Evaluating the Fallout of the Economy of Sri Lanka

Saurish Bhattacharjee* & Rodali Mohan**

Sri Lanka is recognised as the Indian Ocean's Pearl. It is a small island with tea plantations in the centre and a shoreline bordered by sandy beaches that attract tourists from all over the world. The country is noted for its lush vegetation, stunning scenery, as well as its people's kindness, hospitality, and good humour. This island economy benefits from a unique geo-strategic location that facilitates economic and commercial operations. It is a major seaport in the South Asian region, situated as a pendant to the right of India's southern tip and surrounded by the Indian Ocean (Ghosh, 2009).

Sri Lanka's overall economic performance has been quite solid, although growth has been patchy, reflecting the impact of a variety of domestic and international variables. Following the 1977 economic liberalisation changes, the economy grew at a moderately high but fluctuating rate. Economic growth slowed during the civil war's early years before rebounding in the early 1990s. The Asian financial crisis of 1997–1998 had little impact on Sri Lanka, but the rise in global oil and food prices in 2007–2008, as well as the global financial crisis that followed, had a negative impact.

Sri Lanka's GDP growth rates have been lower on average than those of East Asia and the Pacific countries such as China, Indonesia, Thailand, Hong Kong, Korea, and Singapore. Despite lower growth rates on average, high-income economies around the world remain well ahead in terms of per capita real GDP. This indicates the economic path that must be taken in order for the country to catch up to the developed nations. The country appeared to have a well-established and stable political system, with a strong and independent judiciary and a vibrant civil society. Since the turn of the century, Sri Lanka had made a relatively easy transition to parliamentary democracy through a series of constitutional reforms that took it step by step away from a colonial system. The populace had had universal suffrage since 1931, barely three years after the United Kingdom had introduced it. (Athukorala et al, 2017)

The coronavirus pandemic's early negative effects may be seen in all economies. Sri Lanka's instances were reported at the end of March 2020. Sri Lanka declared a state of emergency in mid-March 2020 after the first COVID-19 positive case was discovered on March 11. The Central Bank of Sri Lanka said the country was in the midst of the biggest financial crisis in its history as a result of economic and travel restrictions implemented in the aftermath of the coronavirus outbreak. (Marwah & Ramanayake, 2021).

The unprecedented crisis has had a significant impact on Sri Lanka's economy, resulting in a sharp drop in tourism earnings, remittances, and outflows of foreign investment. In particular, bilateral economic ties between Sri Lanka and China have considerably improved in the last decade. Bilateral commercial and investment agreements, as well as tourism ties, are at an all-time high.

Despite the fact that China is not a major export market for Sri Lanka, it is the country's second-largest source market for imports and tourist arrivals. As a result, the COVID-19-induced slowdown in China could have a significant impact on the Sri Lankan economy. Sri Lanka is experiencing a severe economic crisis as a result of the country's depletion of foreign reserves, which has resulted in shortages of fuel, food, medication, cement, and other necessary products. The present paper tries to investigate the causes of economic depression and tries to put forward a few suggestions to address the scenario.

Objective

The basic objective of this paper is to analyze the causes of the economic crisis in Sri Lanka amidst the covid-19 pandemic situation. Moreover, this paper tries to provide a picture of the government initiatives of the neighbouring country as well as some remedial measures to help the country get out of the serious crisis situation.

Methodology

This paper is based on secondary data and the information is collected from different sources such as journals, newspapers, the internet, books, etc. The study is analytical and descriptive in nature. The paper made use of the different table, charts, graphs, etc. to show the crisis situation in Sri Lanka.

Findings and Discussion

Sri Lanka is experiencing a severe economic crisis as a result of dwindling foreign reserves. Foreign reserves have been declining since August 2020, but they reached a perilous level in November 2021. It was just enough to cover one month's worth of imports. There was a little rise a month later, but it was still insufficient for two

* Asst. Prof., Dept. of Economics, Tingkhong College.

** Asst. Prof., Dept. of Pol. Sc., Tingkhong College.

months' import. According to reports, overall foreign reserves fell further 24% to US$ 2.3 billion in January 2022.

Sri Lanka is scrambling to avoid default amid shrinking foreign-exchange assets, owing to rising oil import costs and a drop in tourism revenue. With inflation already at 15%, the highest in Asia, the crisis between Russia and Ukraine is just making things worse for the tropical island. Fuel shortages and outages lasting up to seven hours have become commonplace, while lines at gas stations have gotten longer as prices have risen nearly 50% this month. Authorities are battling to keep the crisis under control. Interest rates have been raised, the local currency has been devalued, and non-essential imports have been restricted.

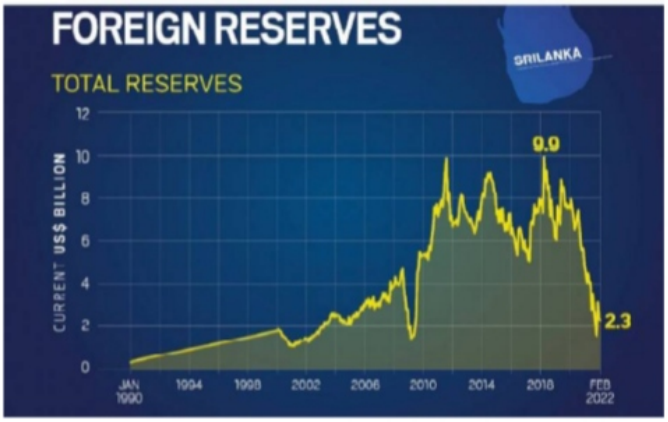
However, with only $2 billion in foreign exchange reserves and $7 billion in debt payments due this year, the battle is becoming increasingly difficult. President Gotabaya Rajapaksha committed this week to meet Sri Lanka's obligations, despite the government's reluctance to request assistance from the International Monetary Fund. According to several Indian economists, seeking assistance from the IMF is the most practical route out of the situation (The Times of India, 2022).

Sri Lanka, with a population of over 22 million people, is a net importer of products ranging from medicine to petroleum. Petroleum items accounted for roughly 20% of inbound shipments in December, with prices up 88 percent year over year. This year's surge in oil costs has added to the load. The country has also been paying off external debt accumulated to aid in the recovery of an economy ravaged by the violent civil war between the majority Buddhist Sinhalese and the mostly Hindu Tamil minority. This has depleted the country's foreign exchange reserves.

The Sri Lankan government's capacity to account for imports of vital products and debt servicing has been hampered by dwindling foreign reserves. Due to the dollar crisis, Sri Lankan officials have recognised that they are having increasing trouble paying import costs, particularly for daily needs such as fuel. The government and the Central Bank of Sri Lanka are certain, however, that due to the current economic crisis, Sri Lanka will not default on debt servicing. 3 With a steady supply of forex, the Governor of the Central Bank of Sri Lanka believes that the stresses on the economy would lessen soon (Sultana, 2022).

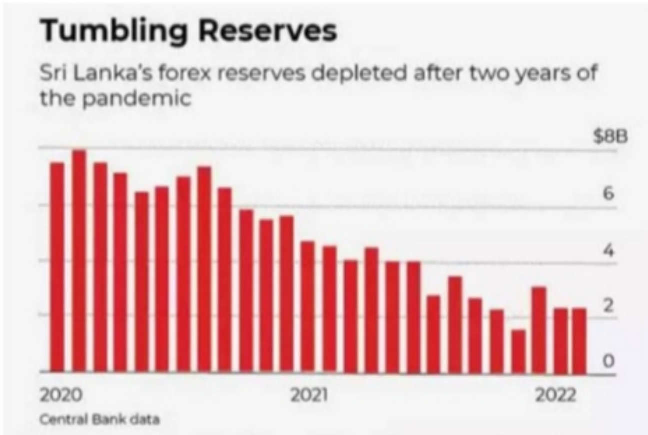
The absence of foreign money reserves in Sri Lanka has had a disastrous effect on the provision of medicine. More than 85 percent of the country's pharmaceutical products are imported and paid for in US dollars. Drugs cannot be purchased if monies are not accessible. Last month, the Sri Lanka Chamber of Pharmaceutical Industry warned that 5% of medications were out of stock and that the situation was likely to deteriorate. Low taxes have resulted in little money being spent on healthcare, while rigorous drug price restriction implemented by the previous government and enforced by the Rajapaksa administration has aggravated the shortfall.

Figure 1: Dwindling Foreign Exchange Reserve of Sri Lanka



Source: Central Bank of Sri Lanka

Figure 2: Dwindling Foreign Exchange Reserve of Sri Lanka



Source: Central Bank of Sri Lanka

To deal with the situation and the ensuing protests, the administration has taken drastic steps. To quell the protests, it has imposed a 36-hour curfew, declared a state of emergency, outlawed social media, and even turned off street lights to save electricity. The economy of Sri Lanka increased at a slower-than-expected 1.8 percent in the fourth quarter of the fiscal year 2021, bringing full-year growth to 2.1% percent, according to data released by the government's statistics department on Tuesday. Lower-than-expected fourth-quarter statistics suggest that Sri Lanka struggled to emerge from its Delta-variant coronavirus lockdown in the third quarter of 2021, according to analysts, who noted that both industry and agriculture had negative growth.

Table 1: GDP growth rate % per year of Sri Lanka

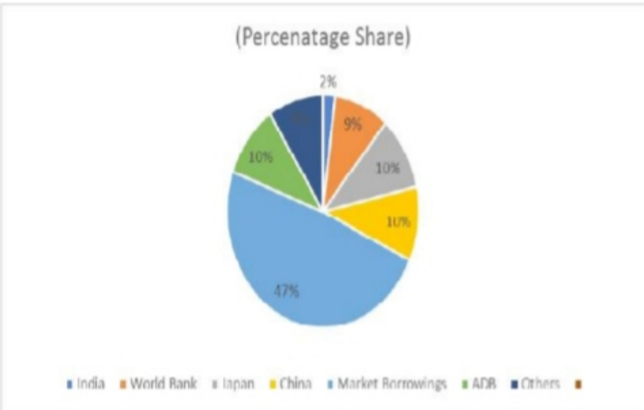
Year	GDP growth rate (in % terms)
2017	3.4
2018	3.2
2019	2.6
2020	2.2
2021	2.1

Source: Business Standard, 2022

Only services grew by 3.8 percent, thanks to a comeback in tourism in the final two months of the year. The island nation has been dealing with a debt repayment crisis that has snowballed into an overall economic crisis, forcing the country to implement power cuts due to fuel shortages, and foreign exchange reserves have plummeted by more than 70% since 2020, to a pitiful \$2.31 billion as of end February.

The country has also been sinking in mounting public debt. The share of public debt has gone up from 94% in 2019 to 119% in 2021. The share of major lenders in foreign debt is shown in the following figure.

Figure 3: Share of Major Lenders in Foreign Debt 2021



Source: Department of External Resources, World Bank

Post-Covid-19 tourism, one of Sri Lanka's biggest contributions to the economy, is entering a vulnerable phase. Sri Lanka's tourism industry has been improving, but the economic crisis has crippled it once again. Due to poor economic policy implementation and high debt, the government has no foreign reserves. The Sri Lankan government is unable to pay its bills for oil imports, and the country's whole supply chain has been disrupted by the fuel crisis. The frequent power cut, lack of food, etc. leads to cancellation of booking by the tourists.

Since April 8, 2020, the CBSL has continued to provide liquidity from the foreign reserves because the government has been unable to raise adequate cash due to unprecedented poor market conditions. The Central Bank used its foreign reserves to settle US\$ 1,007 million in government debt between April 8 and June 22, 2020. 8 The debt commitment for the period July 2021–July 2022 is estimated to be between \$5 and \$7 billion. 9 The current foreign crisis has worsened in recent years due to a decrease in foreign reserve inflows at a time when outflows are high. (Sultana, 2022).

Conclusion and Remedial Measures

The Sri Lankan government believes that previous governments' approach of importing more than income earned has contributed to the current foreign exchange reserves crisis. Loans from international institutions are also thought to have contributed to the country's current state of turmoil. Furthermore, the COVID-19 pandemic has exacerbated the problem; as a result, one of the government's top strategic priorities is to cut import expenditure. Several other "homegrown" strategies to limit capital outflow and increase inflow have also been used in order to strengthen foreign reserves.

The government must restructure the nation's international bond structure. Apart from raising borrowing costs and devaluing rupee, the central bank urged restrictions on non-essential imports of around 300 items (The Times of India, 2022). In order to promote organic farming, the government promoted import restrictions. To avoid an IMF bailout, Sri Lanka has asked China and India for bi-lateral credit lines. The Central bank of Sri Lanka has urged licenced commercial banks to refrain from entering into forward contracts of foreign currency for a period of three months in order to avoid high volatility in the forex market.

Restructuring of the debt structure has also been recommended since the country has been sinking in debt which is around 119% of the GDP in 2021. Moreover, to encourage the investors, the government has initiated the special deposit accounts. A diesel cargo was made possible via a \$500 million credit line with India, which was signed in February (India Today, 2022). India has offered a total of \$2.4 billion in aid. A \$400 million RBI currency swap, a \$500 million loan delay, and credit lines for importing food, fuel, and pharmaceuticals are among the items on the list. The Sri Lankan government is hopeful that the situation gets alright soon (The Hindu, 2022).

References

1. Athukorala, P.C., Ginting, E., Hill, H. & Kumar, U. (2017). The Sri Lankan Economy Charting a New Course (Edited). Asian Development Bank.
2. Ghosh, P. (2009). The Structure and Growth of the Sri Lankan Economy in the Keynes-Leontief-Klein Framework. Doctoral Dissertation, Jadavpur University

3. India Today (2022). Sri Lanka Economic Crisis Explained in ten points. https://www.indiatoday.in/business/story/sri-lanka-economic-crisis-currency-economy-1933828-2022-04-05
4. Marwah, R. & Ramanayake, S.S. (2021). Pandemic-led Disruptions in Asia: Tracing the Early Economic Impacts on Sri Lanka and Thailand. *South Asia Survey,* 28(1), 172-198.
5. Sultana, G. (2022). Economic Crisis in Sri Lanka: An Assessment. MP-IDSA.
6. The Times of India (2022). Sri Lanka's economy is being crushed by war in Ukraine. https://timesofindia.indiatimes.com/business/international-business/sri-lankas-economy-is-being-crushed-by-war-in-ukraine/articleshow/90283823.cms
7. The Hindu (2022). What led to economic crisis in Sri Lanka? https://www.thehindu.com/news/international/watch-what-led-to-the-economic-crisis-in-sri-lanka/article65293498.ece

◆◆