

Do you think the International Monetary Fund's (IMF) Extended Fund Facility (EFF) will trigger a positive short-term response for Sri Lanka in the markets and credit ratings?

We saw a little bit of a market reaction that actually the EFF was treated as positive news. The dollar was depreciating relative to the currency. The markets were probably already ready to take into account that a deal would be happening and there is a positive response. When it comes to credit rating agencies, that is going to take a little bit of time. The problem is that when things start to become better in terms of policy and the IMF programme, it usually takes quite a lot of time before credit rating agencies respond. To put it differently, there is an asymmetry between what is needed to bring the credit ratings down and what is needed to build up that confidence. This is a problem because it makes adjustment more expensive. The rating agencies are not very good at recognising when a government credibly tries to recover or when there is no credibility. Even when the government tries to reform, the credit rating agency will not respond quickly.

Can you point to any other cross country examples in this regard?

A country that I knew very well at the time is Uganda, who actually came out of conflict in a really dramatic way. After a few years the Government wanted to reform and did a lot of the right measures. It actually took many years before the credit ratings recovered even a little bit. It is obvious that it has to go down during all conflict



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periods, but what does the government have to do to build it up? In fact, it took many years to go back to where they were when the conflict eased. It is this kind of asymmetry and it makes the situation in Ghana also quite difficult. There are plenty of examples in the world. When people complain about these issues, I can see that there is a bit of a point too.

The current crisis has doubled the poverty rate in Sri Lanka and increased the number of poor people in Sri Lanka. In your opinion, what types of social assistance responses can we expect to be in place to mitigate the impact on the poor and vulnerable people during the macroeconomic adjustment period?

Sri Lanka has always been known to have reasonable social protection policies and inclusion. I say reasonably, by no means perfect. At the same time, the Sri Lankan economy had been growing fast five years ago. In the end, it is growth that delivers much of the longer term poverty reduction. In the longer term we need to go back to a situation of growth that is inclusive and will actually bring down the poverty level.

We need to look at social assistance very much. In the existing welfare programme, there are errors of inclusion and errors of leakage. About 50% of the people that should be included are not getting this welfare facility, while also quite a lot of people who do not belong to the lowest income base get some of that support. The priority would be to make sure that those who should get the support, get the support. Let's not just focus on the leakage because that still leaves a huge amount of people out of it.

People say we cannot do it because there is no money with

the IMF. What the IMF typically tells you to do is to make sure your overall fiscal number is under control. It does not impose how it should be distributed. We must make sure that more of the poor are protected. We must make the cuts much higher up in the income distribution. Within the context of the IMF programme, the argument should not be about cutting expenditure. The argument could be about increasing expenditure. The key argument has to be about balancing the books. It has to be on the revenue side. That is where ultimately the first priority has to lie. We need to increase fiscal resources through the revenue side.

It is not about just changing the income tax rate. This is about the entire fiscal contract between the population, between the business community and the government system - and they are saying business, as much as individuals will have to bear some of that run. The Government should be fair to the population. Not only individuals, but also businesses should pay proper taxation. It means everybody will probably pay a little bit more, but just make sure it is clear and transparent across the board.

Sri Lanka must implement a strong and credible fiscal and structural reform programme for a speedy economic recovery. How should Sri Lanka design its reform programme to correct fiscal and external imbalances in order to overcome the crisis?

One of the unfortunate things about basic economics, about macroeconomic stability, is that these relationships require a balance of payment, primary balance and a fiscal balance. These are a bit like accountancy relationships. You cannot say it does not matter if one is very high and then there is a mas-

sive deficit forever. At some point you need to find ways of balancing. In the first instance, even though the IMF tells you that there needs to be some balancing of all these things.

I do not think that any adjustment programme or a stabilisation programme of the IMF ever, anywhere in the world, succeeds unless politics tries to build some consensus around what is required and what is not required. I recognise that is not quite present in this country. When you ask me what they should be doing, how you go about it is more important than what you do. What you do is about building up a plan that is for society, for broadly the business community, maybe for the unions or SEOs unions, for all the different parties is kind of workable rather than it is not imperfect.

You will be surprised that the international community, like the IMF or other international financial institutions, likes it when a country tries to somehow build the pieces of the jigsaw together because that is what creates the credibility that a programme will be pursued and seen through. Sri Lanka has a history of not completing these kinds of programmes because of politics. That means anyone that is a responsible politician should try to work with other politicians, professional associations, the business community, the Unions to get out of this crisis because that is the only way we can see this through. That is something we need to do to stabilise the economy in a fair and equitable way so that we do not foreground this opportunity we have and then go back to growth in the next few years.

According to the World Bank, Sri Lanka is expected to have the lowest economic growth

rate among 148 countries. As an outsider looking in, how should Sri Lanka lower the negative growth gap? And what should be the future trajectory of Sri Lanka's economy beyond the IMF?

Despite complicated politics for a long time, lots of conflict and other types of more latent conflict within society, Sri Lanka has come remarkably well over the last 30 to 40 years. Being able to reconnect with that should be possible. It is true that cumulatively, over the last few years Sri Lanka may have lost about a fifth or a quarter of its GDP per capita. Sri Lanka has had many years of growth rates of seven and was 8% per year. That means Sri Lanka has lost about five to six years of growth. But the crucial bit is, can Sri Lanka reconnect to those potential sources of growth it has now?

Sri Lanka has incredibly good human capital. The rest of the world is very interested in your human capital. But that actually still means that anyone with a bit of other capital should find it profitable to invest it here and not just try to get to somewhere else. The link is that. It is important to make this country attractive to foreign investments again in order to bring capital here. No investor simply comes because there is a tax holiday. Every investment comes because in the long term, they can make money.

Of course, tourism has not come to the end of the road. Even though hotels are quite empty and travellers have not quite come back, they will come back and it is a great place to do so. Also agriculture, Sri Lanka has pretty remarkably fertile lands and opportunities and that is where poor people are. If you are going to restrict farmers to go for the lowest yield, lowest return crop, that

is ridiculous. That land could be used for really much higher value crops. With all that human capital, the country should be exporting services to the world. There are actually quite a lot of opportunities that are there.

Which sectors are your top picks for Sri Lanka's future growth?

One of the things that I never like to do is to say, this is my top one, because it is usually about three or four people who will be slightly different when it comes to the economy and attracting investments. But I would still say tourism. You have the capacity that is underutilised. Let's get practical capacity. Agriculture - I would definitely mention, but go for higher yielding crops, higher return crops, export the crops. Your exchange rate, which probably was overdue for a correction for a while, was making imports very cheap. It was really overvalued. You should be able to do all kinds of high end vegetables, coffee, all kinds of things. Now, exports should be possible from this country, which with the previous exchange rate was not possible.

There is an interesting period happening in the global economy because of geopolitics and Sri Lanka has an amazing opportunity in this regard. A lot of value chains will leave China and a lot of firms will not make their chips, transistors, and electronics in China anymore. They should be here. You have better human capital than India and Bangladesh. You have that little skill. However, not all of these will succeed.