tricity reform plans ⚡ Singapore's transport minister resigns over corruption charges ⚡ Sri Lanka welcomes over 1

Sri Lanka has competitive advantage in assembly activities: Dr. Asanka

Wijesinghe

07 Oct 2023 I By Tanya Shan

Ahead of the Institute of Policy Studies (IPS) State of the Economy 2023 report launch this month, *The Sunday Morning Business* interviewed IPS Research Fellow Dr. Asanka Wijesinghe, whose research interests include macroeconomic policy, international trade, labour, and health economics.

The IPS State of the Economy report delves into the historical context of economic reforms in Sri Lanka, specifically examining how past reforms were prompted by economic and political crises. To draw lessons for the current situation, *The Sunday Morning Business* asked Dr. Wijesinghe to explore the specific triggers and circumstances that led to previous reforms.

In the course of the interview, Dr. Wijesinghe explains that two key components of the crisis are the external trade deficit and the budget deficit. While the budget deficit pertains to domestic matters, reflecting the difference between Government revenue and expenditure, these issues have persisted since 2019 and became more apparent around 2022.

Following are excerpts of the interview:

The IPS report discusses the historical context of economic reforms in Sri Lanka, particularly how they were prompted by economic and political crises. Could you delve deeper into the specific triggers and circumstances that led to past reforms in order to draw lessons for the current situation?

If you look at the crisis, the two components are the external trade deficit and the budget deficit. The budget deficit is a domestic matter, representing the difference between Government revenue and expenditure.

However, these issues are not new; they have been recurring since 2019 or became more apparent around 2022. If you look at data from the 1950s, we have been running these two deficits every year.

The Government wanted to finance this gap and it borrowed excessively from domestic or external sources, causing our debt to accumulate. Obtaining loans is okay

– even households do it – but there should be a way to pay them back. Unfortunately, Sri Lanka did not find a way to pay it back.

The primary means of repayment is through exporting. Around the 1980s, we diversified our export basket to other countries. After that, the policy goal was to get into electronic value chains, like producing semiconductors and electronic equipment, as the ASEAN countries such as Thailand, Indonesia, and Malaysia did. However, we could not achieve that and export growth declined.

In the post-war growth period, we borrowed from external sources and developed the domestic sector. As a result, our debt-to-stock ratio, as a proportion of exports, skyrocketed. Finally, we lost our ability to meet debt obligations.

Right now, the lesson is to ensure we have robust export rate growth. That's why the Government is trying these various reforms, primarily focusing on trade reforms in this context. I think it's a good way to approach this problem, as export rate growth is necessary to overcome this crisis.

However, these reforms are painful. While they may generate economic benefits, they also come with distributional costs. For example, trade reform means we should make this country more exposed to the outside world. In that case, certain domestic sectors in the country might be affected. That's why we're focusing on finding a middle path and balancing these opposing forces to achieve an optimum outcome.

Trade policy reforms are identified as posing high distributional and adjustment costs. Could you provide examples of these costs, their impact on various segments of the population, and how they can be mitigated?

Currently, there is a high tariff ratio in certain sectors. For example, the manufacturing of bakery products, soft drinks, furniture, macaroni noodles, and agricultural crops faces high tariffs. High tariffs mean that when you import these products, the domestic price is higher than the world market price. This is done by policymakers to protect domestic substitutes.

For instance, food products like biscuits can be imported, but Sri Lanka has domestic producers, and the Government aims to protect these domestic industries, which provide employment to many.

Trade reforms seek to level the playing field, removing preferences. When import tariffs are removed, domestic industries must compete with imports. Unfortunately, some of these domestic industries are not globally competitive. They rely on high tariffs to survive.

For instance, Sri Lanka's paddy sector and rice cultivation are not competitive, nor are certain domestically-consumed products like bakery goods and beauty products. Removing tariffs would force these industries to cut costs and become competitive or face elimination, leading to factory closures and job losses.

The impact is not only on producers but also on the workers in these sectors, which carries significant political costs. This is why there is high protection for agricultural crops, even those that are not imported.

The majority of Sri Lanka's workforce outside the Western Province is in agriculture, with close to 50% of workers in this sector being in most other districts. Removing tariffs in these sectors would render them non-competitive and force them to stop production.

That's why we propose that any trade policy reform should be sequential, not a sudden shock. We should identify affected sectors and skill groups, considering whether they are educated, skilled workers, or graduates. With proper identification, we can suggest adjustment programmes.

For example, if the bakery sector is liberalised, we identify that bakery producers and workers will be affected. We then suggest trade adjustment programmes that offer compensation for job losses and skill development programmes to facilitate transitioning to other industries.

Different industries may require different skill sets, so the Government should provide relevant training programmes to ensure a smooth transition and prevent political backlash against reforms.

The report also emphasises the importance of a balanced approach to reform. Can you share examples of countries that have successfully implemented such balanced reforms and the lessons we can learn from them?

Finding countries that have successfully implemented balanced trade reforms is somewhat challenging. We have identified various trade adjustment programmes implemented by different countries.

For instance, European Union countries, especially Germany, have excellent skill retraining programmes that facilitate a smooth transition from one sector to another. However, in most other countries, such programmes have not been as successful.

In the US, they have a trade adjustment assistance programme, which was not very successful. The 2016 Presidential Election in the US was largely motivated by individuals who had lost manufacturing jobs due to factors like cheap imports from China. The lack of effective transition programmes contributed to this issue.

One of the best examples to learn from is the European Union countries, especially their focus on skill training. Skill training is crucial in helping the workforce transition to competitive sectors successfully.

The report suggests transitioning the agricultural labour force by expanding the manufacturing sector. Can you elaborate on this?

Specifically, the electronic equipment sector holds great potential for absorbing this labour force. However, it's important to note that attracting investment in this sector can be challenging due to various factors.

Sri Lanka currently has a competitive advantage in assembly activities, where different components are imported and assembled into final products. To target the electronic equipment sector, Sri Lanka would need foreign firms to invest in the country, setting up manufacturing facilities. This investment can provide employment opportunities and help transition the labour force.

Around the 1990s, during a period of globalisation, firms were more willing to invest in different countries, making it easier for countries like Sri Lanka to attract investment. However, the current global circumstances, including political instability and corruption, make it less promising for investors.

To facilitate this transition and attract investors, several policies and actions are necessary:

1. Political stability: Address political instability and corruption issues highlighted by international bodies like the International Monetary Fund (IMF). Investors are more likely to commit to a country with a stable political environment.

2. Bureaucratic reform: Simplify and streamline bureaucratic processes to make it easier for investors to navigate regulations and start businesses. Reducing bureaucratic red tape is crucial.

3. Investment-friendly environment: Create a more investment-friendly environment by removing barriers that deter potential investors. This includes addressing issues like excessive regulations and barriers to entry.

4. Macroeconomic stability: Maintain optimal macroeconomic indicators, such as low inflation. High inflation can deter investors, so ensuring price stability is essential.

5. Trade reforms: Continue pushing forward trade reforms, including engaging in free trade agreements with countries dominant in the manufacturing value chain. Joining agreements like the Regional Comprehensive Economic Partnership (RCEP) can signal to potential investors that Sri Lanka is open to international trade.

6. Skill development: Invest in skill development programmes to ensure that the local workforce possesses the necessary skills for the manufacturing sector. This can include vocational training and education programmes tailored to the industry's needs.

What is the relationship between competition policy and consumer welfare, and how can the country strike the right balance between the two?

The primary goal of competition policy is to promote consumer welfare. When markets are competitive, it benefits consumers through lower prices, greater choice, improved product quality, and innovation. Competition encourages firms to be more efficient and responsive to consumer preferences.

Competition policy aims to prevent and address anti-competitive practices that can harm consumers. These practices include price-fixing agreements between firms, mergers and acquisitions that reduce competition, and collusion among businesses to manipulate prices. When such practices occur, it leads to higher prices and reduced choices for consumers.

While there may be a desire to protect certain domestic industries, excessive protection can lead to reduced competition. For instance, imposing high tariffs and import restrictions can limit the number of players in a market, allowing a few firms to control prices. This can harm consumers by leading to higher prices and lower product quality.

To strike the right balance between protecting domestic industries and ensuring consumer welfare, countries need to design competition policies carefully. This includes setting clear regulations and guidelines to prevent anti-competitive practices while still allowing for necessary protection for strategic industries.

Effective regulatory oversight is crucial. Competition authorities should actively monitor markets to detect and address anti-competitive behaviour. They should have the authority to investigate mergers, agreements, and practices that could harm competition and consumers.

Transparency in policy-making and enforcement is essential. Policies should be well-defined and communicated to businesses and the public to ensure everyone understands the rules and consequences of anti-competitive behaviour.

The report suggests introducing trade adjustment system measures. Could you provide insights into what these measures might entail and how they can effectively support those affected by trade liberalisation?

A trade adjustment assistance programme generally comprises several components. One crucial aspect is providing employment benefits or income support to workers at risk of losing their jobs. This financial assistance serves as a safety net during the challenging period of job transition.

Another critical component involves retraining these workers to acquire the necessary skills to find employment in different sectors. These retraining initiatives encompass vocational training, education, and skill development efforts, ensuring individuals can adapt to evolving labour market demands. By enhancing their skill sets, workers become better positioned to secure new employment opportunities.

These two major components of trade adjustment packages should be identified as essential factors. In the US, for example, trade adjustment assistance primarily focuses on unemployment benefits, with limited retraining programmes. In contrast, the European Union has implemented successful retraining programmes that can serve as a model for Sri Lanka.

By adopting a similar model, Sri Lanka can ensure a smoother transition for those affected by trade liberalisation, minimising the challenges they face. Furthermore, investing in education is mentioned as a means to enhance the skill level of the labour force, providing individuals with a strong foundation to adapt to changing job requirements.

What are some examples of countries that have successfully invested in education to facilitate economic transformation and job transitions? How can Sri Lanka undertake this?

There is a substantial body of literature highlighting China's significant investments in higher education, particularly in colleges. Research has shown that these investments have yielded substantial returns for the country. Educated individuals have contributed to innovation by developing new products and technologies that could be sold in global markets.

In fact, a recent study demonstrated how investments in college education boosted China's innovation capacity. This innovation, driven by educated professionals, often leads to research and patent development for various products.

India also provides a compelling example. The country has made substantial investments in IT education, resulting in the production of world-class IT professionals. These skilled individuals have had a significant impact on the global IT industry.

Sri Lanka can draw inspiration from these countries, particularly regarding investments in skill development. However, it's worth noting that Sri Lanka's education sector may require reforms to align with these objectives. Researchers have already explored potential reform strategies, which could guide the country towards a more education-driven economic transformation and smoother job transitions.

The report recommends a sequential implementation of trade reforms. Could you provide a detailed roadmap of how this sequential approach would unfold?

The current situation necessitates a phased approach to trade reforms in Sri Lanka. Initially, the Government imposed various tariff and non-tariff barriers in response to the economic crisis caused by the Covid-19 pandemic post-2020.

While the Government has begun to phase out some of these import controls since July 2023, complete removal remains a challenge due to concerns about foreign exchange reserves. However, recent developments, such as the IMF deal and remittances returning, provide a window of opportunity for their removal in the short term.

The most complex phase of reform involves eliminating entrenched tariffs and other trade barriers. Historically, tariffs have been strategically employed to protect workers in domestic sectors, particularly agriculture. The medium-term goal for the Government should be to gradually remove these tariffs, perhaps by transitioning them to a unified tariff structure.

Currently, Sri Lanka has various tariff bands ranging from 5% to 35%, alongside numerous non-tariff barriers. The ultimate objective is to achieve a neutral trade policy that does not favour specific domestic industries.

The report identifies three distinct phases for this sequential approach to trade reforms:

- **Phase 1:** The initial phase focuses on phasing out Non-Tariff Measures (NTMs) and Special Commodity Levies (SCLs). SCLs, such as those applied to dairy products and pulses, were imposed after 2020 and should be eliminated in this phase.
- **Phase 2:** In the second phase, the Government can begin to remove paratariffs and work towards neutralising the incentive structure that has historically favoured certain industries.
- **Phase 3:** The final phase involves removing deeply entrenched tariff protections, particularly those provided to conventional sectors like agriculture and domestic manufacturing. These sectors have historically enjoyed significant trade protection.

Given the unique political circumstances, how can Sri Lanka effectively navigate the challenges of implementing reforms in the current context while ensuring political acceptance and security?

Sri Lanka has a history of implementing reforms under strong political conditions. For instance, after 1977, J.R. Jayewardene, who secured a significant mandate, had control of the Parliament, held a super-majority, and served as the Executive President. Similarly, the second wave of reforms in the 1990s also occurred with a strong political mandate, despite facing a crisis during President Premadasa's time, thanks to parliamentary majority.

However, the current situation in Sri Lanka is quite unique. The President holds just one parliamentary seat and commands support in a coalition government, introducing an element of uncertainty.

When the Government attempts to push these reforms, there is likely to be political backlash from the sectors that stand to be affected. We've seen this with income tax reforms, which sparked significant opposition, even though they only impacted a small proportion of the population.

If broad-based tariff reforms are on the table, it could affect a large number of people, especially those in the agricultural labour force. Managing this political challenge will be a formidable task for policymakers, particularly as Sri Lanka heads into a cycle of elections in 2024.

To address these concerns and minimise the political cost, one approach could be to follow a sequential pattern for implementing reforms. Additionally, introducing adjustment programmes can help alleviate the adverse effects of reforms on affected sectors. These strategies provide the Government with tools to manage the political challenges associated with reform implementation.

Looking beyond the report, what role do you see international organisations and partnerships playing in supporting Sri Lanka's reform agenda and export-led growth? What strategies can be employed to leverage these external resources effectively?

When it comes to international organisations and partnerships, there are several key aspects to consider in supporting Sri Lanka's reform agenda and fostering export-led growth. One critical factor is Sri Lanka's participation in the IMF programme, which is currently underway.

It is imperative for Sri Lanka to successfully complete this programme and actively advance fiscal and macroeconomic reforms. The Government has displayed a willingness to collaborate with multilateral institutions in this regard, signalling a positive step in the right direction.

Another dimension of partnerships involves Sri Lanka's expressed intention to enter into Free Trade Agreements (FTAs) with various countries. FTAs provide opportunities to establish trade partnerships and secure preferential market access for Sri Lankan products in these nations.

The pursuit of agreements such as the RCEP and the Thailand-Sri Lanka Free Trade Agreement holds potential benefits, especially if Sri Lanka can negotiate tariff concessions for products in which the country possesses a comparative advantage, like garments.

In terms of strategies for effectively leveraging these external resources, it's crucial to focus on trade diversification and product upgrading. While Sri Lanka currently has a comparative advantage in industries like garments, the next step is to diversify the export basket and aim for electronic equipment and assembly activities. Building strong relationships with ASEAN countries can be instrumental in achieving this goal.

Discover Kapruka, the leading online shopping platform in Sri Lanka, where you can conveniently send Gifts and Flowers to your loved ones for any event. Explore a wide range of popular Shopping Categories on Kapruka, including Toys, Groceries, Electronics, Birthday Cakes, Fruits, Chocolates, Automobile, Mother and Baby Products, Clothing, and Fashion. Additionally, Kapruka offers unique online services like Money Remittance, Astrology, Medicine Delivery, and access to over 700 Top Brands. Also if you're interested in selling with Kapruka, Partner Central by Kapruka is the best solution to start with. Moreover, through Kapruka Global Shop, you can also enjoy the convenience of purchasing products from renowned platforms like Amazon and eBay and have them delivered to Sri Lanka.

React 0 reacts 0 Comments

Add your comment

No comments found here

Be the first to comment

More News..

Ceyline Holdings appoints new ...

18 Jan 2024

SriLankan Airlines misses its ...

18 Jan 2024

‘Cautious’ shopping despite se ...
18 Jan 2024

Over 100,000 tourists visit Sr ...
18 Jan 2024

Emirates to recruit cabin crew ...
18 Jan 2024

SL creditors have not agreed o ...
17 Jan 2024

Opportunity arrived to invest ...
17 Jan 2024

Oil palm cultivation ban to be ...
17 Jan 2024

the morning

The Morning is the news website of The Sunday Morning and The Morning newspapers. It offers latest and breaking news on politics, current affairs, sports and entertainment.

Categories

News
Focus
Editorials
Opinion
Business
Interviews
Brunch
Sports

Quick Links

Sign Up
Sign In
About Us
Contact Us
ePaper
Archives
Terms & Conditions
Privacy Policy

Contact Us

91,Wijerama Mawatha, Colombo 7
themorningweb@gmail.com
0115 200 900

0112 673 451

Social Media