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FT View

Fiscal matters

AS COVID-19 numbers continue to rise in Sri Lanka, there are increasing concerns of what the fourth quarter of the economy will look like and whether it will bring the much-hoped-for recovery. Unfortunately sentiment seems to be trending in the opposite direction from August with most manufacturing and services sector stakeholders expressing fears of a serious downturn, largely due to the resurgence of the virus.

Many economists and even the Central Bank had put their hopes on a resilient fourth quarter. The latter, in its previous monetary policy review, indicated that for the Sri Lankan economy to break even a buoyant fourth quarter was essential. With prospects of that dimming somewhat, it is important for policymakers to have a realistic view of the challenges and tribulations that await Sri Lanka for the rest of the year and in 2021.

The first thing the Government should do is release the second quarter growth numbers. That period ended in June and even though it is now the middle of October, there is no indication of when the Census and Statistics Department will release the data. Many analysts and rating agencies are operating on assumptions of as much as a 10% growth contraction but this is not concrete enough. It could be that the actual news is worse or better, either way it gives a basis on which to make projections for the third and fourth quarters.

Secondly, it is now imperative that Budget 2021 has a set of very clear policies along with a credible implementation framework. The latest World Bank South Asian Outlook report released last week estimated Sri Lanka's deficit for 2020 to be an eye-watering 11%, higher than the 9% projected by the Finance Ministry. Given Sri Lanka's high debt repayment obligations for next year it is imperative that there are significant fiscal consolidation measures outlined in the upcoming Budget.

This is all the more important as the Government has so far steadfastly refused to entertain an agreement with the International Monetary Fund (IMF). This is the right of the Government but it should then set in place a framework for reassuring and winning investor confidence on par with what would be given via an IMF agreement. A run-of-the-mill Budget may find this tough going as Sri Lanka has a poor track record of sticking to goals, especially on the revenue side with successive Budgets failing to hit their deficit targets over the past few years. The previous Government targeted reducing the deficit to below 4% by 2020 but failed dismally to do so.

Putting Sri Lanka's fiscal house in order is all the more important because the toxic combination of COVID-19 and debt is not something limited to just 2021. Sri Lanka faces significant debt repayments for most of the next decade, which will be accompanied by sporadic balance of payment pressures. This means sound fiscal policy will be needed to attract investors, bolter reserves and raise funds from international financial markets. This is a precarious situation that could have deep consequences if it is not taken seriously by the Government.

Having more fiscal space will also assist the Government to increase welfare and social protection measures. COVID-19 is expected to drive unemployment to new highs with the number of near poor expanding exponentially. Therefore the Government must have additional funds at the ready to support these vulnerable communities and reduce the stresses that can cause social unrest.