Sound fiscal policy should be Govt. priority: Leading economist

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- **Righting fiscal policy the major need for next three years, says IPS Executive Director**
- **Fixing fiscal ills will create investor confidence, improve reserves and promote debt sustainability**
- **Also assist Govt. to support poor during crisis such as COVID-19**
- **Expects Budget 2021 to set goals on fiscal consolidation**
- **Says import restrictions an emergency measure, should be adjusted based on global value chain recovery**
- **Borrowing for capital investment will need to be done prudently using SL experience**

By Uditha Jayasinghe

Sound fiscal policy capable of putting public finances in order should be the focus of the upcoming Budget and Government policy making for the next three years, a top economist said yesterday, pointing out that it will improve Sri Lanka's ability to withstand risk, achieve sustained growth and promote public welfare safeguards.

Dr. Dushni Weerakoon

Participating in a panel discussion at the launch of the Sri Lanka State of the Economy 2020 report compiled by Institute of Policy Studies (IPS) titled, "Pandemics and Disruptions: Reviving Sri Lanka's Economy COVID-19 and Beyond," its Executive Director Dr. Dushni Weerakoon noted that realigning Sri Lanka's fiscal policy would provide the best bulwark against external vulnerabilities such as COVID-19.

She also pointed out that as Sri Lanka has significant debt obligations for the next decade, a reduced deficit would protect the country's sovereign ratings, thereby reducing risk premiums, helping attract investment, boosting reserves and giving room for the Government to provide more comprehensive welfare for vulnerable communities. As Sri Lanka has significant debt obligations for the next three years and after 2025, she opined it would be prudent to focus on streamlining fiscal policy over the next three years.

Sustainable fiscal policy will also have to be supported by better borrowing practices, especially for capital investment, Dr. Weerakoon said, calling on the Government to draw on a decade and a half of experience in taking loans for infrastructure projects to be more judicious in their future selections.

Sound fiscal...

"Fiscal policy, including better tax and spending policies, are needed to put public finances in shape. Otherwise Sri Lanka will not build back better. We need to have better fiscal resources at hand, especially over the next three years. Sri Lanka needs to build firewalls because the country has taken on debt that leaves it vulnerable to external shocks for the next decade, and this can best be done through sound fiscal policies," she added.

Dr. Weerakoon added that wider fiscal space will also assist the Government provide better social welfare support to the poor. Sri Lanka's budget deficit is estimated to be between 9-11% in 2020, and public revenue streams remain uncertain even in 2021, according to analysts. This together with low debt sustainability was partly why Sri Lanka's sovereign rating was downgraded earlier this month by international rating agency Moody's.

"Number one priority is the country's debt situation, which has been building up in the last decade, and COVID-19 has made it more challenging. I see two related developments, one is because of this large debt overhang we are not able to implement economic stimulus package as preferred by the Government, and on the monetary policy front we have to be careful about the impact on the exchange rate because currency depreciation could increase the debt burden."

Govt. urged to look beyond "emergency measures"

Dr. Weerakoon added that due to growth challenges it was understandable that the Government might be predisposed to encouraging Foreign Direct Investment (FDI) to sectors such as real estate to ease forex pressures, but recommended that beyond the recovery phase Sri Lanka needs to look at a more sustained growth path based on investment and technology-infused exports.

Given global uncertainty, restricting imports in the short term is a predictable response by the Government, but the Executive Director warned policy makers should be vigilant of decisions made by key economies, and how value chains will reform post-pandemic, adding that Sri Lanka should be ready to connect to these new systems to ensure the country's exports do not continue to suffer.

"Sri Lanka is not the only country rethinking its trade policy and COVID-19 is accelerating that process. The challenge of countries is to create jobs and support its recovery. So to some degree the import restriction is understandable. The sensible thing is to see it as an emergency measure, and see what the future will bring. Sri Lanka cannot afford to lose out by holding onto protectionist measures. A seamless tariff regime is needed to join international value chains, and once the world recovers we must rethink our approach to trade."

The same perspective should somewhat overlap the Government's approach to investment, especially capital investment, Dr. Weerakoon noted. Different countries will have different needs, and while Sri Lanka may find it easier to attract investment to sectors such as construction, once the economy moves to recovery mode, policy makers will need to switch gears and seek investment that is technology-driven and skills-focused to match Sri Lanka's aging population dynamics.

Private sector called on to seek value in education and environment

Dilmah Ceylon Tea CEO Dilhan Fernando responding to questions said COVID-19 had shown the private sector also has a role in protecting jobs and livelihoods across the country, as well as finding value in healthcare, environmental and education investment that are "conventionally" seen as costs.

"There is a role for business outside of the conventional understanding. The private sector needs to understand that things like education and healthcare are not a cost but a value. What we are seeing here is a reassessment of our value systems, and COVID-19 has exposed certain structural issues that trigger macroeconomic vulnerabilities. Inequality is exacerbating the COVID-19 impact and the past few months have shown our interconnectedness and need for the private sector to also pool resources with the State and other stakeholders, to find solutions and a new value system – not just financial or commercial, but one that also spans the social and environmental."

He advocated that companies focus on the sincerity of Corporate Social Responsibility (CSR) projects so they have genuine value, which will be recognised by consumers.

IPS Research Director Dr. Nisha Arunatilake warned that COVID-19 has increased inequality, and due to Sri Lanka's fiscal issues the Government was only able to spend 0.25% of GDP, which is far lower than other peer economies.

"What we have managed to do is not enough, even though it was comprehensive. When it is not enough people move to different coping mechanisms where they run down savings or get into debt. They could also respond by reducing investment on healthcare and education, which can have a significant impact on productivity levels in the future. This is why it is very important to establish macroeconomic stability."

Gender inequality exacerbating COVID impact

She also pointed out that COVID-19 has deepened gender inequality. Even though companies are focusing on flexible work hours – and that can provide opportunities – there is a significant number of women who are engaged in agriculture, and those whose work cannot be transferred online, she added. This is made worse by the fact these women also tend to be in the informal sector and therefore have no social protections.

"Government has to take the lead on social welfare, and it will take time for jobs and livelihoods to recover. Studies have shown that even if there is recovery, it will be less than what would have happened if COVID-19 had not happened. On the spending side wasteful expenditure has been limited, but even if you limit expenditure it will not be enough to do the kind of fiscal rebalancing that Sri Lanka needs to do.

"On the revenue side we need to revisit tax policies, but it cannot be premature. Phasing in of tax and fiscal spending will have to be carefully done as there will be little room in the next three years. I hope the Budget will be able to bring some level of fiscal stability in the short term."

COMMENTS