‘The Writing Was on the Wall’: Debt Distress and Ways Forward in Sri Lanka

Jayati Ghosh

In the fourth in a series of talks organised by Polity *magazine of the Social Scientists’ Association and the Women and Media Collective with feminist economists abroad to help us in Sri Lanka think through this economic crisis that we inhabit, and how best to respond to it in ways that take forward or at least protect the interests of classes and groups that are most marginalised, Professor Jayati Ghosh spoke from New Delhi on 29 July 2022 to a large and international audience in a talk and Q&A moderated by Kanchana Ruwanpura, Professor of Human Geography at the University of Gothenburg. It was transcribed by Tikiri Herath and lightly edited for publication.*

I want to begin by quickly outlining the broader global context and then discuss Sri Lanka. I know for those in Sri Lanka it must feel as if a combination of very particular circumstances has created this ongoing mess and tragedy. Certainly, what is happening in Sri Lanka has deep roots and specific causes including the pillage and corruption of the previous rulers, i.e. the Rajapaksa family, who are still in a way quite influential in the government. But in other ways it is not that unusual. It is something that a number of other developing countries are facing, or are likely to, in the near future. So, in a way, what is happening in Sri Lanka right now is what might be called ‘the canary in the coal mine.’ It is an indication of what is to come. At the moment, the economy is in formal default, but then there are also many other countries that have already formally defaulted – Lebanon, Belarus, while Morocco is close to it, and so on.

Ever since the 1990s there has been this push towards financial liberalisation in the developing world. A lot of developed countries did it in the 1980s, and in the 1990s developing countries were told “you need to attract higher investments and foreign capital from abroad, without imposing restrictions either on inflows or outflows of capital”. These countries were asked to be happy with all the money that is coming in no matter what form it takes, and to encourage domestic producers to borrow from abroad, where they can get cheaper interest rates. So, across the world, developing countries opened their capital accounts and stopped a lot of regulation which were earlier used to direct foreign money into specific sectors.

We know about the global financial crisis that started in the US and had a massive impact on the rest of the world. Following the global financial crisis, advanced economies responded by adopting incredibly loose monetary policy and more liquidity. That is to say, more money creation than we have ever seen in the history of the world; and at very low interest rates – close to 0%. During the global crisis, banks and financial firms were rescued through this massive provision of liquidity. There was all this money sloshing around the globe, for cheap or free really, and they responded by investing this money in all kinds of new areas that were not possible before.

And so, you had the phenomenon of emerging markets and frontier markets. An emerging market is basically a country that has been ‘discovered’ by global finance for investment, credit, and to buy bonds from. Frontier markets are countries seen as the least developed that would never have got money from those kinds of credit sources. The creation of emerging and frontier markets resulted in a massive increase in debt and in bonds held by foreigners in the developing world.

Trillions and trillions in debt, including debt taken on by rich countries. But such countries have currencies that are globally recognised, and do not have to worry about generating dollars or euros, which all the rest of us do.

All of this came to a head by the time of the pandemic – because the pandemic damaged our economies more than those of rich countries. The rich countries were able to put in place very large stimulus measures equivalent to one fourth or even more of their GDP. Compared to that, middle income countries spent only an additional 4-6% and poor countries only 2% equivalent of their economic size. So middle income and poor countries did not actually have such a big fiscal response. But because we were already in debt, because we had already borrowed more, any additional spending in a time of global slowdown and national contraction meant that the debt to GDP ratios rose very quickly. And so now we had a whole range of countries literally on the verge of a very serious debt crisis. So, in many ways Sri Lanka is not alone, yet you are special.

Poster Child of Neoliberalism

Sri Lanka is unique because it was the poster child of neoliberal policies in Asia from the late 1970s, just as Chile in Latin America was the example of early neoliberalism. Neoliberal economic policy dictated that we have to have an open policy that will attract foreign capital to give us export-led growth. And that strategy actually meant encouraging more and more foreign capital. There were other changes made, where you moved from food production to cash crop production. You also encouraged the garment industry, which provided some successes but also had other costs. But overall, it meant that there was a growing tendency to rely on external money for domestic investment, which became particularly marked in the last decade and a half. Your external debt which was only about 10 billion UDS in 2006 before the global financial crisis had risen by 2020 to 56 billion USD. This is a dramatic ballooning which amounts to 69% of GDP, at the beginning of the pandemic, not even during the pandemic.

Sri Lanka's earlier debt was mostly with multilateral organisations like the IMF and the World Bank and also with some bilateral donors. But increasingly, there were more and more private creditors involved. That is because the Rajapaksa government moved to a system of creating government bonds that you could sell abroad. International sovereign bonds (ISBs) were used to attract foreign investors to Sri Lanka and this money was then used to finance the fiscal deficit of the government. Now these ISBs are almost 28% of the total debt. The problem with having these private creditors is that it is almost impossible to negotiate because there are many different pension funds, hedge funds, and private equity funds which have bought these bonds. They are much less likely to be willing to concede any kind of renegotiation of the debt. All that will happen is that the bond values will fall, and you have to pay the yield rises [the return or profit to the bondholder on investing in or holding that bond]. As it gets harder and harder to generate a desire for bonds, you will have to pay more and more to attract bond investors.

Of course, right now as a result of all this debt, your debt service ratio is something like double the money you get from exports in Sri Lanka, and if you even include remittances then the debt service is about 170% of the value of exports plus remittances. In other words, you have to pay more than you can generate in terms of foreign exchange. These payments are very rigid. They do not come down because you are having a domestic crisis. But the writing was on the wall. Someone could have seen it coming a decade ago; we all saw it coming two years ago when the pandemic first struck. We said that there is going to be this major developing country debt crisis. We warned that governments and the IMF would have to act to prevent it by restructuring the debt. That has not happened and so the tragedy of Sri Lanka is that you are one of the first to get the full onslaught of what is going to be a much more widespread crisis.

Debt Restructuring or Debt Relief?

The other uniqueness of Sri Lanka is of course the specific form in which debt has been misused and abused by your leadership. There is definitely truth in the argument that a large part of this crisis is also created by the nature of rule under the Rajapaksa family and the kinds of siphoning off that a lot of this debt implied. Again, it is not the only time this has happened in history. Zaire (now the Democratic Republic of Congo) was looted entirely by President Mobutu. His personal wealth was almost exactly identical to the external debt of that country when he was its ruler. You cannot hope to resolve this problem by simply saying we will start repaying and restructuring our debt, which is essential to get debt relief.

How do you ensure you will get debt relief? Well, you know the standard way is to go to the IMF for help. Then the IMF provides a 'bail-out' but imposes all these conditions and often things get worse. You would know that in Sri Lanka this is the 17th IMF programme that is now being negotiated. I do not know the details of this negotiation, but it is absolutely critical that this negotiation does not adopt the same kinds of conditionalities on the loans that the earlier agreements of the IMF did for Sri Lanka.

So, let us talk about what you can do in this situation. I recognise that there is a political crisis. We hope that the new government will behave differently; we hope that political forces in Sri Lanka will force a different kind of bargaining and negotiation, even with the IMF. But there are certain principles that I think progressives also have to bear in mind in these negotiations with the IMF, and these are very important. Earlier everybody felt that if the IMF came and imposed conditions, you had no choice because you are a small country in desperate need. But now we know it is actually more complicated. Argentina was able to negotiate a reasonably good deal. Not great, but certainly much better than in the past because it held ground. It demanded a lot of things, and it insisted on social protection; safety nets to prevent hunger and disease and other things; and strengthening social sectors.

Conditionalities and Plan B

So, I would argue that whether to take an IMF programme or not has to hinge on many different concerns. First is what exactly do you ask for in an IMF programme? What kinds of conditions are imposed? The second is whether, if those conditions are not accepted, there is a Plan B. In other words, what can the Sri Lankan government do if the IMF proposals are so rigid and so unproductive for the economy that it is better not to do it? What is the other option? So, let me briefly highlight both of these scenarios.

I think it is very clear what we should not be accepting. The conditionalities of the IMF have been anti-people, anti-worker, but also deeply anti-women, in many of its implications. So, what do we avoid?

- We have to avoid fiscal measures that reduce public spending on essential services. Rather, spending on essential services and public employment has to be increased.
- Micro, small, and medium enterprises (MSMEs) have to be protected from interest rate rises and tighter monetary policy under IMF programmes. It has to be demanded that you cannot have the same interest rate on all sections of the economy. You have to protect the MSMEs and you have to protect women-led enterprises. Highly regressive taxes like the Value-Added Tax (VAT), which adds to everyone's burden, actually means that you end up paying even more on basic necessities and living.

What should you be asking for?

- We should be asking for the State fiscal capacity to be built by different kinds of taxation. Tax of the wealthy and multinationals, plugging loopholes in taxes that the rich exploit regularly, and preventing illicit financial flows. There are ways this can be done. There are known legal and regulatory processes that can do all of these things. It is very strange that the IMF never recommends this. They say raise tax revenue, but it is never about direct taxes on the rich; it is always about indirect taxes that affect the poor and affect women in particular. So, first, change the nature of taxation.
- Increase spending on health, on education, on nutrition. Ensure that everybody gets adequate nutrition. Make that a major goal of public policy, and all of these have to be the first charge on spending. At the moment the first charge on public spending is paying interest. It is not any of the other things. It has to be these others that are the first charge.
- If necessary, I would say implement a public employment programme because you are going to have significantly increased unemployment, or you already have it, and the deprivation of basic livelihood for existence. You have to ensure that labour rights are not damaged in this period of massive crisis, because this is always a period when workers' bargaining power collapses and they are forced to accept the worst possible conditions. It is necessary to encourage things like minimum wages and regulatory practices that allow trade unions and associations of workers, especially informal workers, to demand better conditions and wages.
- We have to recognise the massive impact on women who are responsible for household provisioning or social reproduction or the care of their families and communities, and do as much as possible to mitigate those costs, and to reduce the unpaid labour time through specific social policy.

In other words, the conditionalities have to be designed to ensure social cohesion, to ensure a better, more just, and egalitarian economy. And it can be done if the focus is on fiscal discipline through taxing of the rich and of multinationals.

This means that you need to simultaneously look at the climate challenge, which Sri Lanka is a major victim of already, because of the possibility of rising sea levels, and extreme weather events. There is a real case for also demanding different kinds of debt resolution. Increasingly, there is talk of debt for climate swaps. That is to say, you agree to reduce some of the debt in return for specific climate action; that is, the monies released from debt servicing will be directed towards green jobs, green energy creation, and green adaptation. It is possible to think of negotiating along those lines.

Suppose this does not work and that we are being too optimistic to believe that the IMF would ever agree to something like this; even though [Managing Director] Kristalina Georgieva and [former Chief Economist and current first Deputy MD] Githa Gopinath keep saying that that is what they want – on the ground, IMF programmes have been pretty ghastly – I think in that case it is really important to have a Plan B and to announce that Plan B as a bargaining strategy; which is to say that the option then is defaulting on a lot of the private debt.

There is also a justification for that default because a significant part of the recent debt could be classified as 'odious debt'. In so far as some of this debt is so clearly something that had been appropriated by a particular elite through corruption, you cannot hold the rest of the population responsible for it. And there are historical examples, and even recent examples from Latin America, of some of that debt being declared to be odious debt that cannot be repaid, should not be repaid.

So, there is a case for saying; "if you do not give us an IMF programme that we think is acceptable, we are going to stop paying all this. We are going to stop servicing all this debt. We will then divert the resources that we save into ensuring essential imports, ensuring food, fuel, medicines, and everything we need. If that means that you are going to impose sanctions on us, we will look for alternative trading arrangements"; alternative financing regimes which are anyway, as we know, growing in this very fragmented world. So maybe progressives need to think about this. They need to think about having a Plan B, which can also serve as a very important bargaining tool to ensure that IMF conditionalities are not of the terrible kind but are compatible with progressive economic revival.

Q: What about going to the BRICS bank [New Development Bank established by Brazil, Russia, Indica, China, and South Africa] and South-South cooperation?

JG: South-South cooperation is not going to be very open or straightforward. I don't believe the BRICS bank or even the Asia Infrastructure Investment Bank is going to be offering much money in the current context. That's how they are structured, very much along the World Bank lines. So, we need to think of different things. I do feel that a default is often a much better option and especially if Sri Lanka sets the pace, then other countries will follow, and we will force a global debt resolution in a way. So, I think there is a strong case for that, but also remember it's no fun being out of global credit markets. It's really bad news because every country needs minimal credit for current imports and so on. So, you can't simply say "I am going to default and the hell with you!" You would have to give good reasons. You can say this much is odious debt and it was misused. This much we will restructure and repay later, after we have sorted out our domestic concerns and so on.

I think it can be done and that it's an important weapon when bargaining with the IMF. You may choose to stop paying some of those debts immediately, and that would possibly focus the attention of your creditors a little bit more. But in terms of a wider economic strategy over the next two or three years, you will need some engagement with global credit. You can't simply say that we are now no longer part of the world economy, because all these 40 years of neoliberalism means you can't even produce your own food right now. You are importing everything so it's a kind of complicated balancing act.

The Sri Lankan economy will not survive without a dramatic debt reduction. It's essential. To me, the gold standard of all debt reduction, which is worth talking about with your creditors, is Germany in 1951 and 1953, when half of their debt got completely written off and the rest of it converted into loans and grants. The loans were very gentle. You had to repay only 3% of your export revenues every year. That's the gold standard. If they can do that for Germany, they can do something not so great, but maybe halfway there for all the developing countries. I think it's worth taking a much stronger line. Instead of being very desperate, it's worth saying we have to seriously consider that we can't pay, and it's important for us to protect our population, so we're going to divert all our foreign exchange towards essentials. In other words, you don't necessarily declare default, but you do effectively default.

Q: You talked of alternate sources of funding. But since we have defaulted, we depend on whether the IMF, the World Bank, or some countries like China, India, or Japan give us more money. Without restructuring, and given that we desperately need the money, and that there is no real possibility of earning new foreign exchange or very limited possibilities in the short term, where do we go from here?

JG: Right now, you are effectively defaulting because you are not repaying. In terms of the bargaining of it, it might be worth saying "we have no intention of repaying until we are able to ensure our minimum imports". Now I think one of the things that would matter here would be for example, how much of your absolutely essential imports can you pay for with a combination of your current account [balance] and remittances? I don't know. I am not familiar enough with the details of your trade structure, but something I read suggested that the essential imports – not those required for capital investment so much but the minimum food, fuel, medicine, and other things to keep the economy running at a base level – could be fully covered by just about 80% of your export revenues.

Q: You mentioned increasing public employment; in Sri Lanka, the public sector is considered quite large. Many believe that there are too many public sector employees. There's a real difficulty in even paying their salaries, so there's been some discussion about maybe giving them an opportunity to go for foreign employment or be absorbed into the private sector. In that context, do you think expanding or even maintaining public sector employment at current levels is relevant and realistic?

JG: In every country they tell you there's too much public employment. In India they're always saying we have a bloated public sector. In Sri Lanka, you roughly have seven public workers for every 100 people. You are about the same as Europe. Scandinavia has nine per 100. The global average is four and a half per 100. In India, it's less than two. The point is, seven is a good number. Why? Because public workers mean public services. It means you have doctors, nurses, teachers, etc. The less you have of those, the less public services you can provide.

So, the idea that public workers are just a cost is wrong. But I was thinking more in terms of employment guarantee programmes along the lines of the National Rural Employment Guarantee Act in India. Many states in India are now thinking of an Urban Employment Guarantee Act because of the very large number of urban young people, in particular, who are simply unable to find jobs.

Q: IMF recommendations for Sri Lanka include increasing female labour force participation. Sri Lanka, historically from the '70s, has seen major structural changes to women's labour. The World Bank and the IMF had a role in that. Now there are questions about what it means when they say female labour force participation and increasing it. What should we look out for? How should we think about it?

JG: Women's work is a complicated issue, but the basic point is that women are always working, but they are not recognised as working. It's only when they get paid for their work that they are recognised to be working. Paid employment provides various positive results for women, particularly in terms of their own autonomy and the role within the household. But it can also lead to the double burden, as Diane Elson said so many decades ago, it can also lead to different kinds of oppression. A rise in women's workforce participation, in itself, is not necessarily a good thing, although a decline is usually an indication of a bad thing. You really have to look at the nature of that work, the conditions under which it is performed, and the remuneration that the work receives. Women's waged work is important, but it is not at all by itself sufficient for the empowerment of women.

Jayati Ghosh *is Professor of Economics at the University of Massachusetts, Amherst. She previously taught at Jawaharlal Nehru University, New Delhi for almost 35 years. She has authored or edited 20 books and more than 200 scholarly articles. She most recently co-edited* When Governments Fail: A Pandemic and Its Aftermath *(Tulika Books, 2022) and is co-author of the forthcoming* Earth for All: A Survival Guide for Humanity *(New Society Publishers).*