

# **Sri Lanka in South Asia: Economic Crisis and Way Forward**

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## **I. Introduction:**

Sri-Lanka is a multinational state, home to diverse culture, languages and ethnicities. The Sinhalese are the majority of the nation's population. The Tamils, who are a large minority group, have also played an influential role in the island's history. Other long-established groups include the Moors, the Burghers, the Malays, the Chinese and the indigenous Vedda. In the 19<sup>th</sup> and 20<sup>th</sup> centuries, Sri-Lanka became plantation economy famous for its production and export of cinnamon, rubber and Ceylon tea, which remained trademark national export. While the production and export of tea, rubber, coffee, sugar and other commodities remain important; industrialization in the nation has increased the importance of food processing, textiles, communications and finance. The country's main economic sectors are: tourism, tea export, clothing, rice production and other agricultural products. In addition to these economic sectors, overseas employment especially in the Middle East, contributes on the generation of foreign exchange. Manufacturing, especially garment making, has become a major income earner for Sri-Lanka. The Sri-Lankan government has created free trade zones, where the foreign manufactures operate with fewer controls on their activities. Agriculture employs are more than 30 percent of Sri-Lanka's workforce. Due to land re-distribution scheme in the past, most rural farming families have at least a small plot of land to grow rice and vegetables. Tea is the leading exportable crop of Sri-Lanka, grown on state owned plantations.

## **II. State of Sri-Lanka's Economy:**

The free market economy of Sri-Lanka was worth US\$ 80 billion by nominal Gross Domestic Product (GDP) in 2020. In 2019 with GNI per capita of US\$ 13,215; Sri-Lanka was reclassified as a lower middle-income nation by the World Bank from a previous upper middle-income status (Deyshappriya, 2020). Sri-Lanka had enjoyed 5.6 percent growth in 2014 and 2015; after 2016 onwards, its economic growth began to fall gradually. For example, Sri-Lanka's economic growth stood at 3.3 percent and 2.3 percent respectively for 2018 and 2019. Amid the COVID-19 pandemic, its GDP has reduced by 3.6 percent points. While government health promotion measures helped contain the impact of the pandemic, these measures negatively affected sectors like tourism, construction and transportation. Similarly, collapsing global demand for Sri-Lanka's manufacturing output, especially textiles, caused further harm (Australian Government, 2021). The manufacturing and service sectors accounts for nearly 80 percent of Sri-Lanka's GDP. Agriculture, previously the backbone of Sri-Lankan economy, contributes approximately 8 percent of GDP. The Colombo Metropolitan region generates 45 percent of total Sri-Lankan GDP. In 2019, Sri-Lankan working abroad remitted approximately US\$ 6.7 billion, the equivalent of 8 percent of GDP. In spite of Sri-Lanka's good human development outcomes, it is recognized that the country's economic performance has been dogged by a volatile macroeconomic environment, arising primarily from weak public finance management. Weaknesses in revenue generation and expenditure controls have both contributed to high deficit and large debt overhang (Weerakoon, Kumar, & Dime, 2019).

## **III. Sri-Lanka's Economic Crisis and Its Impact:**

Sri-Lanka had maintained healthy economic growth till 2016; with the influx of remittance and inflow of tourists for entertainment purposes. Sri-Lanka had its sustainable mode of agriculture sector; where majority of Sri-Lankan relied for their livelihood. This sector used to feed growing population cereals and export trade was possible for Sri-Lanka with the surplus of agriculture produce. Tea, spices, handicrafts were the major exportable items for Sri-Lanka through which it used to earn foreign currency needed to run the economy. Sri-Lanka used to collect more tax revenue from private sectors; this had also helped to sustain its economy as a part of capital formation and thereby investment. Sri-Lanka's vulnerability to global capitalist boom-and bust

cycles has been intensified by its own domestic economic crisis such as populist electoral politics and inefficiencies in policy implementation across the many levels of governance. Additionally international donor dependence which entails related sets of conditionality and no successive government after country's formal 1948 independence has been able to independently steer the economy with a well-planned, stable, long-term vision (Gunasekara, 2021).

Between 2009 and 2019, Sri-Lanka issued sovereign bonds amounting to US\$ 17 billion. Of this amount, 70 percent was issued between 2015 and 2019, when the country underwent reform under an International Monetary Fund (IMF) Extended Credit Facility and Credit rating reviews (Zilwa & Illanperuma, 2021). Since 2014, Sri-Lanka's foreign debt level has been on rise and reached 42.6 percent of GDP in 2019. This surge was a result of both Sri-Lanka's low economic growth rate and the issuance of International Sovereign Bonds (ISBs) to repay previous foreign loan obtained from 2007 to 2014 (Moramudali, 2021). Verite Research, a Sri-Lankan think tank had published an analysis of the country's debt stock. It showed that the total debt stock has grown by 42.8 percent between 2015 and 2019. At least 89.8 percent of the increase in such stock was due to cost of interest accumulated on the debt obtained by the government of President Mahindra Rajapakse. Most of the loans from China went to fund colossal projects in his hometown of Hambantota but the projects have become white elephants, placing an incredible burden of debt on the nation (Weerasooriya, 2022). Sri-Lanka's public debt, which was already on an unstable path before the pandemic, is estimated to have risen from 94 percent in 2019 to 119 percent of GDP in 2021 (Welle, 2022). In order to become populist, Sri-Lankan government induced tax exemption or tax reduction initiatives particularly after 1990's. This process further weakened or reduced Sri-Lanka's taxable revenue that could be utilized on development activities in its economy. Since the early 1990's, the tax-to-GDP has declined from an average of 18.4 percent (1990-92) to one of 12.7 percent (2017-19), reaching a low of 8.4 percent in 2020. Government began spending substantially less on social goods than they did in the past, with average health and education spending in 2010-19 amounting to 1.8 percent and 1.4 percent of GDP, respectively (Fernando, 2022).

In 2019, there were two further shocks to the Sri-Lankan economy. First, the Easter bomb blasts of April 2019 in churches in Colombo led to the death of 253 people. Consequently, the number of tourists fell sharply leading to a decline in foreign exchange reserves. The blasts dealt a severe blow to the prospects of economic recovery (Ramakumar, 2022). During the presidential

campaign, Gotabaya Rajapaksa had promised to cut the 15 percent value-added tax by nearly half and abolish some other taxes as a way to boost consumption and growth (Welle , 2022).The crisis is widely seen on Sri-Lanka as a result of mismanagement of government finances and ill-time tax cuts, in addition to the impact of COVID-19 pandemic. Fitch estimates Sri-Lanka will need to arrange US\$ 2.4 billion to help state-owned and private firms in the country to honor 2022 debt obligations; these will be over and above the US\$ 4.5 billion central government debt. The country also needs around US\$ 20 billion for essential imports such as fuel, food and intermediate goods for exports (Srinivasan, 2022).

Sri-Lanka is a highly protectionist economy that relies heavily on import tariffs to protect domestic industries and interests. Sri-Lanka's export composition has not changed much since 1990s. Despite entering into several bilateral free trade agreements and benefitting from the US and EU generalized scheme of preferences programs, Sri-Lanka has failed to diversify its export basket beyond apparel and tea (Thowfeek, 2022). Inflation too began to accelerate from 4.3 percent in December 2019 to 17.5 percent in February 2022 in Sri-Lanka. The worrisome feature was the increase in food inflation up to 25 percent mainly due to the shortage of food production due to the government's flush organic drive. The true inflation is underestimated when one looks at the long queue for fuel, LP gas, milk and food etc.(Wijewardena, 2022). In 2020, COVID-19 was more than a spark, and completely sucked out the air from the Sri-Lankan economy. The pandemic led to a global recession curtailing global demand. Sri-Lanka's exports dipped and imports (mainly goods for survival) went up; adding to this, Sri-Lanka's tourism sector too came to a grinding halt (Agrawal, 2022).

#### **IV. Way Forward:**

Sri-Lankan government gradually ignored agriculture sector's growth initiatives 2000 onwards. Agricultural production was least prioritized by each successive Sri-Lankan governments. In contrast, it began to import food items and other consumer goods from abroad with the haphazard use of its scarce foreign currency reserves. This resulted in gradual decrease in its foreign currency reserves over the years. Corruption from the part of each successive government of Sri-Lanka, particularly after 2000, and tax reduction by the government to become more populist among the people further weakened internal resource collection process

and thereby mobilization it on productive use during the course of development. On one hand, high interest-bearing loan agreements with the donors became popular among the people. And on the other hand, the administration in the past by successive Sri-Lankan governments further facilitated to pile up the amount of loans and its obligations of repayment to the donors. This also drained Sri-Lanka's foreign currency reserves over the years. Furthermore, Sri-Lanka's bilateral loan agreement with China to construct port and other facilities under Belt and Road Initiatives pushed Sri-Lanka towards a debt obligation.

Meaningful restructuring of Sri-Lankan economy prioritizing agricultural sector's development through sustainable investment practices could again revive Sri-Lankan unstable economy to normalcy. Furthermore, it will provide assurance of basic needs to people for survival and will create more employment opportunities. Sri-Lanka could produce consumable goods within the country and such surplus produce could be exported abroad. It is known that over 350 "non-essential" items are now banned for import by Sri-Lankan government, including milk, oranges and household appliances so as to lessen erode of its foreign currency reserves (Tennekoon, 2022). Sri-Lankan government could also come up with the clear road map of agricultural revival strategies in the years to come. Sri-Lanka could revive its fishery industry on sustainable manner for its internal consumption and focus on export of such surplus fish items abroad. Coastal residence of Sri-Lanka could equally involve in such fishery businesses in a sustainable way. This will yield additional employment opportunities along with foreign currency earnings. Promotion measures through planned way by the Sri-Lankan government to engage idle workable youths in handicrafts businesses could also open the venue of employment. Revival of Sri Lanka's tourism industry on sustainable manner is equally important to bring the country on right path of its crisis prone economy. Promotion of cultural tourism is equally important for Sri-Lanka for attracting cultural tourists and thereby earning of foreign currencies. Sri-Lankan government should take concrete measures for economic recovery of the country as soon as the shortage of certain essential commodities ends (Ramakumar, 2022). Emerging economies like China and India could also support Sri-Lanka to bring its economy back on right track. China could waive the interest of its total loan obligations that was obtained by Sri-Lanka in the past to launch major BRI projects. India could also support with the assurance of softer loan (line of credit) facilities to Sri-Lanka through which it could import oil, machineries etc., for a desirable revival of the economy. It is worthwhile to mention that in February 2022, shortage of foreign

currency led Sri-Lanka signed a US\$ 500 million credit facility with India to import fuel. This was part of the financial package India agreed to provide Sri-Lanka to encounter the economic crisis (Moramudali U. , 2022). Foreign investment particularly in fishery and tourism sector in Sri-Lanka especially from ASEAN and other developed Asian countries is equally important to restore its crisis prone economy at this juncture.

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