

Global economic crisis deeper than expected,
developing country's not immune
Structural, institutional and regulatory
impediments to development
Even at the expense of growth,
Macro economic stability a must to survive global crisis

By Devan Daniel

The Executive Director of the Institute of Policy Studies (IPS), a think tank for the state, Dr. Saman Kelegama said the global financial crisis has got deeper than what it was in mid-2008.

"World growth is projected by the IMF to fall to just 0.5 percent in 2009 which is the lowest in 60 years. The IMF growth forecasts for the world economy and for individual economies keep changing.

"This clearly shows the gravity of the global financial crisis and that it is much deeper than what we all thought it to be mid-2008," he told a seminar organised by the IPS last week.

According to IMF projections, advanced economies enjoyed growth of 2.7 percent and 1.0 percent in 2007 and 2008 respectively but is projected to contract by 2 percent in 2009 and record a marginal growth of 1.1 percent in 2010.

Meanwhile developing countries in Asia are projected to grow by 5.5 percent in 2009 and 6.9 in 2010 while having recorded a growth of 10.6 percent in 2007 and 7.8 percent in 2010.

Dr. Kelegama also showed the uncertain nature of the crisis and its worsening trend by quoting World Economic Outlook report which has been revised thrice, April 2008, October 2008 and January 2009.

Growth forecasts for the US in the three revisions were 0.6 percent, -0.7 percent and -2 percent respectively.

The Euro area was forecast with growth of 1.2 percent, -0.5 percent and -2.6 percent by the respective revisions.

"Very few predicted a crisis of this magnitude and until mid-2008 many said that all developing countries would be insulated from the crisis," Dr. Kelegama said adding that six countries belonging to this group have already approached the IMF for a bailout.

"Continuous financial instability could adversely impact the large financial needs for developing countries' high development objectives including infrastructure, health and education," he said.

Wake up...

Dr. Anura Ekanayake, Vice Chairman of the Ceylon Chamber of Commerce, said Sri Lanka has a tremendous window of opportunity with the speedy cessation of hostilities and the likely hood of the deficits in the Balance of Payments and Trading Account easing off due to new investments as a result coupled with low global commodity prices.

However, he said there were structural, institutional and regulatory impediments to development.

The formal economy is faced with a serious problem. There is a fear of a Balance of Payment crisis, a foreign exchange crisis and a likely hood that the trade deficit would keep widening.

"Be optimistic, but be extremely sensitive. The economy will have to face some painful adjustments and there is an extremely difficult time ahead of us," he said.

"If these issues are not accepted, we will not be able to do the things we have to do right," Dr. Ekanayake said.

Resilient...

Dushni Weerakoon, Deputy Director of the Institute of Policy Studies, said that Sri Lanka's economy had been resilient to such shocks as the decades-long conflict, the tsunami and the oil price hike of early 2008.

She said the positive outlook for the country is the reduction in world oil prices while capital expenditure of the government was on the increase while the budget deficits have experienced a reduction.

But...

Despite the positive outlook there are negatives that need immediate attention.

Inflation, the trade deficit and keeping the exchange rate steady are some of the issues that need to be addressed.

Although inflation is on the decreasing trend it has not resulted in the easing of the credit squeeze with high interest rates still burdening the private sector.

With falling demand of spending power of the global economy, the country's export sector is not only suffering job losses in orders, but the propped up exchange rate and domestic costs are also taking their toll resulting in factory closures and job losses.

The Employers' Federation of Ceylon are bracing for more job losses in the export and domestic industrial sectors.

The government announced a stimulus package to aid the export sector last week (see Island Wednesday 18, page 5) which is a part of a proposed Rs. 16 billion package.

The country's macro economic policy was weak to begin with much before the global financial crisis and a revenue squeeze is expected as industries continue to face hard times.

"The Rs. 16 billion economic stimulus package is marginal, just 2 percent of the government's budget and is mostly a redirection of expenditure," Weerakoon said.

The exchange rate...

The country's export sector is calling for a more realistic exchange rate so that decent returns can be made.

However, the government is unwilling to allow a drastic adjustment to the exchange rate so as to avoid pressurizing the country's capacity to meet its external obligations.

However, maintaining the rupee at a stable position has depleted the country's reserves thus sparking off another crisis.

With economies around the world shrinking, it is yet to be seen how foreign remittances from our migrant workers will help buoy the Balance of Payments, (which began to show a deficit for the first time in October last year.

There is also considerable pressure of foreign borrowings.

But the Deputy Finance Minister Dr Sarath Amunugama, said Sri Lanka has all the foreign capital requirements lined up for large scale development projects but said US\$ 500 million had to be found in order to kick start them.

Weerakoon said the options available to maintain reserves are to either have stringent exchange controls or a free float of the exchange rate.

"But the most prudent step is to build up reserves by whatever means," she said.

She said that a more flexible rate would be helpful and that reducing global price trends would make an adjustment less painful at this stage.

Facing up to the global crisis...

"We need to keep an eye on internal developments and restore macro economic stability even at the expense of low growth," Weerakoon said.

"In 2009 we should regain macro economic stability to be able to respond to the global crisis," she said.

For government...

The IPS is working on a policy paper to be presented to the government based on the findings at the seminar.

There have been many discussions about the global financial crisis but little has been done at policy level to study and understand its affects to Sri Lanka's economy.

According to the Economic Advisor to the Finance Ministry, Prof W. D. Lakshman an adequate study of the crisis and how policies adopted by

other countries would suit and benefit the Sri Lankan economy has not yet been done.

The IPS's annual publication, 'Sri Lanka: State of the Economy' will have the global economic crisis as its theme for this year's edition.