

Spotlight: Econ Op-eds in Summary

Week ended 08th December '21

In Summary

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

1. Further on Budget speech Cost of Living, public debt and collective responsibility

By Dr. Laksiri Fernando

- Sri Lanka's cost of living has been increasing continuously, while the budget speech acknowledged the issue, highlighting possible reasons for the recent sharp rise in prices, it offers little solutions to manage the rising prices.
- Government debt to GDP has increased considerably, due to the large number of loans and borrowings obtained after the war, to finance large scale infrastructure projects. While such infrastructure is necessary as long-term investments, production should be promoted parallelly to reap the short-term benefits. The lack of which had led to Sri Lanka being driven to a debt trap.
- The debt crisis had also been exacerbated by commercial loans obtained through ISBs with high interest rates, most of which are without a concessionary period. In such a situation, the refusal to go to the IMF could make the crisis worse.

Cost of Living

The Budget speech has taken price inflation, affecting the cost of living, as a major challenge. That is commendable. The answer given however is the following.

"We believe that matters, such as, changes in consumption patterns, inadequate increase in production yield, inability to adapt to modern technology, issues with transportation and storage, the impact of intermediaries, and the asymmetry of information, within the production chain have all contributed to rising commodity prices." (Para 4.5). "We have to accept that the increase in prices is due to a shortage of goods, the imposition of import restrictions, the overreliance on imports, the depreciation of the rupee together with the failure to adequately encourage manufacturers." (Para 4.6).

It is simple economics to consider inflation in any country a function of demand (pull factor) and supply (push factor). If the first paragraph gives reasons in the domestic context, the second is primarily relates to external factors. However, it is wrong to begin with or blame 'changes in consumption patterns' for the 'rising commodity prices.'

The author should have made a distinction between the (luxury) demands of the rich, and the essential needs of the poor or the ordinary. The country's problem at present is particularly the latter. Of course, there is a rising demand even on the part of the poor and middle classes because of population expansion and people's desire to have healthy and quality foods and goods. Leisure and entertainment also are their needs.

It is not wrong to identify 'inadequate increase in production, inability to adapt modern technology, issues of transportation and storage, interference of intermediaries and asymmetry of information' as contributory factors for the shortages of supplies. If we particularly refer to the agricultural sector (rice, grains, vegetables, fruits, etc.), the

Minister should have frankly admitted to 'organic fertiliser' blunder more than anything else for the present inflation and food crisis. That is not done. It was a blunder because of its unplanned and haphazard nature.

On the external side, there is nothing wrong in identifying 'overreliance on imports, depreciation of the rupee, imposition of import restrictions' as reasons for shortages and increase in prices. However, restrictions on the importation of luxury items not only necessary to soften the balance of payments, but also to ease the rupee depreciation under the present circumstances. These have not been in the horizon of the Budget speech at all.

When we take the Consumer Price Index (CPI) even as a conservative reflection of people's cost of living, the present conditions are appalling. From January to November this year, the CPI has increased from 138.7 points to 150.7 points, by 12 points. In a budget speech when problems are identified, clear solutions also should be proposed or offered. Unfortunately, this is not the case.

Public debt and foreign exchange

It is partly understandable that public debt (foreign and domestic) going over 100% of the GDP during the civil war. This is something that had to be resolved thereafter. This was not done and in addition many new loans were procured mainly from China and others in the name of ports, airports, and roads. Benefits of these are long term.

There was no five-year plan or similar. Production, entrepreneurship, and businesses should have been promoted through public-private partnership, and through the private sector, before going into particularly large-scale ports and roads. Promotion of production and infrastructure should go hand in hand, not one after the other.

Of course, there are some developed or high capitalist countries who allow debt to go over the GDP. The US (128%) and Japan (235%) are two such countries. This is like big businesses taking loans even exceeding their assets and doing their rollovers. However small businesses cannot do so, or not allowed to do so, because their basic capacities are limited.

Likewise, the poor or just developing countries cannot afford to take major stakes in respect of loans and debt. They can easily get into a debt trap, to mean taking more and more loans to pay back the interests and loans. Sri Lanka at present is within this trap.

How has the Finance Minister explained the present debt question to the people? The following was his explanation:

"In 2014, when President Mahinda Rajapaksa handed over the country to the previous Government, the total debt of the country stood at Rs. 7,487bn. It was 72.3% of the Gross Domestic Product. When the present President came to power at the end of 2019, public debt had increased to Rs. 13,032bn. That is how the Government of 'Good Governance' had created debt." (p. 14).

Collective responsibility

I use the term 'collective responsibility' in this article not only in the traditional cabinet sense. On the question of debt trap, forex bankruptcy, high cost of living, balance of trade, balance of payments, etc. both main parties of the so-called political divide are 'collectively responsible' to the country and the people. No one should or could escape from that responsibility.

At present, Sri Lanka's external debt trap is mainly due to the commercial loans primarily obtained through International Sovereign Bonds (ISB) from international capital markets with high interest rates (around 6-8%) and without concessionary periods. The stubborn refusal to go before the IMF is another reason for the present debt crisis. It was in 2007, during the Yahapalana regime, that the first ISBs worth US\$ 500mn was raised and then continued during the same period and by the present Rajapaksa regime to cover foreign expenses and previous loans. These commercial loans which was only 2.5% of all foreign loans in 2004, became 56% by the end of 2019.

Even in covering the day-to-day internal government expenses, both regimes had to rely on Treasury bills and bonds in auctions and allowing direct participation. Because the Treasury is always running out of funds, without a proper tax system in the country and almost all State enterprises are loss-making entities.

Since January 2020, over 150 auctions/issuances have been conducted for treasury bills and bonds the final obligations running into billions and billions until 2015 and beyond. As a result, the Government at present is bankrupt both externally and internally. This has been the fault of not one regime, but both regimes with 'collective responsibility' to this pathetic situation.

[For full article – Refer Daily FT](#)

2. Do we have a solution to the perilous state of our external finances?

By Nimal Sanderatne

- The foreign reserves of Sri Lanka have fallen to dangerously low levels, increasing the possibility of debt default and inability to fulfill import needs. Expectations to overcome this through currency arrangement and trade credit have not materialized, despite the CBSL being optimistic.
- While India's Rupee line of credit to import Indian commodities would be beneficial in the short run it would be inadequate to address the external financial crisis. The more longer-term assistance which could help resolve the crisis may come with the condition that we seek assistance from the IMF to resolve the crisis in external finances.
- In such a condition, the oft repeated fact that the country has never defaulted in meeting its obligations is no assurance that we have the capacity to repay current debt obligations. The reserve position and the current performance of the balance of payments indicate the incapacity to repay the debts falling due next year. As such, the best option seems to be the option of obtaining assistance from the IMF.

Everyone is aware of the perilous state of the country's foreign currency reserves. No one knows how the country will extricate itself from the perils of the inadequate and dwindling foreign currency reserves.

Foreign reserves

Foreign currency reserves have fallen to about US\$ 1.2 Bn at the end of November. This is inadequate to meet essential import needs. The current shortages of essential items are likely to aggravate unless the government obtains foreign assistance soon.

Moreover, the country is on the verge of bankruptcy and is among several countries such as Angola, Cyprus, the Congo, Gabon, and Mozambique that are on the verge of defaulting on their foreign debt repayment obligations.

Yet there is no solution in sight. We are told the country has enough expertise to manage our external finances, and what we lack is foreign currency, not expertise.

Expectations

For many moons, there have been optimistic statements that there is no need to worry as there would be various currency arrangements and trade credit to replenish the foreign currency reserves and enable essential imports. Although these expectations have not materialized, we continue to hear similar statements that are now taken with a pinch of salt.

Still optimistic

In spite of this and the serious plight of the external reserves, the Central Bank of Sri Lanka (CBSL) continues to be optimistic that there would be significant inflows of foreign currency and there is no reason to worry. However, these expectations throughout the year have not been realized. It is becoming less and less likely that there would be substantial foreign assistance soon.

No consequence

Criticizing rating agencies for pointing out this dangerous position and repeatedly saying that the country has never defaulted in its debt repayment obligations are of no help. There must be a replenishment of foreign reserves from whatever source.

Best option

The best option of assistance is from the International Monetary Fund (IMF). However, it has been repeatedly and emphatically ruled out by the Central Bank and government. Will we be compelled to reverse this refusal and turn to the IMF?

Hopes and expectations

At present hopes and expectations of financial assistance appear to lie solely from India. Finance Minister Basil Rajapaksa, who is in New Delhi, is expected to seek substantial assistances from India in several forms such as

- trade credit,
- currency swaps
- and large investments.

Indian response

The finance minister has no doubt been warmly welcomed by Prime Minister Narendra Modi. Whether India could lend a substantial amount of dollars to a country that is near bankruptcy and has no means of repayment is a salient question. India may agree to a financial accommodation on condition that we seek assistance from the IMF to resolve the crisis in external finances.

India may also provide a Rupee line of credit to import Indian commodities, like the Chinese Yuan credit earlier. Such an arrangement would relieve the current nadir in external finances to an extent. Will we also agree to sell some national assets?

Successful mission

We have to wait anxiously to know how successful the Finance Minister's attempt to get assistance from India would be. **In any case it will be a short-term palliative, not a solution to our external financial crisis.**

No prospects

The country is in a perilous state without a solution to the grossly inadequate foreign reserves of US\$ 1.2 Bn. As serious is the fact that **there is little prospect of these reserves increasing autonomously as the trade and balance of payments deficits are widening. Furthermore, remittances are also declining because of the artificially low official exchange rate compared to the market rate.**

Besides, **the expectation of a substantial increase in tourist earnings is unlikely. Only a slight increase could be expected in the next couple of months with the global resurgence of the virus.** It would also be prudent to control tourist arrivals to avoid the spread of COVID-19 in the Island.

Recapitulation

The current reserve position is threatening as the debt repayment obligations this month and early next year and somewhat later in 2022 is much higher than the reserves of the country.

The oft repeated fact that the country has never defaulted in meeting its obligations is no assurance that we have the capacity to repay current debt obligations. **The reserve position and the current performance of the balance of payments indicate the incapacity to repay the debts falling due next year.**

Conclusion

As the foreign currency reserves are moving towards a dangerously lower level there is no indication of how the country could save itself from a state of bankruptcy. There is little doubt that assistance must come from foreign countries as international sovereign bonds or commercial borrowing is impractical. Bilateral assistance from countries is the current mode of attempting to replenish the reserves.

However, there are still no signs of any substantial assistance from friendly countries even as bilateral currency swaps and trade credit to import essentials like food and fuel.

There is no clear idea as to how the country's external financial crisis will be resolved. What is in store for the country at the end of this year and the beginning of the next?

[For the full article – Refer The Sunday Times](#)

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