SOE 2023: IPS offers some inputs to proposed growth lab

Monday, 6 November 2023 00:30 - - 4358

SOE 23 says that IMF's insistence on further tightening monetary policy when the inflation had been subdued by the Central Bank through its tight policy measures is an 'over-kill' and that policy prescription ignores the inflationary pressures due to supply shortages, an outcome of negative or slow economic growth

Missed lab approach timeline

President Ranil Wickremesinghe addressing the nation in June 2023 announced that his Government will use 'lab approach' to decide the strategies to be followed by Sri Lanka to deliver richness to people by 2048, when the country celebrates the centenary of independence from Britain. This lab approach is a technique borrowed from the Growth Lab of the Center for International Development or CID of Harvard's Kennedy School of Government.

Wickremesinghe has a bias for CID because he himself is an alumnus of the Kennedy School. He said that he would assemble top private sector leaders, bureaucrats, and Cabinet ministers in a six-week retreat to design the policy strategy to be followed. The document that will come out of the lab will be signed off by all the three parties giving them the ownership to the policy. According to his timeline, the lab was to be assembled in early July, the report ready by end-September, and the public will approve of it by end-December 2023. Since he has missed the first two milestones, the third is a non-event. If he is still interested in the lab approach, the timeline should be shifted to 2024 making his work more difficult in a scheduled election year.

If it is done after all, the three parties meeting in the lab can draw on the policy options presented by the Institute of Policy Studies or IPS in its latest release, 'Sri Lanka State of the Economy 2023', known as SOE 23. The sub-title of the publication is 'Economic Policy Choices from Stabilization to Growth' which is the subject matter that falls on the participants in the lab.

Ignored IPS advice

IPS was created in late 1980s by the Ministry of Finance with technical support from the Dutch Government to provide alternative economic policy options to Sri Lanka's state policymakers. Since then, it has been issuing an annual report digging into the state of the economy with an apt theme. The report is an early bird since it comes about five months before the release of the Central Bank annual report and seven months before the annual report of the Ministry of Finance. Hence, it provides rich material for the finance minister to prepare his budget in addition to the special confidential report submitted by the Central Bank before 15 September each year. However, as I have commented in this column previously, the IPS report does not receive the attention it deserves from bureaucratic policymakers and top politicians in the Government. To make the matters worse, it is not publicly debated and discussed in the media.

This should not be the case and those in the proposed growth lab, if it is formed in 2024, can break the bad habit. Since it is not practicable for them to prepare a lasting policy strategy valid till 2048, the IPS report will help them to prepare the foundation for such a policy program.

> *What this means is that IMF program is helpful, but overreliance on it as Sri Lanka's saviour is a short-sighted policy action. The country should design its own economic strategy to ensure medium to long-term sustained economic growth on the foundation laid by IMF. In this connection, there are certain policy risks faced by the country. The present pliable mood of many people to ongoing painful policy reforms may not be there when they are driven to the wall. The repressive measures being taken by the Government to silence such dissent may not work at that point*

Low-level equilibrium

The subtitle of this year's report is from stabilisation to growth. That is because the present extended fund facility program of IMF and the work done by the Central Bank will only put the main macro variables which have gone haywire to a temporary stable position. This position was labelled as 'low-level equilibrium' by Shirani Cooray who delivered the 73rd Anniversary Oration of the Central Bank recently (visit: https://www.youtube.com/watch?v=UoKrMsPmbxY).

Due to Central Bank's tough monetary policy actions, the consumer price inflation has declined from 74% a year ago to less than 2% in September 2023. The suspension of the servicing of the foreign debt received from the commercial and bilateral lenders plus the clamping of exchange and import controls have reduced the foreign exchange outflow enabling the country to use the limited availability of forex reserves to buy essential goods like fuel and cooking gas. The demand for same has been cut by the increase in the respective price of these products. These two measures have practically eliminated the queues for same.

At the same time, the availability of fuel has helped the CEB to avoid lengthy power cuts. The country is returning to normalcy gradually but to make it sustainable, economy should grow at an accelerated rate. If the goal is to make Sri Lanka a rich country by 2048, the required annual compound economic growth rate from 2027 is a little over 8%, assuming that the World Bank's rich country threshold of per capita Gross National Income is about $ 18,000 and Sri Lanka's population is about 25 million in that year. This is a formidable task. Otherwise, the painfully earned gains by way of the low-level equilibrium so far will have to be sacrificed. That is the reason for IPS to talk on from stabilisation to growth in its SOE 23 Report.

> *The SOE 23 says that the current EFF program is harder than the previous ones because Sri Lanka had had a frustrating record of fulfilling its promises in previous programs. Sri Lanka had failed to complete the needed policy reforms which were a necessary condition for the long term sustained economic growth. Hence, the current program has two aspects, one concerning 'prior action' which SOE 23 has termed as 'front-loading' and the other relating to the action to be taken while the program is on. All reforms are painful and, therefore, the prior actions which required Sri Lanka to increase fuel, electricity, and water prices to cover their costs and the increase in taxes – both income and value added taxes – to support the worsening public finances were methods to prepare the ground suitable for receiving IMF support*

Weaknesses of IMF programs

The SOE 23 says that the current EFF program is harder than the previous ones because Sri Lanka had had a frustrating record of fulfilling its promises in previous programs. Sri Lanka had failed to complete the needed policy reforms which were a necessary condition for the long term sustained economic growth. Hence, the current program has two aspects, one concerning 'prior action' which SOE 23 has termed as 'front-loading' and the other relating to the action to be taken while the program is on. All reforms are painful and, therefore, the prior actions which required Sri Lanka to increase fuel, electricity, and water prices to cover their costs and the increase in taxes – both income and value added taxes – to support the worsening public finances were methods to prepare the ground suitable for receiving IMF support. Simultaneously, the Central Bank adopted very restrictive monetary policies to cut the total demand – known as aggregate demand – to halt the price increases and thereby bring the inflation under control. However, these are, according to SOE 23, 'growth inhibiting policies' resulting in dampening economic growth, on one side, and increasing poverty and unemployment, on the other. The social costs of this outcome are visible everywhere. Poverty has increased from 13% to 25%, income distribution has worsened by making the rich richer and the poor poorer, higher inflation and subsequent tax increases have cut peoples buying power, and wage freezes have cut the real wages of workers.

Growing public protests

In this backdrop, the austerity enforced by the IMF program has been the target of criticism by those who oppose economic reforms. While calling this criticism 'unimaginative', SOE 23 has pointed out the weaknesses of a typical IMF program too. It says that the $ 3 billion facility is an inadequate liquidity support to come out of the external debt crisis because it covers only less than 8% of the central government's external debt stock. Also, the condition that the country should accomplish performance criteria set for receiving the next instalment is burdensome because it involves drip-feeding, a slow disbursement of funds rather than supplying a mega amount to meet the requirement. What this means is that Sri Lanka should do a lot to resolve the crisis on its own.

This requires Sri Lanka to persuade other creditors and investors to provide funds to help fill the gap. There is a belief that the IMF program will be conducive to build confidence among these groups because it will enforce discipline on the Government. But the program should be implemented within a narrow timeframe – in this case within four years – forcing people to bear a heavy pain within a short period. When this time-bound, target-driven program is implemented, the whole attention of the Government is to satisfy the IMF thereby losing sight on the medium-term growth requirements.

SOE 23 says that IMF's insistence on further tightening monetary policy when the inflation had been subdued by the Central Bank through its tight policy measures is an 'over-kill' and that policy prescription ignores the inflationary pressures due to supply shortages, an outcome of negative or slow economic growth.

Growth is Sri Lanka's responsibility

What this means is that IMF program is helpful, but overreliance on it as Sri Lanka's saviour is a short-sighted policy action. The country should design its own economic strategy to ensure medium to long-term sustained economic growth on the foundation laid by IMF. In this connection, there are certain policy risks faced by the country. The present pliable mood of many people to ongoing painful policy reforms may not be there when they are driven to the wall. The repressive measures being taken by the Government to silence such dissent may not work at that point.

There is a call for early elections since policy reforms are being implemented by a President who is unelected by the people. Many believe that he or the Parliament that supports him has no legitimacy. The country also has not got many choices at this time. Even if an opposition political party captures power riding on the wide-spread public dissent, it may soon find that the economy is not strong, exchange rate and external finances are sketchy, the tamed inflation is a short-term dream, the government cannot meet its bills, and there are many angry and hungry mouths out there needing quick appeasement. Therefore, Sri Lanka's grave economic crisis is not a problem of the present Government alone. It is a problem of all the people.

Economy-wide reforms

In this connection, early action for accelerated economic recovery supported by continued sustenance is a must. This is where SOE 23 comes in handy for policymakers. It says, in addition to the current IMF led policy program, substantive policy measures should be brought in to increase efficiency and productivity of economic enterprises. They involve the full implementation of the reform of the state-owned enterprises, land, labour, and education sectors, trade, and competition, among others. But these are not policies supported by everyone. As a result, there is the risk of stalling the implementation of the reforms until the end of elections. If the mood of the electors is not in favour of such reforms, there is the risk of their being totally discarded. It will slowly push Sri Lanka back to where it was in 2022, an unfavourable development that should be avoided at all costs.

Since economic confidence is low given the trust deficit created by the Government with people, a great deal of good behaviour and policy consistency is needed to get the people back to business within the country. The Government should demonstrate its intentions are genuine, and it will observe the good governance practices recommended by both the IMF and the civil society organisations. This was emphasised by Shirani Cooray, a Presidential advisor, in her Central Bank Anniversary Oration referred to above. What is needed is that the Government should prove to people that it is ready to eliminate bribery and corruption, observe the rule of law, and conduct free and fair elections. It should take out from the minds of people the accepted notion that 'for friends, everything and for enemies, the harsh laws', a sarcastic statement coined in Brazil to describe the behaviour of the rulers.

Intentions of inviting opposition should be genuine

SOE 23 has been very critical of the present policies and failures of the Government. This is a rich tradition it has maintained throughout. It is one of the reasons why it is ignored by policymakers and top politicians. What I have noted is that those in the opposition use its critique to castigate the Government. But when they are in power, they simply ignore its recommendations. It is now time to put a stop to this evil cycle. The President is inviting the opposition to join with him to rescue the country.

That call stresses the need and the urgency for a cross-party policy consensus as recommended by SOE 23, because the country is in turmoil, in low-level equilibrium as labelled by Shirani Cooray, and about to explode externally and implode internally. With or without IMF, this is the reality facing the country today. But to make the cross-party consensus a reality, it is necessary to convince the opposition that the call for support is genuine and not a mere lip service.

> *SOE 23 has been very critical of the present policies and failures of the Government. This is a rich tradition it has maintained throughout. It is one of the reasons why it is ignored by policymakers and top politicians. What I have noted is that those in the opposition use its critique to castigate the Government. But when they are in power, they simply ignore its recommendations. It is now time to put a stop to this evil cycle. The President is inviting the opposition to join with him to rescue the country*

Agree on a priority list

In this connection, SOE 23 has offered the following piece of advice: "The solution and best hopes are to build cross-party consensus on areas that do need fixing. Sri Lanka's disproportionate attention to investing in infrastructure with borrowed funds now has to shift to making exports more competitive globally. Externally, building partnerships to achieve these ends is fast becoming a diplomatic and geopolitical game. The global economic order is being reshaped as the US-China tensions mount – trade and investments have become battlegrounds as countries opt for 'near-shoring' or 'friend-shoring' with factories and critical supplies relocated closer to home or in trusted friendly countries. Large subsidies and tax incentives to build up domestic production capabilities in strategic industries like semiconductors and clean energy are being rolled out, while export (import?) bans are imposed on crucial raw materials and other products."

My advice to the Growth Lab if it is assembled in 2024: SOE 23 provides rich material for you to suggest the needed policy reforms and use it to the maximum to produce a good strategy report for implementation by the Government.

(The writer, a former Deputy Governor of the Central Bank of Sri Lanka, can be reached at waw1949@gmail.com.)

Recent columns

COMMENTS