

COULD SRI LANKA CONTROL THE DEPRECIATION OF RUPEE VALUE

By Edward theophilus

Many newspapers, electronic websites and TV news in Sri Lanka frequently report that the foreign and domestic value of the national currency unit is being radically and continuously depreciated and the general price level of the country daily increases in response to the depreciation incurring economic predicaments to people. This unfortunate situation has created a tremendous plight to lower income earners, especially in rural and semi-urban poor community. It also reflects the economic instability in the country, despite the promises given by politicians. The public is quite uncertain whether Sri Lanka can go back to previous exchange level and the regime controlling depreciation of the national currency unit. Current situation shows the economic instability has gone too far and the weakness of the management of the economy by the Yahapalana regime has gone from bad to worse.

The practical experience of the world indicates that the depreciation of national currency units is not an unnatural exposure specifically in Sri Lanka, but it's a common plight in many countries in the Asian region as well as in African and Latin American countries. Recent increase in interest rate by the Federal Reserve in USA has badly impacted to currency value of India, Australia and many other Asian countries. The relationship between the American interest and currency depreciation of other countries is that investors in other countries withdraws their investments with a view to invest in American bonds to make more profits. The historical financial information indicates that although the domestic currency unit depreciation incurred in many countries, they were able to go back to previous level when the instability changed, for example during the year 2000 Sydney Olympic period, Australian dollar depreciated to US \$ 0.50 level, the Australian Dollar recovered after the crisis of stability, Sri Lanka has an enduring depreciation trend for a long period and the experience after 2015 appears that it is an unmitigated tragedy like a specific experience in the currency history.

The other point that significant to consider is like in stock market, the past information is not relevant to present and the future. Is this a beginning of a new Asian crisis or a problem with the management of economy and political leadership of the country? It is hard to predict as Ravi Bavadra predicted in late 1980s. The adapting to the dynamism would be a successful strategy and the development of contingency is relevant to the present and the future. It is also needed to understand that the purchasing power is comparatively higher in Sri Lanka than dollars in Australia or USA. For an exam-

ple when a dollar converted to Sri Lanka rupees, more goods or services could be purchased in Sri Lanka than in Australia or in USA using the same dollar.

In this gloomy situation, common people of Sri Lanka must understand a vital point that the determination of the domestic and foreign value of Sri Lanka rupee relates with abundant macroeconomic factors, which are not analogous like microeconomic determinants. The relationship between foreign value of Sri Lanka rupee and macroeconomic variables is not a direct simple correlation identically between X and Y. According to the textbook economic theory the demand for a product or service is determined by limited variables based on an assumption that the other factors remain silent, and the determination of foreign value of Sri Lanka rupee is not so a simple process, but it concerns with multiple correlated factors. The nature of influence of each factor is not linear and the relationship couldn't be easily estimated at 99.9% accurate level by a research. The identification of dependent variables for the determination of foreign and domestic values of Sri Lanka rupee for a multiple regression analysis need accurate historical data for each variable and it should have been a continuous practice during the past five decades. In fact, the identification of macroeconomic factors is an arduous task due to dynamic conditions of the modern environment and using such research data for the development of successful practical policies might not be efficaciously worked in Sri Lanka's economy. I also suspect whether the Central Bank of Sri Lanka, which is responsible for maintaining the stability of the domestic and foreign value of Sri Lanka rupee has been maintaining a database of macroeconomic factors which are influencing to the currency value. I never read an analytical research report on the depreciation of rupee value published by the Central Bank of Sri Lanka or any other organization in the country.

The second vital point that public needs understanding is, Sri Lanka is not an economic and trade giant in the international market, this means that Sri Lanka has not absolute power to aggressively react and naturally play a manipulative role in policy responses as it is not an economic and trade power base, and financial manipulator with a huge quantum of forex reserves. With this point, people also need to understand that Sri Lanka has confined to competitive behaviour and GATT agreement and signed legally binding several free trade agreements with assorted countries. Despite the legal conditions related to free trade agreements the government of Sri Lanka cannot act like a bull in a shop of clay cooking

utensil. Sri Lanka is a disciplined country respecting international conventions. Therefore, the people of Sri Lanka must understand the process of the international trade and financial framework and the limited capability of the country taking policy options for preventing the depreciation of rupee value, this doesn't mean that Sri Lanka is an impotent country without potential policy options, it has many practical alternatives, however they are not teaching theories of textbooks and potential policy options are practical solutions. and initiatives and intuitive process with international co-operation.

When Sri Lanka received independence in 1948, the foreign value of a Sri Lanka rupee was equivalent to US Dollar 0.21 or one US \$ was valued at Rs 4.76 and now it has changed to Rs 170. Policy-makers expect that the price of one US \$ would be risen to Rs 200 soon. In 1948, Sri Lanka Rupee was linked with the British Sterling Pound through the Currency Board System, which was a dependent currency management (Please read the book **From Dependent Currency to Central Banking System in Ceylon by H.A.de S Gunasekera**) and at that time, when the British pound was in a stable condition, Sri Lanka rupee was automatically stable preventing radical fluctuations. The favourable condition for the rupee value was supported by macroeconomic factors too such as the well-managed balance of payment which had a US \$35.0 Million overall positive balance and the current account had a positive balance of US\$ 28.8 Million and the value of foreign assets was the US \$ 237.16 Million. In that condition, Sri Lanka had a well-managed money supply (M1 and M2), the rate of interest and affirmative fiscal operations and very lower unemployment, lower level of foreign and domestic debt, lower level of inflation, business and investors' sentiments, which contributed to the stability of the foreign value of Sri Lanka rupee. The purchasing power of rupee remained at a higher level and the country was not involved in international politics and trade wars. Because of the combined effect of such macroeconomic factors, Sri Lanka was enjoying a higher value of rupee and there was a favourable market condition for rupee in the foreign exchange market.

The regulations of the International Monetary Fund maintained preventing the unstable situation had in the world during 1930s. The Briton wood agreement controlled the game playing of America. Therefore, America did not play games like how Donald Trump plays his political and economic stability.

Before 1950, Sri Lanka had a depen-

dent financial authority, which was called a Currency Board System, that was changed after establishing the independent Central Bank. Under the independent Central Banking system, the monetary authority was given a broader responsibility to achieve four specific objectives primarily focussing on the stability of national currency unit and the economy (Please read **Central Bank and Financial institutions of Ceylon by HNS Karunatilake and Economic Development of Ceylon by HNS Karunatilake**), the first challenging test to the Central Bank was the economic and trade conditions created after the Korean boom. The government of Sri Lanka at that time wisely acted with the support of China. As Sri Lanka rupee was linked to Sterling pound, the domestic and foreign value of rupee maintained a reasonably stable level until 1967 the official depreciation of British pound. On the advice of the International Monetary Fund, the foreign value of Sri Lanka rupee was officially depreciated by 20% in 1967. The official depreciation of the national currency unit resulting the problem of British Pound was 24.58% compared to the rupee value had in late 1940s and it was a very high depreciation.

After settling this problem, Sri Lanka was encountered another financial and trade problems with the oil crisis in early 1970s, then the national currency unit linked to US dollar with a view to preventing fluctuation. Soon after the change, the national currency unit faced a crisis resulting from the US dollar depreciation as a result of the change of gold and dollar link. At that time, there were crisis in dollar in addition to gold parity, the environment created by Euro Dollars and Petro Dollars. The US economy followed monetarist advices of economists mainly Milton Friedman and others. The fiscal management got away from Keynesian views, which were strong followed American Economists such as Alvin H. Hanson

During the late 1960s, Sri Lanka's government, as well as the Central Bank clearly understood the weak symptoms of the economy and the financial system of the country. Sri Lanka highly concerned on the increasing unemployment, increasing population, weak foreign exchange market, and many other matters. Sri Lanka began diversification of the export market, import controls, and a dualistic foreign exchange market introduced through Foreign Exchange Entitlement System (FEECS) in 1968 and the Central Bank maintained an Adjustable Peg System to maintain the foreign value of Sri Lanka rupee. According to