# Spotlight: Econ Op-eds in Summary

Week ended 08th April '20

## In Summary

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

**1. Curfew, Lock down and Economic Livelihoods**
**By: Sharhan Muhseen**

- Measures taken to combat the virus outbreak has an economic fallout. Sri Lanka has opted for a stronger form of lockdown to combat the Covid-19 outbreak. Success of such a prolonged lockdown would depend on the ability to deliver essential supplies. Sri Lanka may need to gradually phase out of the curfew and transition to an intensive testing-based approach.

- Sri Lanka needs a comprehensive targeted strategy that addresses the supply side issues. Sri Lanka's macro-economic fundamentals and several key sectors of the economy remain threatened. Whilst the monetary initiatives deployed would typically lead to higher inflation and Rupee depreciation, low demand the U.S. economic woes may work in our favour.

- Fiscal measures should be more far-sighted. Using the already struggling banking sector as the first line of defense will make it a huge challenge to engineer the post crisis economic recovery. Direct pay outs from the EPF is thinking in the right direction. Some other options available are partially offsetting of wages, provide unpaid leave and work insurance cover for vulnerable segments.

Economists across the world are debating various stimulus packages to get their countries back on track and shake off the effects of the economic crisis from Covid-19 the novel Corona virus. The number of infected have surpassed well over one million with no part of the world secure from this ravage. As countries struggle to put in place emergency medical personnel, hospital beds and ICU units there are early and encouraging signs that the medical community will take the right measures to push back and eventually contain Covid-19. As the focus on the medical initiatives intensifies the economic policy-makers have been working towards containing the economic devastation that is to follow.

The fears for the economy were highlighted by the often-repeated phase 'if you try zeroing the coronavirus you will end up zeroing the economy'. The potential economic devastation will be most severe on the most vulnerable poorer segments of the population.

**Curfew and Total lockdowns**

A few countries in the world have enforced complete lockdowns. Most countries have preferred a partial lockdown where essential services such as supermarkets, pharmacies and gas stations are permitted to remain open. This approach is prevalent in the more developed markets. Several emerging and developing countries including Sri Lanka have opted for a stronger form of lockdown which follows the 'Hammer and Dance' theory. The key challenge to this approach is the question on the length of sustainability of the 'Hammer' or lock down period.

The success of a prolonged lockdown can only be effective if essential supplies can be made accessible or delivered to vulnerable households. The sufficiency of national resources to facilitate this support net is central to this determination. If the appropriate mechanisms are not in place to address the concerns of the vulnerable segment the short-term measures put in place to arrest the spread of Covid-19 may not be successful over the medium to long term. In light of this, Sri Lanka may need to gradually phase out of the curfew restrictions and move to an intensive testing-based approach to tackle Covid-19 in the days ahead.

**Safeguarding Livelihoods**

The most vulnerable segment to a pro-longed indefinite curfew are peoples on daily wages. It is estimated that there are 6-7 mn people in the Island depended on daily incomes. Self-employed and contract-based individuals typically have limited monetary reserves and need direct support to withstand their loss of income. Food security is the immediate concern for this group as the number of days of the curfew lengthen. A pro-longed curfew could also lead to job losses with some estimates putting this at around 2 mn with no intervention from the state in the short term. A compounding complication in delivering a solution is that a vast majority of this group are not in the formal banking systems making it more difficult to provide direct monetary support.

**Scoping a stimulus package**

Globally a series of economic and fiscal stimuli are being rolled out to try and counter the impacts of Covid-19. The U.S. is now taking a more aggressive stance as the epicentre of the virus shifts to New York and the U.S. Economy begins to feel its effects with unemployment levels surging to new highs. In Asia, Singapore has one of the largest stimulus packages with USD 33.7 bn being earmarked to counter Covid-19 fallout. The main trust of the Singapore relief package is to offset wages in the food services sector, provide co-funding to the aviation and tourism sectors and provide direct money to low income households. Most countries globally and in Asia have also put in place multi-billion dollars packages to try and soften the impact of Covid-19.

**A Sri Lankan Roadmap**

Sri Lanka needs to take a comprehensive review of the vulnerable sectors and put together a targeted strategy with its limited resources to support a rapid recovery. Whilst we need to recognize that this is both a supply and demand driven slowdown, to get the economy back on track addressing the supply side is more fundamental to facilitate a quick recovery

On a broader macro level, Sri Lanka will be looking at slower growth, larger budget deficits and deterioration of the Balance of payments (BOP) for 2020. Most economists are now looking at GDP growth to come in around 2-3% depending on their views on the length of the epidemic. The budget deficit already primed with the pre Covid-19 tax cuts now needs to account for much higher health related spending programs and slower revenue collections. On the BOP front, the drop in tourism, remittances and exports will not be offset by a lower fuel bill and import restrictions in place.

Key sectors under tremendous pressure are the Tourism, Apparel Industry, Food services and Transport sectors. Apparel industry executives are estimating an impact of around USD1.5 billion with a loss of revenue from the March to June period resulting in about 30% lay-offs. Apparel industry accounts for 6% of GDP and 40% of total exports.

To-date, the state has rolled out several commendable measures on both the fiscal and monetary side. Whilst the monetary initiatives have been robust fiscal stimulus could be more-hard hitting and far-sighted. The monetary initiatives centred around liquidity injections (from a series of rate cuts and profit transfers) needs to take into far greater account the linkages between monetary stability and the exchange rate soft peg. In particular, the widening of the USD sovereign credit spreads warrants full attention.

The quantitative easing measures deployed would typically lead to higher inflation and Rupee depreciation. In this environment of low demand, inflation pressures maybe better contained and the U.S. economy woes may take some of the sting out of the Rupee depreciation. A sharp fall in the Rupee against the dollar raises concerns on the ability to re-pay dollar liabilities.

**Fiscal stimulus key to economic management and recovery**

On the fiscal font, several short-term measures centred around extension of deadlines for payment of taxes, utility bills, personal loans, grace period for lease payments, etc. have provided much needed immediate relief. Direct support measures including providing Rs 5,000 as single payment to low income families, Rs 50 bn bailout package for Covid-19 hit business can be effective under proper administration and deployment.

Several of the fiscal measures announced, directly impact the banking sector. Whilst the efforts to get the banking sector to share the pain is sensible, attempts to use the banking sector as a first line of defence by absorbing a large portion of the full economic impact is fraught with dangers. The banks sector is already struggling with non-performing loans and are poorly equipped to take a full hit and more importantly a weakened banking sector will make it a huge challenge to engineer the post crisis economic recovery.

The Sri Lankan government in its Covid-19 combat tool-kit has several levers to deploy. the proposed direct pay outs from the Employee's Provident Fund to its members is thinking in the right direction. Some other initiatives for the government to consider targeting key vulnerable sectors is partially offsetting of wages in the tourism and apparel industry and provided unpaid leave and work insurance cover for vulnerable segments.

In conclusion, whilst the Presidential Task Force on Covid-19 is focused on containing the virus and supporting livelihoods a separate Task Force needs to be composed to develop the post Covid-19 economic recovery roadmap to ensure the administration vision of 'Vistas of Prosperity and Splendour' remain on the horizon.

For the full article – Refer LBO

**2. Funding a fiscal stimulus - How to borrow a bazooka**
**By: Daniel Alphonsus**

- As the economy comes to a standstill due to the current lockdown, Demand will fall significantly across the economy for a sustained period of time. The only means of helping the economy is for the government to provide a considerable stimulus. This, however, is also an issue given the country's very large debt-to-GDP ratio and the fiscal deficit due to tax reliefs.

- The depreciation of the rupee is only exacerbating the issue. Central Bank's money printing to finance the fiscal deficit also adds pressure on the rupee. In such an instance the government should use a tripartite toolkit. Firstly, the government should secure the best bailout packages available. Secondly, The Central Bank and Foreign Ministry should be working hard to expand existing foreign currency swap lines.

- Finally, the parliament must also be convened to place revenue and borrowing measures on a legal footing. Apart from these, non-conventional methods such as the issuance of collateralized bonds using government assets can be implemented to help the economy out of the current status.

**Sri Lankan economy**

As this article is written, most economic activity has come to a standstill. With social distancing measures in place, consumers are unable to consume. Investors are unable to invest. Exporters are unable to export. The tourism, aviation and apparel sectors have ceased almost all operations.

This is just the beginning. As the shock filters through the economy, even if actors are able to spend, they may not be willing. Demand will fall significantly across the economy for a sustained period of time.

If consumers, businesses and the global market cannot generate demand, then the government must step in. This is the dearly purchased lesson of the Great Depression. If the Government fails to write large cheques and many of them; businesses will fold, banks will bust and mass unemployment will follow.

Tragically Sri Lanka's public finances were already precarious prior to this crisis. The upshot is simple. If the Government writes the cheques needed to keep the economy afloat, many will bounce. The sources of this fragility are both old and new. Sri Lanka has historically maintained a high debt-to-GDP ratio. However, since 2007 Sri Lanka's risk exposure increased considerably.

In addition to a high debt-to-GDP ratio, the Sri Lankan Government liberally borrowed short-maturity debt from international markets at high-interest rates. Until 2017, when the VAT rate rose, this borrowing spree was paired with an exceptionally low and falling tax-to-GDP ratio. The gains of 2017 to 2019 were reversed, and more, with the tax-cuts earlier this year.

The recent depreciation of the rupee is exacerbating this situation. As the rupee falls, Sri Lanka's debt-to-GDP ratio rises. This is because about half of Sri Lanka's public debt is denominated in foreign currencies. Rising debt-to-GDP ratios further erode investor confidence and could lead to further pressure on the rupee (capital controls help for a time of course).

There is also the temptation to accelerate monetary financing of the deficit when Government revenues experience such a shock. In the last month alone, the Central Bank printed money to purchase Rs. 170 bn worth of Treasury bills. This too places pressure on the exchange rate.

**Implementing the standard fire-fighting tool-kit**

Implementing the standard fire-fighting tool-kit is a key first step.

*First*, secure the best possible bail-out package from multilateral and bilateral creditors. Here too, goodwill is not at a high. The Government of Sri Lanka gave the IMF the proverbial finger early this year – making mockery of the fiscal deficit target and structural benchmarks, such as the Monetary Law Act. That relationship will have to be restored immediately.

*Second*, swap lines are playing an increasingly important role in crisis fighting too. The Central Bank and Foreign Ministry should be working hard to expand existing foreign currency swap lines, such as those with the People's Bank of China and Reserve Bank of India. In addition to opening new ones, such as with the Bank of Japan.

*Third*, the $500 mn grant from the Millennium Challenge Corporation is vital. There can be no delay. Parliament must also be convened to place revenue and borrowing measures on a legal footing. This will help restore some small measure of donor and investor confidence.

However even a generous bail-out package, deft Central Bank action, access to grants and restoring the legal footing underpinning public finance will not be sufficient. With a collapse in both demand and supply, the Government must provide a record stimulus. To avert an unprecedented depression, the Government must spend lavishly and swiftly. But the Government cannot spend. It does not have the fiscal space to do so.

Markets expect a default before October. Yields on Government debt are reaching the triple digits on secondary markets, up from the mid-single digits even in the aftermath of the Easter bombings. The recent $ 220 mn issuance of Sri Lanka Development Bonds only attracted $22 mn worth of bids. Therefore, the challenge is to find ways for the Government to borrow so that it can spend to replace consumer, business and export demand.

**Generating financing for large fiscal stimulus amidst crisis**

In these circumstances, the perfect is the enemy of the good. Therefore, I share these ideas not with confidence but as a vehicle for generating a conversation on how a highly-indebted country like Sri Lanka can generate the financing for a large fiscal stimulus amidst an unprecedented crisis.

In normal times, asset sales would have been an obvious choice. The Government could sell the assets it has hopelessly mismanaged in order to finance a stimulus. But there are two problems with this approach.

- First, any asset sale will be at firesale prices.
- Second, it will take time to conduct such a sale.

But there are less conventional instruments for raising capital fast.
Thus far all public debt issued by the Sri Lankan Government has been uncollateralised. That is no Treasury bill, Treasury bond, Sri Lanka Development Bond or International Sovereign Bond grants the holder a security interest in any asset. However, many other countries, especially those with poor credit-ratings like Sri Lanka have issued collateralised bonds. They provide a way to access credit at lower interest rates because they are linked to a real asset. This may be one of very few avenues Sri Lanka can use to tap capital markets at this desperate time.

Cabinet has already approved the creation of a holding company for assets owned by the Government, such as the Hilton, Hyatt and Grand Oriental Hotels. Other Government owned assets can also be included in this holding company to create a diversified and substantive asset pool. This can also be complemented by shares the government owns in publicly-listed companies.

Backed by this holding company's assets, a special purpose vehicle can issue a couple of billion dollars' worth of bonds on international capital markets. It should be very clear that this bond does not have a Government guarantee. This helps ensure that any re-scheduling or conversion of the debt that may take place in the future does not affect the Government's unblemished repayment record of over 70 years.

Concomitantly, even if the bonds are issued under US law (as is the case with Sri Lanka's international sovereign bonds), investors will be concerned about their ability to enforce their security interest in the event of default. The Government can offer comfort on this anxiety too. Considering the desperate need for these funds, it would be constitutionally proper for the President to seek the opinion of the Supreme Court on the enforceability of that interest.

In terms of cash-flow confidence, the Government could make selection of holding company directors a responsibility of the Constitutional Council. Such an apolitical and transparent process will help appoint professional management. Thus creating investor confidence in cashflows needed to repay the debt.

The funds raised by this bond can be used for infrastructure projects that generate an economic stimulus. For example, they can be used to fund projects in public transportation, energy, industrial parks and airports. Ideally the projects will be PPPs, as they enable further mobilisation of capital and thus stimulus. While the projects are being prepared to become shovel-ready, the SPV can lend the money to the Treasury or state-banks to generate an immediate economic stimulus.

Even should the holding company default on debt in a couple of years, the liquidation of assets will take place after the peak of the crisis passes. Therefore, asset prices are likely to be more reflective of their value in tranquil times. Moreover, the liquidation will be managed transparently – perhaps via a stock exchange listing – helping ensure the tax-payer obtains the highest value, something that cannot be taken for granted in an ordinary Sri Lankan privatisation.

The UDA, Ceylon Government Railway and other Government agencies with significant real assets can undertake similar initiatives on a smaller scale. The UDA and CGR own large swathes of premium undeveloped real estate. By issuing a collateralised bond backed-up by this real-estate, they can build low-cost, high-density housing, mixed developments and shopping centres. This will also add to the stimulus, improve living standards and help in urbanising Sri Lanka's population.

This is an unprecedented crisis. No one but the Government can make any real difference. But options are few. Old taboos will have to be revisited. Creativity will be required. To plagiarise Hank Paulson and Mario Draghi, two of the heroes of the last crisis, the Government must beg, borrow or steal a financial bazooka to do "whatever it takes". Without a record fiscal stimulus, a lockdown of a few weeks or months could lead to stagnation for years. Even a timeframe of decades cannot be ruled out at this stage.

For the full article - Refer Daily FT