both unrealistic and inconsistent with Sri Lanka's current economic and financial situation.

In conclusion, this budget is a farce set in an alternate reality. I cannot understand whether those who prepared it and who supported it are entirely devoid of thinking capacity or callously devoid of any regard for our people and our environment. Are they playing ostrich to fool themselves or making the emperor parade in his new clothes to fool himself and others? Either way, during 2021 and beyond, Sri Lanka will remain a country of vast potential and lost opportunities.

For the full article – Refer the Daily FT