Spotlight: Econ Op-eds in Summary

Week ended 16th December '20

In Summary

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

1. Why Sri Lanka cannot be a Singapore: Chief Festus Budget
By: Bellwether

- Sri Lanka aspired to be a Singapore after liberalizing trade and ending a closed economy of the 1970s, however, the current situation in the country indicates that this may not be possible. One of the major problems Sri Lanka faces is its continuous reliance on import substitution.

- Looking into the lessons from Singapore, it is clear that this is not a policy favoured by investors and businesses. Another threat to Sri Lanka comes from nationalism which over the years had resulted in conflicts that had pulled back the country's economy and made the economy unattractive for investments. This had been amplified by regime uncertainty.

- Another threat that looms in front of Sri Lanka comes in the form of money printing for debt servicing, which is the result of the powers rested on the Central bank by deciding to eliminate the currency board in 1951. Almost all Prebisch-Triffin central banks in Latin America that tried import substitution ended up with sovereign default or complete meltdowns. It is now time for Sri Lanka to learn a lesson, from these countries if it is to make the dream of becoming a Singapore come true.

Sri Lanka aspired to be a Singapore after liberalizing trade and ending a closed economy of the 1970s, but it all failed as the currency collapsed, triggering unrest and strikes while smouldering nationalism ratcheted up into a civil war and later, trade controls came back. All economic activity was tied up in draconian import and exchange controls while the central bank bought Treasury bills to finance the deficit. The 2021 budget has taken the country back to the 1970s era with all efforts to 'save foreign exchange' amid the worst money printing in its history, and looming sovereign default with the credit rating at 'CCC' which is barely above default. Sri Lanka is effectively locked out of bond markets. Most Latin American countries with bad central banks, that engaged in import substitution to save foreign exchange and boost domestic industry, also ended up in sovereign default. The greed to make easy profits through the exploitation of the common people through high tariffs and import substitution, flourishes under soft-pegged central banks which create forex shortages. There is also a profound lack of understanding that trade and current deficits are created mainly by deficit spending with foreign borrowings, with private individuals being net savers who buy Treasury bills.

Import Substitution Greed

The current administration came to power criticizing a free trade deal with Singapore. "Free trade agreements should be drafted with strategies to bridge the trade gap by limiting imports through the production of goods that can be manufactured within the country, facilitating industrial development," Prime Minister and Finance Minister Mahinda Rajapaksa said. "Therefore, I propose to formulate a balanced trade policy yielding long-term returns so as to increase the export earnings of our industrial products and to save foreign exchange through import substitutions." The line was running all along the budget for 2020. "Since the foreign exchange spent on the importation of fuel for power generation is saved through the development of renewable energy, it will be one of the main import substitution industries," it said.

The easiest path to easy money is to produce basic goods; food, clothing and shelter which people cannot do without and sell them at exorbitant prices under the cover of protective tariffs. The policy would be "limit importation of agricultural commodities except for the items that cannot be produced domestically (negative List). Maize is another racket where billions are made, restricting imports through taxes as well as licenses and selling overpriced grain to chicken farmers and feed millers. Shoes of school children continue to be taxed heavily to give profits. Owners of Sri Lanka's 'infant industries' have sent two generations of their own children to study at foreign universities while children of poor families are struggling to buy food. This is in sharp contrast to Singapore which created free trade in a single day in 1967, or Vietnam which had no private enterprises to oppose free trade when the Communist Party decided that self-sufficiency had failed.

Chief Festus

Singapore's Prime Minister Lee Kwan Yew once recalled having met the then Finance Minister of Nigeria, Chief Festus Okotie-Eboh in 1966 at a Commonwealth meeting in Lagos. "I will never forget Chief Festus," Prime Minister Lee Kwan Yew said at a meeting of African Leaders in Lagos in 1993. "We had sat opposite each other at a formal dinner at the hotel where we were all staying and where the conference was held. He said that he wanted to leave politics soon to devote more time to his business – that of a shoe factory. He also said that he had increased taxes to protect the viability of the shoe factory." "Two days later, whilst I was in Accra a coup took place in Lagos. The Nigerian Prime Minister Abubakar Tafawas Balewa was killed, along with the Finance Minister, Chief Festus Okotie-Eboh." Chief Festus was a former accountant of Bata in Nigeria who had set up his own shoe factory later.

In Sri Lanka's Chief Festuses are now dictating policy. A shoe is to be taxed at 1,000 rupees a unit. There are Chief Festus's not only in shoes but in most inefficient industries which are export un-competitive. A number of building material producers in steel, tiles, and aluminium are exploiting the people with overpriced goods and making the country uncompetitive in exports and tourism as well, and putting houses out of reach of married couples and making them take bigger loans than needed. Meanwhile, in a bizarre policy twist, tax-free inputs are allowed for mega property developers involved in luxury apartments. After pushing up housing costs, 7% interest rates loans are also mandated in a price control on banks. The bigger problem is while the ordinary people are paying high prices under cover of the tax, the money is not going to the government budget but to the pockets of the Chief Festuses. The import substitution Chiefs are not actually producing anything but are going through the motions of production and are collecting and pocketing the taxes, in a tax-arbitraging action.

Robbed Freedoms

Sri Lankans got economic freedom after the British East India Company monopoly and trade protection was dismantled by the colonial civil service officers. After self-determination in 1948, Sri Lanka's Chief Festuses and state enterprises gradually robbed freedoms, justifying protection to save foreign exchange, where shortages started to come after 1951. It was not just Chief Festuses giving campaign contributions to politicians that drove import substitution, though this seems to have become the driving force of the phenomenon later

The ideological support for exploitation of helpless poor by import substitution was given by the likes of Raul Prebisch, the architect of the Argentina Central Bank who promoted state-led industrialization to catch up with the West. In many Latin American countries with bad central banks inspired by Prebisch and fellow traveller Robert Triffin at the Federal Reserve, import substitution naturally followed as money printing created forex shortages. Foreign exchange shortages occurred regularly in Sri Lanka also after a Latin America style central bank was set up in 1951 by Fed money doctor John Exter. Instead of fixing the central bank which is the source of the trouble, people were being told that they must pay higher prices and forego foreign goods and allow their pockets to be picked by 'domestic' industries which could not compete elsewhere.

Dependency Theory - Structuralism

But the philosophy that was articulated by the likes of Prebisch was much broader. The Prebisch-Singer hypothesis, for example, claimed that the primary commodity exporting countries were at a disadvantage (before WWII during the great depression, commodity prices collapsed as credit collapsed in the US) and they were dependent (dependencia) on industrial countries. Proponents came up with the theory that there was a centre and a periphery. In actual fact, industrial firms collapsed in the US also, creating mass unemployment, while farms were foreclosed. In Latin America, multinational companies (MNC) were demonized particularly due to the actions of firms like the Boston Fruit Company. As currencies collapsed and cost-of-living was driven by the central banks, socialists came to power. Anti-Americanism flourished. Later the backlash against neo-liberalism also came from countries like Chile where market reforms were constantly undermined by depreciating currencies. Santiago academics were a fanclub of Prebisch. The International Monetary Fund (originally a New Dealer agency) invited the backlash by not fixing the central banks and supporting currency depreciation on ideas such as 'overvalued' currencies. Every fiscal reform failed at the hands of depreciating currencies. The so-called 'overvaluation' never went away in these countries, despite ever present depreciation. Ideas like dependencia or the 'Global South' may have been easy to push to anyone who had an inferiority complex and were prepared to believe that so-called 'white' people were capable of doing something they themselves could not do. Singapore rejected these ideas outright. "Singapore rejected conventional wisdom when it did not accord with rational analysis and its own experience," Prime Minister Lee said. "For example, in the 60s and 70s, it was politically correct to be anti-American and anti-MNC. The theology expounded by Latin Americans like Raul Prebisch was that MNC would reduce them to "dependancia". We did not accept this. "Instead we assiduously courted MNCs. They had the technology, know-how, techniques, expertise and the markets. We decided it was a fast way of learning on the job working for them and with them. Indeed they have been a powerful factor in Singapore's growth."

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Subjugated by self-determination

Monetary instability and economic nationalism were not the only cancers unleashed on the people by the new rulers who got control of the state machinery from former Colonial rulers. The roots of most of Sri Lanka's problems are also not new. Outright ethno religious fascism, rarely if ever found under ancient kings, spread like cancer after self-determination, though it was festering earlier. Linguistic nationalism came in 1956 with the Sinhala only Act, through a law-making parliament created by the British. Sri Lanka's last King was Kannasamy Nayak (Sri Wickrema Rajasinghe) descending from the many wives of former kings imported from South India who nationalists would call a 'Tamil' or a Dravidian (South Indian).

Nationalism

Like French was widely used in Royal Courts around Europe where inter-marriage is the rule (The 'British' monarchs are 'German') Tamil was spoken in the Royal Court. Kings had no problem with commoners having different languages or races – in fact, successful emperors rule over vast regions with people of many religions and races, knighting even the most successful commoners among and taking them under their wing. But in a democracy (read popular vote) appealing to the majority and discriminating against the minority was the easiest path to power. This was a problem of many new countries given self-determination by Imperial powers. Without the vote, it had not been too much of a problem when Empires broke up in earlier ages. It became a visible problem from the break-up of the Austro-Hungarian Empire in Europe in the 19th century,

Turkey itself (Armenians) after the break up of the Ottoman Empire as well as Africa and Asia where mainly European powers ruled in the 20th century. This is what Prime Minister Lee told African leaders, where there were many tribes. "The Singapore solution to the problems arising from its young nationhood has been a policy of deliberate gradualism in all issues which involve race, language, culture and religion," PM Lee explained. "We are 76% Chinese, but of different clans speaking different dialects from different parts of China. We are 15 per cent Malay-Muslims from different parts of Malaysia and Indonesia. We are seven percent Indians from different parts of India. The rest came from Europe and other parts of Asia. We need a common language. We solved this by making everybody learn not one but two languages, English and the mother tongue. "English is not any group's mother tongue, so no advantage is gained or lost by any one group. "We have neither forced nor pressure-cooked a national identity. We have refrained from suppressing ethnic culture, languages, religions or sense of identity." In Sri Lanka, religious nationalism also took wing along with linguistic nationalism, with religious leaders adding fuel to witch's brew of ethno religious fascism. Minorities cannot solve the problem of nationalism. Only the majority can. It was the 'Chinese' majority who solved the problem in Singapore. Slavery was not abolished by the slaves, but by the mainly white liberals. Donald Trump was defeated mainly by white male voters switching under the leadership of a white man, while the share of blacks and Latinos voting went up according to exit polls in the US.

Regime uncertainty

Regime uncertainty also came pretty fast as the new rulers expropriated both foreigners and local businesses. British owned plantations were expropriated both in Sri Lanka and Zimbabwe, where the central bank ended up in hyperinflation. Singapore did the opposite.

"Singapore consciously set out to maintain continuity with past policies. We accept our colonial heritage," PM Lee said. "Continuity with the past helps the evolution into new growth sectors. This is one of our secrets to growth. We encouraged all British, European, American, Japanese and Asian businesses to stay and expand their investments. We encouraged our own businessmen to enter trade and manufacturing and services not by displacing these foreign enterprises but by working as their suppliers or competitors." Sri Lanka expropriated bus companies, the Bank of Ceylon and land along with oil companies. In 2011 more firms were expropriated.

Latin American structuralism

Singapore did not always have free trade, though it always had monetary stability (except during Japanese occupation in WWII with Banana Money) due to having a currency board. When Singapore was part of the Malayan Federation and a so-called 'common market', import substitution was attempted based on the Prebisch style theory. Prebisch's Latin American structuralism had infected Malaysia as well. Prebisch became influential because he became director of the Economic Commission for Latin America and later the United Nations Conference of Trade and Development, which did enormous damage to newly independent countries, impoverished them and kept them in the so-called third world.

"Like the other developing countries in the 1960s, Singapore tried to kickstart industrialization through a policy of import substitution, advocated religiously by academic UN Economists," recalled top civil servant Ngiam Tong Dow in 'A Mandarin and the makings of public policy'.

"Import tariffs were imposed on a full range of consumer products to give fledgeling domestic industries time to grow.

As Singapore's domestic market was minuscule, we sought a common market with Malaysia through a political merger. On gaining independence on 9 August 1965, we had to learn very quickly to face frontally the headwinds of global competition. "Fortunately for Singapore, we were the exception in a world of infant industry protection. Multinational companies invested in Singapore because we practised a free and open economy without exchange controls or protected industries."

Liberty at midnight

The Malaysia-Singapore separation took place on 9 August 1965. "Mr. I F Tang (a colleague of Albert Winsemius, a Dutch economist who advised Singapore) played a great role in our economic development," recalled Ngiam. "Before that, we were perusing import substitution. The Malaysian common market was the order of the day. "But the moment we left Malaysia, there was no more Common Market. There was no more domestic market. So I F Tang gold Dr Goh (Keng Swee), "Ok from now on we must be export oriented. "And in one stroke we removed all duties and tariffs." In Sri Lanka, Mercantilists always claim that tariff removal must be gradual. It is not so. In 1978, tariffs were removed. By 1994 when A S Jayewardene took over as Treasury Secretary a large portion of government revenue still came from import duties. "I felt sorry for the Small and Medium sized Enterprises because they believed in us," Ngiam said. "We sold them the idea of Malaysia, the Malaysian Common Market. And then we put duties to protect the Common market, so they built factories and started their business. So when we left Malaysia they were left holding the can. And then we invited the MNCs in. So sometimes it is difficult. We have to adjust. "But now I am glad to see that SMEs have become independent. They are the ones who are producing components, the contract manufacturers. I would say the EDB (Economic Development Board) had a role in this because in the EDB we set up training centres." However, if the domestic market is insulated, no firm will become cost competitive to produce components for exporters. Ngiam recalls how he called Colgate which had a plant in Singapore to ask why they did not drop the price after the taxes were taken off to be told that the price was set at what the market could take. "So they never dropped the price," he said. "So having domestic industries does not mean that prices will drop at the marketplace. Only competition does that. So later on you had other brands of toothpaste coming in. Only then did the prices drop. So I think competition is the key to efficiency, not protection. And if we remove the protection it doesn't mean the manufacturers will drop their prices. No, only competition does that."

Sri Lanka also had a currency board when Malaysian firms raised capital in our stock market before self-determination. But in 1951 a Latin America style no holds-barred central bank was set up with an unrestrained constitution.

Infant industry was a concept that pre-dated Latin American import substitution. It was started in the US by Alexander Hamilton and was made popular in Europe by Friedrich List, a German historical economist, which is a type of Mercantilism. "Fortunately for Singapore, we were the exception in a world of infant industry protection," Ngiam said. "Multinational companies invested in Singapore because we practised a free and open economy without exchange controls or protected industries."

Foundation of monetary stability

Singapore did not have exchange controls because it refused to build a soft-pegged central bank, which was a mistake of many newly independent nations. As a result, underpinning the policy framework was monetary stability. Without monetary stability, people will take to the streets as the cost of living goes up and the government will get kicked out even if it practices sound policies. Corruption rises as real wages fall, especially in the public sector. Permits, controls, price controls and smuggling degenerates the entire society. Singapore's economic framework was backed by monetary stability through a currency board, which was a legacy of the British. The British honoured all the pre-war money after the end of Japanese occupation. Singapore's first Finance Minister, a classical economist who had studied at the London School of Economics, kept it intact.

"That was to Dr Goh's great credit," Ngiam recalled. "He believed in the Currency Board system. I would say there were two very successful policies in Singapore, which we claim to be our very own. First, the Central Provident Fund. Second, the Currency Board. Both were actually British colonial policies, which worked so well that we retained them even when we were on our own. "And with a Currency Board, before you can issue a dollar, you must have so many pounds banked with them as a reserve. Every (Singapore) dollar is fully backed by reserves. The system maintains its own stability. It is a beautiful system. It can never lead to currency depreciation. "The currency board is a very clever idea. Very clever. So even after Brits left, Dr Goh did not change the Currency Board. So that is why our currency is still fully backed. "The Finance Minister will never be able to issue currency unless he has reserves to back the currency. Singapore can ever print money. So we will never have runaway inflation. What the British imposed on us turned out to be a great virtue." Goh later modified the currency board to be able to appreciate the currency, but with a floating policy rate as in a Currency Board and it is the only such system in the World. The Singapore dollar is now about 1.2 to the US dollar from the original 3.0 to the dollar.

Looming threat

Sri Lanka also had a currency board when Malaysian firms raised capital in our stock market before self-determination. But in 1951 a Latin-America style no-holds-barred central bank was set up with an unrestrained constitution. The anything-goes Monetary Law allowed the central bank to do anything.

Argentina's per capita GDP was almost the same as the US before the soft-pegged central bank was set up in 1935. Mexico was once an Imperial power that owned parts of what is now the US but its soft-peg reduced the country to a basket case. Even now, most of the immigrants into the US come from Latin American countries with Prebisch-Triffin central banks. Sri Lanka's central bank went to extremes under the Sirisena Wickremesinghe administration, creating two currency crises and imposing deposit rate controls, breaking all restraints. It is hitting new lows in 2020. Its Treasury bill holdings are over half a trillion rupees.

"Our economy was and is both small and open. Financing budget deficits through Central Bank credit creation appeared to us as an invitation to disaster," Goh said at the 30th anniversary of the Monetary Authority of Singapore. "There was no effective way of exchange control in an open trading economy like ours to deal with the inevitable balance of payments troubles." In Sri Lanka, balance of payments troubles are blamed not on state failure but on imports and the people, who – wonder of wonders – happen to be net savers in the banking system and also buy Treasury bills to finance the government – unless their bids are rejected and money is printed for the holy grail of targeting the yield curve. It is all happening now, again. But this time it is more dangerous. Sri Lanka got away in the 1980s with massive money printing because there was no commercial debt and trade was relatively free. But Sri Lanka now has a credit rating of CCC. Almost all Prebisch-Triffin central banks in Latin America that tried import substitution ended up with sovereign default or complete meltdowns. But it is never too late to learn a lesson, even now.

For the full article - Refer Echelon

2. Protecting jobs & enterprises during crises: How can Sri Lanka respond better?
By: Ashani Abayasekara

- The Budget 2021 proposes a COVID-19 Insurance Fund, stirring controversy among different stakeholders in the country, as the government has limited fiscal space to extend further relief to the public. Employees are currently covered by the EPF and ETF, where there is limited provision for a withdrawal of funds in the case of economic shocks.

- These funds are managed by the Central Bank and represent the largest source of investments for government domestic borrowing, so the fund itself is heavily affected when the government is cash-crunched. Currently, contributions to the fund remain low due to evasion and manipulation of contribution requirements, among other factors.

- In the wake of COVID-19, other countries have made amendments to their EPF regulations to bolster employee protection. In line with this, Sri Lanka should take this opportunity to reform EPF regulations to come to a fairer agreement between employers and employees. A possible option in this context is to allow withdrawals from the EPF to provide assistance during crisis periods.

The policy proposal in Sri Lanka's 2021 Budget to impose a 0.25% tax on the revenue of companies to set up a 'COVID-19 Insurance Fund' has raised concerns among many private sector industry stakeholders. They argue that this is a big blow to industries already suffering in the wake of the pandemic, and warn that mandating payment of an additional tax can push them to reverse current measures taken to retain staff, amidst dampened business activity and customer demand.

The government's aim of establishing a guaranteed fund to help workers during COVID-19 and other future crises is well-placed. Statistics from the Department of Census and Statistics show that Sri Lanka's unemployed population rose by 100,000 during the first quarter of 2020, along with the first countrywide lockdown in March. Increased job losses, however, are often a reflection of enterprise losses too. According to an e-survey conducted by the Department of Labour among a sample of 2,764 private sector organisations, as of May 2020, 53% of the interviewed businesses were closed, and 39% of establishments indicated an inability to pay worker salaries. The means of generating emergency funds, therefore, needs to be thought through carefully for it to be sustainable in the long-run.

While the government – which is grappling with massive debt burdens and fiscal deficits – has limited capacity to assist workers and employers, are there ways in which current employment-related social protection programmes can be used to provide for both job and enterprise protection during crises? What measures have other countries taken that Sri Lanka can learn from? This blog examines these issues.

Current Protection for Private Sector Workers in Sri Lanka

Private sector employees in Sri Lanka are covered by the Employees' Provident Fund (EPF) and the Employees' Trust Fund (ETF), both of which provide a lump-sum payment at retirement. Employers and employees contribute jointly to EPF at rates of 12% and 8% of monthly wages, respectively, whereas ETF is financed entirely by employers who are required to contribute 3% of an employee's salary. Early withdrawals from both funds are only allowed for specific reasons, such as a permanent sickness or disability or permanent migration. There is also limited provision for withdrawal of funds under specified circumstances, such as in cases of economic shocks. The funds are managed by the Central Bank, and represent the largest source of investments for government domestic borrowing. This means that when the government is cash-crunched, so are the funds.

The active contributions to and usage of the funds have been low due to several reasons, including poor awareness of the schemes and its benefits, and evading or manipulating contribution requirements, given the absence of any near-term benefits and concerns of its sustainability. As of end 2018, the EPF had a total of 18.6 million accounts, of which only 2.6 million were active, while only 43% of employers contributed to the ETF in 2017.

COVID-19 Policy Responses in Other Countries

The rapid spread of COVID-19 has seen governments across the world resorting to unprecedented measures to support workers and businesses, including income support, investments in healthcare, job retention schemes, and business facilitation. Many developed countries have used already existing unemployment insurance schemes – designed to protect workers against job losses – to extend support. Additionally, countries with provident fund schemes similar to those in Sri Lanka have provided extra benefits and introduced more flexibility.

India's EPF scheme, for example, allows a non-refundable advance when the government has declared a disaster or epidemic, which employees need not deposit back into their EPF account. An amendment to the EPF regulation following COVID-19 now allows employees to withdraw up to 75% of their savings as a non-refundable advance, or three months' basic salary, whichever is lower. The government also cut employee EPF contributions to 10% from the existing 12% from May-July 2020.

In Malaysia, employees below the age of 55 are allowed to withdraw RM500 (~LKR 22,700) per month from EPF for 12 months, starting March 2020, to buy essential goods. The minimum EPF contribution by employees was reduced from 11% to 7% from 1 April to 31 December 2020, while discussions are also underway to allow certain contributors such as laid-off workers to withdraw funds. To assist employers, an Employer Advisory Scheme was introduced, which evaluates the specific conditions of affected companies and offers tailored plans on EPF contribution schedules, including restructuring or staggering payments for outstanding contributions.

Employers in Singapore are supported via a Jobs Support Scheme, under which they receive a 25% cash grant (up from 8% pre-pandemic) on the monthly wages of each employee who is part of the Central Provident Fund. In Brazil, the government increased withdrawal limits from the Fundo de Garantia por Tempo de Serviço (FGTS) – a fund which provides account-based cash benefits to employees on termination of employment for any reason – up to R$ 1,045 (~LKR 37,000) per worker until December 31 2020, which is expected to benefit over 60 million workers. The FGTS is entirely funded by the employer, via compulsory monthly deposits equivalent to 8% of the employee's salary.

Looking Ahead

The COVID-19 impacts on Sri Lanka's labour market have made a strong case for revisiting employment social protection. The country should take this opportunity to introduce reforms to make better use of employment provident funds to support both workers and companies during times of crisis. The above country examples provide important insights in this regard, particularly in allowing for flexible withdrawals from funds in emergencies. Encouraging more active and regular contributions is essential for there to be sufficient funds to draw from when needed. One option in the current context is to allow withdrawals from ETF – currently funded solely by employers – to provide assistance during the crisis, instead of requiring employers to make additional contributions to a new fund.

Assigning the management and administration of the funds to an independent body is also important to assure a guaranteed return upon retirement or to draw from during emergencies. Creating more awareness of the schemes and different types of benefits they offer will also help encourage more participation.

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