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Rupee float is ill-conceived - Dr. Nicholas

Says macro economic indicators will worsen, urges other means to push exports and boost economy

By Nisthar Cassim

Top economist Dr. Howard Nicholas on Tuesday said that a floating rupee will only worsen Sri Lanka's macro-economic indicators posing greater hardships for the economy and the people.

Expressing his strong reservations over the benefits adduced by the Central Bank in floating the rupee and emphasised the importance of introducing far reaching measures including cheaper credit to boost the export and manufacturing base, make it dynamic and globally competitive.

Dr. Nicholas in a presentation titled "Economic and financial consequences of the recent exchange rate fluctuations and policy shift in Sri Lanka," told a seminar organised by the Sri Lanka Economic Association (SLEA) that the rupee float has far reaching and serious implications.

He said it will lead to the worsening of the Balance of Payments (BOP), shoot real inflation to 30% or more and send interest rates higher whilst increasing the Budget deficit to 11% this year. He also said that these developments will have a domino effect causing a slower economic growth (he forecast a GDP growth rate of 2.5% or less this year as against 5 to 6% in 2000).

The reasons for the negative outlook was that Sri Lanka's rupee is weak and imports will continue to be higher whilst in the short-term exports will not show a dramatic increase given the poor outlook in global markets with recession in the US. He noted that such an environment would exert continued pressure on the exchange rate.

The seminar was co-chaired Dr. Neville Karunatillake, former governor of the Central Bank and Prof. W.D. Lakshman, former vice chancellor of Colombo University. Among the audience were Dr. Lal Jayawardena a former economic advisor to President Chandrika Kumaratunga.

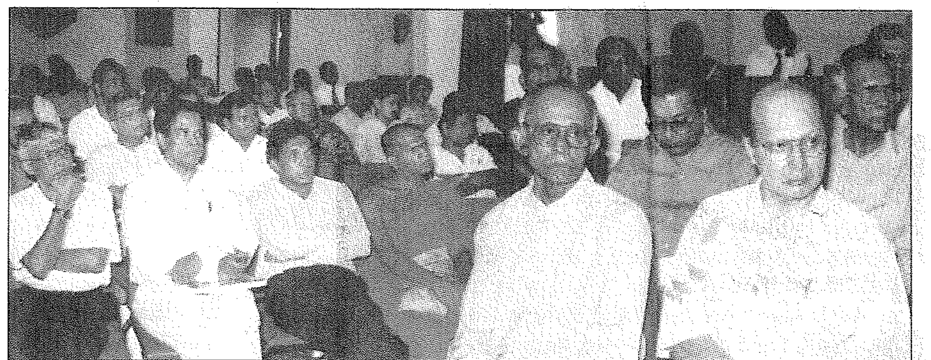
Dr. Nicholas, who is the Senior Lecturer at the Institute of Social Studies in the Netherlands, argued that the Government floated the rupee on the advise of the IMF to level the playing field and let market determine the exchange rate. But given a host of weaknesses, a thin and under-developed forex market, low reserves, weaknesses in Sri Lanka's export structure, a weak manufacturing base, and high dependence on imports, the country would not benefit.

"At present importers are not opening LCs because there is uncertainty and how could one say that the market is determining the rates," he quipped.

He was also of the view that given the inherent weaknesses in the system using the float to address BOP weaknesses was not a wise move.

It was pointed out that a level-playing field does not necessarily improve a small country's prospects to compete effectively in global markets and Dr. Nicholas said that the Government and the people should have the courage to refuse prescriptions suggested by international lending agencies and develop national policy initiatives for the better.

Dr. Howard Nicholas (left) with Dr. Neville Karunatillaka (centre) and Prof. W.D. Lakshman.



Some of the participants among whom were top economists. Pix by Samantha Perera.

For example, concessionary credit to the export sector may not get the nod of IMF but the Government must persist with it since that's how Japan and the East Asia developed rapidly. High interest rates are a bigger drawback than an overvalued rupee for exporters, he said.

Dr. Nicholas said that there is a growing lobby to open up capital account following the free float, which if done would spell disaster to Sri Lanka.

To cushion the impact of deteriorating macro indicators, he said that the government this year would be compelled to remove subsidies, increase GST and other taxes. But this in turn would hurt the productive economy as well, he added.

Though he predicted a higher Budget deficit for this year, Dr. Nicholas said that countries should not be overly worried about high deficits in the short-term and was of the view that given the crisis situation, the Government should increasingly tap captive sources such as the NSB, EPF and Insurance funds to finance the deficit in the short-term. This he said would help to take the pressure off high interest rates in the market. Some weaknesses in the inter-bank money market as well its liquidity were also highlighted by Dr. Nicholas.

Having painted a gloomy picture, Dr. Nicholas during his presentation also suggested some radical measures to stabilise the economy and improve the country's prospects, even though such measures may not be to the liking of IMF and World Bank.

He listed several short-term measures after saying that those though radical could be done if the country has the will. He suggested that Government could immediately go back to a managed float and fix the dollar at Rs. 90 telling the market that the real exchange rate has been determined. Other was to overvalue the rupee and take the exchange rate back to Rs. 80 to lessen the impact of import liabilities. He also said that the government could tell the people and trade unions that the country was in crisis and ask them to bear and support the adjustment measures for one year.

Dr. Nicholas also blamed certain sections of the private sector and chambers for blindly welcoming the rupee float and said that they must be held accountable if and when the desired objectives are not realised following the float.

If the first half of Dr. Nicholas' presentation was realistic the second appeared to be shocking for many of the senior and young economists present. To be fair, Dr. Nicholas (as he explained) did not hide behind economic theories while some also perceived the observations as pragmatic.

To a laymen the presentation as well as ensuing discussions could have been merely academic or fictitious because the audience had several prominent economists who had served both or one of the regimes, UNP and/or PA in different capacities and the fundamental problems of the economy have been continuing without being properly tackled over the years.