Agenda for urgent economic action for the new Cabinet

Now that the parliamentary elections are concluded, the focus of the new government should shift to the serious business of fixing the economy. COVID-19 has hit Sri Lanka's economic outlook harder than expected.

A gloomy prognosis suggests a scenario of negative economic growth, high unemployment and rising foreign debt in 2020 and 2021. Revenue from tourism, remittances and foreign investment are all down. At all costs, one should guard against a pandemic-induced economic crisis from turning into a crisis in the financial system which would be a double whammy for an already debellated economy. Although good weather may help revive the agricultural sector, the economy faces a slower and longer road to recovery from COVID-19.

The new government's election platform over the past few weeks put forward several useful policies to aid economy recovery in Sri Lanka. The President's proposal for accelerating regional economic development through four multi-dimensional commercial cities – Colombo, Hambantota, Jaffna and Trincomalee – will help spread the benefits of economic development throughout Sri Lanka. The emphasis on improving domestic agricultural production and reducing post-harvest losses will support food security for the people in difficult times. Planned investments in tertiary education and primary schooling will improve the quality of human capital. Promoting digitisation and e-commerce can support dynamism in business and government. Of course, economic recovery will be dependent on continuing the success in combating the pandemic.

But, to ensure a sporting chance of achieving economic success in a slower growing global economy beset by risks, the Pathfinder Foundation recommends that three other things should be done by the new government.

First, Sri Lanka needs to find the resources to pay for the government's agenda. Mobilising a large volume of external financing is crucial to create the necessary fiscal space. So far Sri Lanka's fiscal stimulus has amounted to under 0.5% of GDP while the figures in Malaysia and Thailand is between 12-15% of GDP and in advanced countries between 15-20%. This means sorting out legacy issues which have clouded the macroeconomy over decades. A coherent and predictable medium-term fiscal-monetary policy framework needs to be adopted to ensure macroeconomic stability.

This has the advantage of giving confidence to investors, both domestic and foreign; creditors; and rating agencies. Such a framework can also serve as a basis for negotiating an agreement with the IMF. An IMF programme would also unlock substantial multilateral and bilateral financing (possibly debt relief as well); increase the prospects of improving the sovereign rating; and open up the possibility of accessing international capital markets which would be necessary to secure the debt roll-over which Sri Lanka requires until it builds up capacity to earn and save sufficient foreign exchange to service its debt on a sustainable basis.

Partnerships with the European Union, India, Japan and the US should be looked at dispassionately and in non-ideological terms. Accordingly, early decisions on bilateral agreements with global and regional economies can provide clarity that will assist in maximising international support and foreign direct investment for Sri Lanka's recovery. Furthermore, efforts to mobilise bilateral and multilateral financing should be supported by leveraging government to government relations to attract equity rather than debt. Public private partnerships for infrastructure investment should be looked at seriously.

It also means stopping haemorrhaging losses from state-owned enterprises (SOEs) and strengthening the operations of others through better management. For instance, the cash requirements of several hundred million US dollars for SriLankan Airlines is unsustainable. In addition, as the World Bank has identified Sri Lanka as one of the countries that is most vulnerable to the effects of climate change, attention should also be paid to tapping into financing, both conventional and unconventional, to support the integration of sustainability into the planning and budgeting processes. Second, Sri Lanka needs to continue to be linked to the rest of the world. As a small low middle-income economy of only 22 million people, Sri Lanka lacks adequate domestic demand, production capacity and home-grown technology to erect protectionist walls and completely turn inwards for its development momentum. Doing so also means squandering a strategic geographical location in the centre of the Indian Ocean on the main East-West trade route. Naively opening up the economy to foreign trade and investment may not be an answer either due to potentially large trade adjustment costs. Instead, Sri Lanka could follow a managed opening up strategy pioneered by China, Korea and Viet Nam other high-performing East Asian economies.

This means significantly cutting red tape affecting investors, both local and foreign, as well as digitising all government services. It means a joined-up approach to economic diplomacy by Sri Lanka's overseas missions in partnership with the EDB and the BOI. Building up trade negotiating capacity to pursue Sri Lanka's commercial interests in free trade agreements (FTAs) with Asian countries like China, India and Thailand is another important area. The relaxing of import restrictions should be calibrated to the recovery in foreign exchange availability, business performance, and the country's supply capacity. Economic history suggests that gradual moves away from autarky to greater openness provide significant economic benefits to small economies like Sri Lanka.

Third, Sri Lanka needs to set up an inter-disciplinary group of experts to develop a recovery strategy. These should be qualified and credible experts, with international experience, who can provide the government with independent advice on formulating an economic recovery strategy, monitor outcomes and suggest mid-course policy corrections if needed. To be meaningful, discussions between these experts and high-level policy makers should take place behind closed doors. Successful East Asian and advanced countries continuously seek policy advice from such independent experts to manage economic crises and formulate recovery strategies. The Pathfinder Foundation believes that initial months of a new government offer the best possible opportunities for serious policies to stabilise the economy and strengthen its growth potential by increasing its productivity. The ongoing pandemic and its impact on the global and domestic economies constrain the options open to the new cabinet. However, the government needs to formulate a bold package of measures which combines the continuation of its success in containing the pandemic with policies and programs which focus both on stabilising the economy and putting in place frameworks which will stimulate sustainable and inclusive growth over the medium term.

In April 2020, The Pathfinder Foundation set up a study group of eminent persons from academia, research and the private sector to examine the implications of COVID-19 for the Sri Lankan economy. In May 2020, the Pathfinder study group presented President Gotabaya Rajapaksa with a report containing a set of action-oriented recommendations aimed at steering Sri Lanka into a post-COVID-19 era of economic recovery.