

TRANSFORMING SRI LANKA'S ECONOMY FOR A BETTER TOMORROW

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“WHILE MERCHANDISE IS AN INTEGRAL PART OF THE COUNTRY'S EXPORTS AND IMPORTS, THE SERVICE SECTOR IS A VIBRANT PART OF THE ECONOMY, ESPECIALLY SERVICE EXPORTS SUCH AS TOURISM, BUSINESS PROCESSING SERVICES, EXPORTS AND OTHER KNOWLEDGE PROCESSING SERVICES. THE SERVICE SECTOR HAS GREAT POTENTIAL, BUT I HAVE IDENTIFIED THAT THERE IS AN OVEREMPHASIS ON THE TOURISM SECTOR, WHICH IS A VERY FRAGILE SECTOR AS WE WITNESSED DURING THE PANDEMIC. THE SERVICE SECTOR SHOULD BE STRENGTHENED TO DEVELOP THE MOST VALUABLE SERVICES RATHER THAN ONLY FOCUSING ON PROVIDING HOSPITALITY SERVICES”

To begin with, when looking back at the free market economy in Sri Lanka, can you brief us on the export earning pattern in Sri Lanka after the 1977 economic reforms?

Sri Lanka liberalized the economy in 1977, but even after this export earning patterns can be best explained by looking at the

percentages than numbers. There is a clear pattern that can be traced to identify how as a country our exports have increased over the years while the import percentage is roughly around twice the export earnings. While the exports have increased, the imports have increased much further leaving a negative trade balance. It is difficult to find a year where we had a surplus in the trade balance. However, both import and export

composition underwent drastic changes during this period.

Today, 77.6% of the country's exports are industrial exports and the rest is either agricultural or mineral exports. A larger majority of industrial exports includes textile which totals up to 43.5% and the second-largest category is rubber materials or semi-finished rubber materials which is 8.4 % of the total industrial exports of the country. It

is fair to say that Sri Lanka's export composition has improved vastly over the years and has not stagnated at all as we export various products including military and engineering equipment in minute quantities. The main weakness is that despite all this, the country still depends on textile and agricultural goods as the main exports. Therefore, the export diversification has happened in a very slow process that did not allow to produce a new product to dominate the export earnings. So far, the liberalization of the economy has not helped to diversify the export sector.

In terms of import composition, it mainly consists of intermediate goods such as petroleum products, textile articles etc., which totals up to 59.6% while investment goods make up a total of 21.6%. These two together alone roughly make up a total of 80.7% of the country's imports. It cannot be said that we are importing more consumption goods because it is clear that a large majority of the imports consist of intermediate goods and investment goods. A country's imports are very difficult to change as it clearly affects the export capacity. For example, without petroleum goods, we cannot run the factory machinery and without textile articles, we cannot run the garments. Therefore, it is clear that without importing, the country's exporting capacities are very much limited.

Given the current context, as you mentioned, it seems impossible to maintain a balance between imports and exports. Do you think in the next 10 to 15 years, the country can reach a considerable balance

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between these two categories?

Well, from 1977 onwards there were many opportunities to achieve this balance in the country, opportunities provided by mother nature to learn lessons from past experiences but unfortunately, we never did. According to my opinion, the main ideology that led us to this situation is that everything should be produced locally, and it is not a concept that we can nurture to take the country forward. The world is very much integrated today, not only politically and culturally but also

economically. We cannot live isolated from the rest of the world where we only focus on exporting and not importing. As I mentioned previously, it is not feasible to produce everything locally when we do not have certain resources such as petroleum in the country. So, the basic policies of the imports and exports of the country were flawed, to begin with. We are passing a very difficult time, if we learn right from this as disasters bring opportunities, this is a good time to make much needed radical changes to the economy to move forward in the necessary direction.





The concepts of home-grown solutions and nationalist economy should be replaced with modern concepts, and we need to focus on finding and maintaining our place in the world economy as the only way to move forward. The current economic policies should be changed in order to reach this goal.

How has Sri Lanka's trade policy addressed the payment issue up until now?

While merchandise is an integral part of the country's exports and imports, the service sector is a vibrant part of the economy, especially service exports such as tourism, business processing service exports and other knowledge processing services. The service sector has great potential, but I have identified that there is an overemphasis on the tourism sector, which is a very fragile sector as we witnessed during the pandemic. The service sector should be strengthened to develop the most valuable services rather than only focusing on providing hospitality services. For an instance, business and

knowledge processing services can bring more money to the country. Further, our traditional exports such as tea, rubber and garments are now outdated where we have been overtaken by countries like Bangladesh and China. We have to look for major changes, find new items to produce in the country, necessarily a finished product like garments. Now, Asia, especially east Asian countries are moving towards intermediate exports and a larger part of the European trade is in intermediate exports as well. Sri Lanka must focus more on the intra-industry trade using the production network and value chain concepts. That way, Sri Lanka can do much better than waiting for investors to arrive, invest, produce goods and export. Whatever products we use are world-class goods, where components are from different countries and assembled in one place. Sri Lanka has a very talented and vibrant labour force. At present, the country's human capital is migrating to other countries to earn economic capital which should be changed to retain that labour force in the country to strengthen the local economy. If

these things happen, I think we will be able to regain that momentum of exports. When considering imports, through exports the country can be developed economically, and imports increase naturally in a developing country.

According to your point of view, what are the long-term and short-term impacts of the recently tightened trade restrictions and floating currency in Sri Lanka?

It is a desperate situation where the country does not have money, so the only logical solution is to impose control over the imported goods. Other than that, I do not think the country has taken any policy decision to restrict imports. When the dollar shortages are clear, and the country's reserves are running down the imports have to be controlled. I think this is a temporary measure when the economy is back to normal the restrictions will be eased out. However, the restrictions on

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imports have a direct negative impact on the country's exports. This is evident at present in many sectors, where the export capacities have become very limited due to the lack of input, especially petroleum which is a mandatory input for many sectors.

What is your opinion on the government seeking assistance from the IMF and what could be done to help Sri Lanka regain its creditworthiness?

The country had an opportunity to seek IMF's support as early as 2000. But the government repeatedly labelled the danger signals as conspiracy theories and announced that there was no problem since the country had enough foreign reserves and an ample supply of resources. The problem lies in the fact that the country waited till the last moment to turn to IMF. It was only after every dollar was drained from the reserves that the government wanted to request assistance from the IMF. Whenever a country turns to the IMF, there is usually a bargaining power for the

country; however, when a country turns to the IMF as a last resort, as we did, this stronghold is lost.

In fact, the IMF has not promised us anything at the moment. They expect Sri Lanka to reschedule the loans; appoint a legal and financial officer to negotiate with the creditors and then reach out to the IMF for an extended fund facility or short-term facility. So, in order to gain the support of the IMF, we must negotiate with our creditors and take certain steps; however, this too is at a deadlock as our Chinese creditors are not too keen on rescheduling. According to their lending method, there is no rescheduling; What they can do at most is to grant a bigger loan to pay off the loan already taken. This bigger loan will not come under the default category so Sri Lanka will be obliged to pay the instalments as usual to China.

According to my point of view, it is not acceptable to go for various agreements with different creditors. The IMF, nor the creditors will accept such an arrangement. Overcoming this situation is indeed a great

challenge. Turning towards the IMF is not a panacea for every ill Sri Lanka is facing; they can give us a maximum of 3 to 4 billion USD whereas our outstanding debt is 51 billion USD. IMF support or seal of approval will be important in reaching out to other credit markets. Our creditworthiness could be improved if we get a first or second instalment from the IMF and that will give some kind of credibility to Sri Lanka. But till then, how is Sri Lanka going to manage its finances is a problem. India has also provided more than 5 billion USD already and they have also promised to help Sri Lanka with food, gasoline, medicine, and other essential goods. If not for India's support, we will be in great trouble as the Middle East countries are not willing to extend their hand at this juncture. The country is in a very desperate situation. Going to IMF is a must; there is no alternative. But I don't think that it will immediately ease the situation in the country.

In terms of the fiscal and monetary policy changes to be implemented to reset the country's economy, some economists like Professor Steve Hanke, of John Hopkins, have provided a solution to this mess. It has been suggested to install a currency board system in the country to put a barrier on the central bank to print money, affix the LKR to USD or any other currency and based on those reserves, the country may proceed with printing money. This currency board system has proven to be effective in other countries that have faced similar situations. However, for this system to work, we need to build at least 4 to 5 billion USD reserves. This system may not be very popular among politicians as it will be difficult for them to propose ambitious

budget proposals that require money to be printed excessively since Sri Lankan Rupees can be printed only if enough dollars are available. Nevertheless, this currency board system can create a fiscal discipline and also preserve the currency's value both externally and internally. So, it is a very plausible option for Sri Lankan policymakers to consider, but it is not very popular among politicians.

What is the role to play in FDI in time to avert the severity of this "emergency economy"?

Well, Sri Lanka has been looking for huge foreign investments; the expectations to gain massive foreign direct investments after the war, especially in the years spanning from 2009-2012, were not fulfilled. Although there were a lot of opportunities unfolding after the war, for many reasons like the business environment in the country, it was very difficult for foreign investors to consider Sri Lanka as a profitable site of investment. Due to this, the investments did not pile in even after the war. The only way out of Sri Lanka's peril is foreign direct investments (FDI) and creating a very conducive environment and climate for investments. The main factor that discourages the investor from investing is the government's policy uncertainty. These frequent policy changes, which sometimes occur within the tenure of the same government, affect business performance and profits and other returns. The labour market rigidity and the cost of energy can be noted as other constraints. Although these problems can be identified in Japan also, they are doing well due to the production of high-value products. By exporting garments and tea, we can't charge higher prices even though the

labour is expensive. FDIs should investigate these areas; the future of Sri Lankan business should be based on high value-added items. It is advisable to even look at producing components rather than complete products. We have many talented inventors in Sri Lanka; the airbag triggering device for automobiles was invented by a Sri Lankan although unfortunately it had been given to a foreign company due to the lack of interest and opportunities within the country. There are so many people who can contribute to creating new devices that are commercially successful but unfortunately, a business culture that encourages these creations has not yet been established in Sri Lanka. There is great potential if FDIs come in these high valued areas. Most local industrialists have short-term visions, but investors must have long-term visions. It should not be about the immediate profit but the long-term goals. Local direct investments in the country are extremely poor, so FDI is the only way out. But this has to be promoted with a comprehensive plan.

What are some steps that you think local businesses can adopt to limit the outflow of foreign currency from Sri Lanka?

As of now, Sri Lanka's currency has come to a peak exchange rate. Even at this high rate, local businesses cannot get dollars from official sources. In a dire situation like this, local businesses may not be able to survive. Even the banking sector is in a crisis and somehow, in whatever way possible, the government has to bring in dollars to the country. For the moment, I know that the local businesses have downscaled, and they are not functioning at their

full capacity because of multiple reasons. All are trying to survive at the moment; for some companies, even survival is a major problem. Some industries like the construction industry which were significant contributors to the country's GDP have been completely stalled right now. This is a kind of spiral impact that is happening. At this point, the main goal of the businesses has to be survival, not expansion. If they survive this crisis, they can consider development. But how long this crisis lasts is dependent on two things: the political stability and the IMF's support.

Finally, to be more resilient amidst this crisis what could the household sector do in the short and long term?

As a short-term action, the household sector should go back to the tradition. We were a very resilient society. Those living in the town are heavily affected by this crisis but those living in the peripheral areas can live and overcome this situation. Gas and electricity were not available around forty years ago; these are all new additions to our lifestyles. If you are living in a village, you will be able to get many things for free.

Food security is the major issue for the household at the moment. A minimal yet sustainable food security has to be designed for the household. Cultivating in home gardens, rearing animals, and going back to our roots, our tradition would be the best option at the moment as food security is the most important factor to be considered by every household.

**By Jinandi Chathurya
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