

ROLE OF KPOS IN ECONOMIC REINFORCEMENT

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Could you give us a brief introduction to your organization?

Acuity Knowledge Partners is the world's largest financial analysis and research services provider to the global financial institutions and management consulting industry. We serve investment banks, asset management firms, private wealth management firms, commercial banks, hedge funds and asset management firms, as well as management consulting firms globally. We have more than 4700 analysts working from Colombo, Bangalore, New Delhi, Beijing in China and San Jose in Costa Rica. We have large sales and marketing and consulting offices in London, New York and Hong Kong. We are owned by one of the world's

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leading private equity firms, Equistone Partners, as well as our management and staff. We have been in existence for well over 20 years. So, that is basically our

background and our global organizational structure.

As a well-experienced professional in the field of finance, you must have witnessed and faced economic situations similar to what we are going through right now. How different is it this time?

Sure, as experienced professionals, during our professional life we have worked during a period when there was a war in the country. And then we saw the war coming to an end followed by a massive post-war economic boom. And now we see the country going through, I would say, an unprecedented economic crisis that has no parallels with any of the

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previous periods in our post-independence history. We have gone through economic difficulties in the past, however, I would say that the current challenges are unprecedented, because it is a culmination of a debt serviceability crisis, as well as a foreign exchange liquidity crisis and a budgetary unsustainable situation. This is also a combination of both domestic factors that were driven by some of the political and economic choices we have made as a country and certain external factors that are outside our control. Further, I would say that the current crisis is basically a culmination of long-run economic choices we have made in the past - at least going back to the 1990s - where we have perhaps run the most extensive welfare nation outside the developed world without having adequate taxes to support it. It is also due to certain underlying conditions in our political and social structures, where successive administrations that have chosen political popularity and economic populism, have hesitated to turn around our declining tax revenues since 1990. For example, any country that would have ended a war and experienced a post-war

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economic boom would have taken the opportunity to increase its tax base, unfortunately, we did not opt for that safe and sustainable path, instead, we wanted to boost every possible economic activity while maintaining a low tax base. The issue is that a country can do that if the government expenses, welfare measures, and energy subsidies did not trend upwards during this period of low tax income. However, in Sri Lanka, we saw a massive increase in government

expenditure. Such measures spilt over to excess demand conditions and with the monetary policy also being at lower levels to accommodate continuous economic expansion, imports increased to unsustainable levels. Even before the pandemic, Sri Lanka went through multiple rounds of mini balance-of-payment crises every four to five years.

So, what we are experiencing today is a culmination of both long-run factors and the pandemic closing down our tourism industry. This negative impact on the country's tourism industry resulted in a loss of 4 to 4.5 billion US dollars to the economy. Also, we have seen that due to various reasons the administration hesitated to go into the IMF program early enough. This also contributed to the crisis which we must now fight our way out by trusting the IMF process and World Bank process in restoring investor confidence in the country by way of extremely prudent and confidence-building debt restructuring. Even though Sri Lanka is currently in a crisis, we have demonstrated a very long track record of not defaulting on foreign debt obligations and once we come out of this crisis, we

believe that our investors will also re-establish their confidence in the country. I think what is required now is for the entire country to understand the gravity of the economic situation that we are in and have hope that if we can make the required economic, political and social changes, we can come out of this situation, perhaps within a couple of years. But if we don't have that collective approach, this recovery will be delayed further and most of the citizens will continue to face the negative impact of this economic crisis.

In terms of the foreign exchange crisis that we are facing today, what do you see as the root causes of this and the immediate consequences?

So, as the long-run factors, I would say that our unsustainable monetary and fiscal policies contributed to this situation where such measures resulted in excess demand for imports which were not corrected by a tight monetary policy. Further, the lack of investments in expanding the country's export base worsened the balance-of-payments pressure. Also, this balance-of-payments pressure did not support the authorities to allow the self-correcting mechanism to operate where the natural demand and supply mechanisms would allow the interest rates to rise and the currency to depreciate in order to maintain the equilibrium. Also, holding the exchange rate fixed for a long period resulted in the depletion of reserves which ultimately led to a situation where the country required IMF assistance.

While the 2019 tax cuts, low-interest rates, and fixed exchange rates led to the creation of excess demand for imports, the pandemic added more



pressure with its negative impact on the tourism industry and employee remittances. So, the culmination of such long-run and short-run factors created the crisis, and the breaking point was the recent Russia-Ukraine war that resulted in a massive rise in the energy prices that simply ended with us running out of foreign exchange to pay for our fuel imports.

What are the short-term and long-term strategies you recommend at this point?

So, I think the Central Bank of Sri Lanka and the Ministry of Finance, which has the main responsibility for the monetary policy of the country have published their own

road maps for the recovery from the crisis. At this particular point in time, we need to understand that the IMF program creates the sponsorship for our debt restructuring process and the debt restructuring proposals that would be presented to our debt holders. Therefore, going through the IMF program is the biggest confidence builder to come out of the crisis. The program not only supports the country with the funding they provide but also, assures the investors that they will continuously monitor the process and keep the government of Sri Lanka on track in meeting restructured debt payments on time. I believe, Sri Lanka has already completed a certain percentage of reforms required in qualifying for the program. Some of the reforms that had already been implemented are increases in the interest rates



and free flow of currency. Some amounts of fiscal reforms are also required by way of reduction of removal of the energy subsidy not only relevant to domestic usage but for all other commercial purposes as well. Our tax base must be increased to the level that it was under the previous programme because now we are one of those countries which collect the lowest taxes as a percentage of GDP which can be identified as a major contributing factor to the crisis, we are in. So, this change in terms of taxes needs to happen soon with political collaboration. Also, I believe, the bridge financing we need, ahead of the formal finalization of the IMF Programme will start materializing from bi-lateral as well as multi-lateral sources. I believe that if the tax reforms can be passed in the parliament, IMF itself will provide the extended funding facility. We need to stick to the program that is the way to come out of this crisis and that's the way to build investor confidence.

What do you think is the contribution of KPOs like your organization to the Sri Lankan economy right now?

Our industry has been a growth driver and has been a US dollar revenue source for the Sri Lankan economy. I'm happy to say that

companies like ours have grown by more than 50% even with the pandemic. We have been creating highest paid jobs in the Sri Lankan economy. We have taken our efforts in ensuring that young professionals are not without any career opportunities. We all know that Sri Lanka is going through an unprecedented economic crisis, but it has not yet been transferred to a professional labour market crisis. We have grown by 50% and some of our other peer companies such as the London Stock Exchange Group have grown by hundreds of qualified staff headcount in this particular area. We are also in a position to increase our compensation benefits which we have already done in several cycles. Due to the currency depreciation, we have a higher ability to absorb it, compared to companies that don't have foreign exchange revenue sources. I believe that we can be an immediate growth driver to the Sri Lankan economy and ensure that the professional labour market conditions remain very strong, despite the economic crisis.

What do you think is the role of the general public – especially the youth - in resolving this situation?

I totally understand the frustration and the anger that the

youth would have. The current situation is due to collective political choices and social choices that we have made in the country, by the previous generations including me. My generation and previous generations have had this unfair advantage of consuming more welfare benefits which have also partly contributed to the present situation we all are in. So, when austerity measures come in, those would have a bigger impact on the young people, they will see fewer welfare benefits and higher taxes. So that anger should be very well understood and accepted from purely a social equity perspective. Having said that, it is very important for the youth also to have built up their own economic knowledge and financial literacy to understand the corresponding economic and political choices that we make.

So, it's very important that the youth understand how untargeted subsidies, loose monetary policy and unsustainable fiscal policy created the present situation we are in and push the politicians to talk uncomfortable economic truths with their voters. So going forward, the youth of the country should push politicians to address the real economic issues than promising unsustainable subsidies at election times which would lead the country to a massive debt crisis down the line. It is important for the youth to read quality economic content and share that knowledge with their family and friends and drive collective understanding. Ultimately, it's the youth's responsibility to hold politicians responsible for economic sustainability.

By Narmada Balasuriya & Daupadhee Gamage