Spotlight: Econ Op-eds in Summary

Week ended 06th January '20

In Summary

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

1. Three formidable challenges in 2021: Containing COVID, debt repayment and fiscal deficits
By: Nimal Sanderatne

- Containing COVID is something many countries have struggled with. Achieving the right balance between containing the virus and relaxing restrictions for economic activity to take place is a formidable challenge. However, effectively containing the pandemic would be a precondition for achieving the potential growth of over 4 percent for this year.

- Repaying foreign debt is the most serious economic challenge we face this year. However, the government and other authorities are confident that this challenge can be met by either commercial or bilateral borrowings, foreign investments or potential facilities from multilateral agencies.

- The fiscal deficit is also likely to remain at an elevated level of 9% of GDP or more this year, weakening the country's ability to recover. A comprehensive programme for enhancing revenue and the effective implementation of development projects is required to achieve fiscal stabilization which would be a prerequisite for achieving economic and social development.

Containing COVID

Containing COVID from spreading and ensuring the least dislocation of economic activities is a tricky problem, as many countries have found. While lockdowns contained the spread of the virus in many countries, their relaxation led to fresh outbreaks necessitating further lockdowns

Economies

Many economies are paralysed. Most countries have opted to open up their economics with restrictions and health guidelines and social distancing. Sri Lanka too has advocated limited area-specific lockdowns and is administering regulations on complying with health regulations, limiting social and religious gatherings and practicing social distancing.

Nevertheless, the adherence to these precautions and social safety measures appear to be less rigid now.

Travel

Meanwhile the increase in island-wide travel during the festive season, large congregations at some churches, political gatherings, the travel to and pilgrimage to Adam's peak for the annual pilgrimage, and the opening up of the country for limited and controlled tourism are fraught with dangers of a new wave of the pandemic.

Danger

While stringent controls of social activities and tourism activities are difficult when the revival of economic activities are needed, the dangers must be recognised and prompt responses are needed to contain any resurgence.

The containment of the pandemic is a precondition for the country to return to its economic potential growth of over 4 percent this year.

Repaying foreign debt

The most serious economic challenge this year is the meeting of the country's foreign debt repayments. With the country's foreign reserves as low as about US$ four bn, a continuing trade and balance of payments deficit and no significant inflows of capital, the country's external finances are in a perilous state.

However, the Government, and other authorities are confident in meeting its foreign debt obligations in 2021,whether this is by further commercial borrowing at high interest costs, loans from friendly countries, large foreign investments that have been negotiated or facilities from multilateral agencies is not clear.

Fiscal consolidation

Bringing down the large fiscal deficits that the country has incurred in recent years is a prerequisite to macroeconomic stabilisation and economic growth. In the current state of the country's public finances, the deficit could be brought down only slightly from nine & of GDP or more this year. Even achieving the desired four to five percent fiscal deficit by 2024 is indeed a challenging task.

Bold decisions are needed to reduce the ballooning fiscal deficit by enhancing revenue by a comprehensive programme of progressive taxation, cutting down of non-productive and wasteful expenditure, reforming loss making state enterprises to reduce government expenditure and an effective implementation of development projects that increase the country's output and exports. Without fiscal stabilisation the country's economic and social development cannot be achieved.

The good news is that unlike the two previous years of economic retardation, the economy is expected to grow by about four percent in 2021. The growth statistic being assisted by the low output of the previous year when the production of goods and services contracted.

For the full article – Refer The Sunday Times

2. MMT: What's wrong with printing money
By: Sumanasiri Liyanage

- Recently, well known economists in Sri Lanka have criticized the government's monetary policy alleging that CBSL, while distancing itself from inflation-oriented policies has begun to follow closely the policy framework that derived from the main tenets of Modern Monetary Theory (MMT).

- MMT posits that a continuous increase in money printing through deficit finance after achieving full employment would generate an inflationary pressure and that inflationary pressure may occur if increased government expenditure focuses on elite projects and highly skilled employment.

- Thus, if a country like Sri Lanka adopts deficit financing and printing money in a crisis situation, it is imperative such policies should be accompanied by import restrictions, proper direction of Government expenditure and increase of direct taxation. Otherwise, the main criticism against the MMT, that it neglects inflationary pressures, could materialize.

Criticism has been set forth that the extant monetary policy paradigm of the Central Bank of Sri Lanka (CBSL) alleging that the CBSL while distancing itself from inflation oriented policies has begun to follow closely the policy framework that derived from the main tenets of Modern Monetary Theory (MMT).

MMT as new discourse on the monetary-fiscal policy mix gained credence among left leaning Democrats especially during the presidential campaign in the US. Why is the issue of MMT raised in the Sri Lankan discourse? According to criticism, Central Bank Governor Prof. W.D. Lakshman's recent statement at an economic forum that domestic currency debt in a country with sovereign powers of money printing is not a huge problem is in close affinity with the MMT argument.

Of course, there is also the admission that the Government may borrow moderately. "What I mean by moderately is that money printing should not cause unwarranted unaffordable inflation."

MMT may be okay for advanced countries like the USA and Japan with reserved currency, but not for a small country like Sri Lanka. Moreover, he seems to think that MMT like policies are unavoidable at present conjuncture. He writes: "The recent monetary expansion points to imminent dangers in adopting MMT-style monetary policy in a country like Sri Lanka, though such policy stance might be unavoidable amidst the unprecedented economic setback caused by the COVID-19 pandemic."

This article intends neither to defend the extant monetary policy of the CBSL nor to posit that the main arguments of the MMT are correct. For myriad reasons, it is hard to say that the CBSL policy per se is governed by MMT. Nonetheless, the interpretation of the MMT given by Dr. Wijewardene and Prof. Colombage appears to have missed some of the complexities of the MMT argument as their contestation of the MMT seems to be based on the neo-classical and monetarist premise that money supply is exogeneous. On the contrary, post-Keynesians and MMT theorists posit that money supply is endogenous and linked with the effective demand. Hence, deficit financing does not necessarily lead to inflation.

Modern Monetary Theory

MMT proposes to bring the government to the fore. According to Randall Wray, the main weakness of macroeconomics texts and teaching today is that they start with unanswered question. Where does money come from? Modern macroeconomics skips this question leaving it to circular reasoning.

Secondly, the MMT may not be reduced to a notion that upholds deficit financing through printing money. It posits referring to historical evidence a nexus between printing money and redemption of tax. Hence, Dr. Wijewardene's following statement is a result of simplistic reading of the MMT. Critiquing Stephanie Kelton, he writes: "One of the bold statements of Kelton is that taxes are charged for paying for government expenditure is mere fantasy. That is because there are many other ways of paying for such expenditure such as printing money. Governments can pay for expenditure by borrowing. When it comes to repaying, they can print money and repay the debt. So, there is no problem."

Thirdly, MMT does not totally neglect as critics say the possibility of inflationary pressure as a result of deficit financing. It has its own explanation of the phenomena of inflationary pressure before achieving full employment and hyper-inflationary situations.

A simple MMT macro model is adequate enough to demonstrate the complexities of its basic postulates. Scott Fullwiler's MMT macro model that was derived from the famous Keynes, Kalecki Post-Keynesian identity (National Income equals National Expenditure), the key equations of the MMT read as follows:

Investment = Private Savings + (Tax – Government expenditure) + (Imports-Exports)

If Private Sector Surplus (PSS) equals Private Savings – Investment

PSS = Government Deficit + Current Account Balance

So, *PSS – Current Account Balance = Government Deficit*

Suppose that the Current Account Balance remains unchanged, an increase in Government Deficit leads to increase in PSS that equals Wages Saved + (Profit – Investment). Assuming that all wages are consumed we may write the fundamental equation of MMT as follows:

Net Profit = (Profit – Investment) = Government Deficit

The above equation shows that Government Deficit increases net Profit.

MMT posits that an increase in government deficit leads to expand the economy that in turn leads to increase the tax base.

Deficit finance and inflation

Can deficit finance lead to inflation? MMT has two answers to this question. Agreeing with the post-Keynesians, MMT posits that a continuous increase in money printing through deficit finance after achieving full employment would generate an inflationary pressure. If the resources are not fully employed, deficit financing would not necessarily lead to inflation. Besides, this full employment inflation, Randall shows that inflationary pressure may occur if increased government expenditure focuses on elite projects and highly skilled employment. Such an expenditure may create more what David Graeber called 'bullshit jobs'.

MMT has multiple weaknesses. However, those weaknesses have nothing to with the critique of MMT by mainstream economists. If a country like Sri Lanka adopts deficit financing and printing money in a crisis situation, it is imperative such policies should be accompanied by import restrictions, proper direction of Government expenditure and increase of direct taxation.

In lieu of conclusion, it is imperative to note without giving room for a misunderstanding that MMT as well as all the varieties of Keynesianism suffer from basic flaw. They seem to inverse the nexus between human labour, value and money. Michael Roberts has highlighted this in the following words: "They ignore that all the things that we need or use in society are the product of human labour power and under a capitalist economy where production is for profit (i.e., for money over the costs of production), not need, then money represents the socially necessary labour time expended. We see only money, not value, but money is only the representation of value in its universal form, namely abstract labour as measured in socially necessary labour time. It is a fetish to think that money is something that is outside and separate from value.".

For the full article - Refer Daily FT