



## Sri Lanka's Economic Crisis: A Brief Overview

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**Abstract** - Sri Lanka's economic crisis, which began three years ago, has resulted in great hardship for the people and has posed the greatest challenge to the government. Lanka is currently experiencing an economic and political crisis, which continues with high inflation and sporadic demonstrations throughout the country. The government of Sri Lanka requests citizens abroad to send home cash 13 Lankan banks have been placed on rating watch negative Sri Lanka defaults on \$51 billion in external debt. Trouble is brewing on the island paradise. There is no food available. Sri Lankans have fallen into poverty by at least 500,000 in the last few months. There is no fuel, no medicines, and critical surgeries are being cancelled. According to doctors, the economic crisis may cause more deaths in Sri Lanka than COVID did. There are daily power outages and large-scale protests in the streets. The absence of power and the inability to obtain safe drinking water has resulted in significant difficulties in the provision of emergency health services. The safety net programmes have been interrupted. The situation in Sri Lanka is much more than just an economic crisis. Clearly, this is a humanitarian crisis. The question is, how did it occur, and how did the government of Lanka lose all of its money? The purpose of this research paper is to answer these questions. In addition, the author of the paper outlines a comprehensive analysis of the issue as well as the causes of the economic crisis.

**Keywords:** Economic Crisis, Sri Lanka, COVID-19 Pandemic, High Inflation, Central Bank of Sri Lanka (CBSL), World bank, Tax cut, Money creation, Sri Lanka, India.

### 1. INTRODUCTION

Various factors contribute to the current economic crisis in Lanka from 2019 to 2022. Such factors include economic mishandling, a rise in foreign debt, diminishing foreign reserves as well as a diminished currency and the rising prices. Apart from tax reductions, money creation, and national policy shift towards organic and biological farming, there were other factors like the Easter bomb attacks, and the effect of the (COVID-19) virus which added to the crisis. Coalition government has lost its majority with March-April 2022, and political unrest has risen, including their resignation from ministerial posts. After a fall in output as well as a shortage of food, switching to organic agriculture has been reversed. Sri Lanka was set aside for a sovereign default as the outstanding foreign exchange reserves would not be enough to meet the country's external debt obligations in 2022, [1]. The government was required to pay back an international (sovereign bond) in 2022. A series of debts are payable back in 2022, including domestic and foreign debts [2,3]. The Sri Lankan rupee fell to its lowest in April 2022, as the world's worst-performing currency, with the US dollar trading in Sri Lankan rupee [4,5].



According to a report released by the Sri Lankan government in April 2022, it has taken steps to temporarily default on all of its external debt in order to prevent a hard default.[6,7,8] Sri Lanka's unblemished record of service of its external debt has also been broken by the announcement.[9] The Governor of the (CBSL) insisted that Sri Lanka would restructure its debt to avoid a hard default.[7] However, both the ground situation as well as analyses of government policy measures and world geopolitical and economic trends, including the fallout from the Russia-Ukraine conflict, indicate that there is a situation of uncertainty over the Sri Lankan economy. In this article, the author will also discuss the causes, impact, and consequences of the crisis. As this economic crisis did not occur overnight, this article seeks to explore how web-based mass media has covered Sri Lanka's journey into this crisis over the past few years.

## 2. METHODOLOGY

The methodology applied is the "Keyword Research Methodology". Using keyword research is the most efficient method of gathering indexed online content. Thus, this research's goal is to collect keyword-related content from web services using the basics of keyword research methodology. First, Google was used to search for the keyword "Sri Lanka Economy", "Lanka" Economy and Political Crisis Sri Lanka" and all articles from January 1, 2010, to today were filtered. The duplicates and unreliable sources were removed, and only 45 popular news items were included in the study. However, since no winning news has been reported internationally for the past two years, the cue "Sri Lanka Economy" and "Lanka" Economy and Political Crisis Sri Lanka" had only produced negative news. It is also a noteworthy observation when searching for information on web content.

## 3. THERE ARE NUMEROUS EXPLANATION FOR THE CRISIS IN SRI LANKA

There are many explanations for the Lankan crisis. A problem exists in the country. Beyond policy, there are political factors beyond Sri Lanka's control, which people refer to as fate. It is also believed by the Sri Lankan population that China is responsible for many of the problems in Sri Lanka. Let's begin with the policy. The situation found now is the result of years of mismanagement. Sri Lanka has a fundamental issue. Imports exceed exports, spending exceeds earnings, and the country experiences a trade deficit. In addition, there is a budget deficit. There is a double debt. It is an ideal recipe for disaster. The response of Sri Lanka to this disaster has been disastrous. Instead of reducing its deficit, it has increased its debt. A large amount of money was borrowed by Colombo from foreign countries and agencies. Currently, Sri Lanka's debt to GDP ratio is 111%, meaning that it owes more than it produces. The Asian Development Bank flagged this issue in 2019. It claimed that the country's national expenditures exceeded its national income and that its production of tradeable goods and services was inadequate.

## 4. CAUSES OF THE SRI LANKAN CRISIS

### 4.1 Tax reductions and money creation

In 2019, campaigned for the presidential election. In accordance with current government election promises, they intend to cut taxes if they are re-elected, and ensure that people will pay less taxes. In this case, how will the country make money? Both the voters and the present government never bothered. The result of the election in November 2019, the current government was elected to office with more than 52% of the vote, and a series of significant tax cuts followed. Due to Sri Lanka's current president's policy of large tax cuts, government revenue and fiscal policies have suffered, resulting in soaring budget deficits [10,11]. Among these measures were the increased tax-free thresholds, which decreased the number of



taxpayers by 33.5%, reducing VAT to 8%, reducing corporate tax from 28% to 24%, eliminating the Pay As You Earn (PAYE) tax and imposing the 2% "nation-building tax" that financed infrastructure development. Because of the substantial reduction in tax revenue, rating agencies have downgraded the sovereign credit rating, making it harder to take on more debt. The rating agencies expressed concern. Consequently, Sri Lanka's state coffers will soon be empty, and the country may soon run out of funds. Due to this, investors fled Sri Lanka and it became difficult for the country to access international markets.

Although the current President was aware of the revenue loss in 2021, he considered it an "investment" and does not intend to increase taxes for another five years [12,13]. For the purpose of covering government expenditures, the Central Bank began printing money at a record pace, disregarding the advice of the International Monetary Fund (IMF) to cease printing money and instead raise interest rates and taxes while reducing expenditures [x8]. The IMF cautioned that continuing to print money will result in the collapse of the economy [14]. CBSL allegedly printed 119.08 billion rupees on April, 2022, the highest amount reported on a single day for the entire year 2022 [15]. In 2022, the total amount of money added to the financial markets raised to Rs. 432.76 billion [15].

## 4.2 The external debt of Sri Lanka

Sri Lanka's external debt has doubled from 2010 and 2020. Foreign debt was approximately 42 percentage of its GDP in 2019, however it has gone up to 119 Percentage of its GDP in 2021 [16,17]. Sri Lanka expects to repay its debtors US dollars 4 billion towards the end of 2022, while government reserves amounted to US dollars 2.3 billion as of April 2022 [18]. Even though commentaries blame China for a debt crisis, the (ALI)- Australian Lowy Institute noted that Sri Lanka was not mired in a Chinese debt trap, due to the fact that external debt due to China was only around 10 percentage of total debt in April 2021. The vast majority of Sri

Lanka's foreign debt stock is owed to international capital markets, which account for 47 percentage. A further 22 percentage is held by international development banks, followed by Japan having 10 percentage of Sri Lankan foreign debt [19]. The President's office announced in January 2022 that it would request to China to postpone its debt burden during talks with its foreign minister [20]. As of March 2022, China has not responded officially [21]. In 2020, Global credit Ratings agency indicated that Sri Lanka's existing financing sources were insufficient to cover the country's debt service requirements, valued at little over US dollar 4.0 billion in 2021[22]. For Sri Lanka to solve its budgetary problems in repaying its debt, Treasury auctions must succeed, according to Bellwether. As soon as this is accomplished, the foreign exchange problem will be automatically resolved. Consequence of failed auctions of Treasury bills filled with printed currency, the government is sinking further into debt [23]. According to Bellwether, the debt crisis needs to be resolved, Sri Lanka would require a reliable fiscal plan as well as monetary policies, a tax increase to re-pay debt, and a reduction in interest rates as well as the opening of imports that would allow tax revenue to flow back into the government. Increasing interest rates and curtailing domestic credit are both effective ways of generating dollars to pay off foreign debt, however, it is impractical to do so on a continuous basis for several years. Investors may be able to regain confidence if their foreign reserves increase following the repayment of debt, but it will be a painful process that might or not succeed given current ideologies[24].

In September, 2021 the government has declared an economic emergency because of a falling national currency exchange rate, rising inflation because of rising food prices, as well as pandemic restrictions on tourism, which further reduced income. Due to this, Sri Lanka's foreign reserves dropped to US dollar 1.9 billion from March 2022, which is



insufficient to pay foreign-debt obligations of US dollar 4 billion and an ISB–International Sovereign Bond payment of US dollar 1 billion for the year 2022 [10]. According to the (NCP) National Consumer Price Index [25], the (NIR) national inflation rate rose to 17.5 percentage in Feb 2022. While economic analysts and experts across the board advised the government to postpone the payment of its ISBs in order to preserve foreign reserves, the government repaid US dollar 500 million in International Sovereign Bonds that were due in January, 2022[26]. Sri Lanka announced on April,12 2022 that it will not pay its foreign debt of US dollar 51 billion [27,28].

#### 4.3 The Sri Lankan agriculture crisis

In April 2021 the current government made another blunder. It has been announced that Sri Lanka will only permit organic farming, banning all inorganic fertilizers and agrochemical fertilizers. The government believes that this will be beneficial to health. Many critics rolled their eyes. Many realized that the real issue was insufficient funding, not health. Sri Lanka was saving foreign reserves by banning the import of fertilizers. However, this impacted agriculture production [29]. The drop in tea production due to the fertilizer ban alone resulted in losses of millions of dollars. In addition, the country was forced to import rice due to a 20 per cent drop in rice production in the first six months alone. Tea farmers described the situation in the industry as critical, claiming that organic farming is ten times more costly and yields half as much as conventional farming.

Though the proposal was supported by its advisor, it ignored criticism from the scientific and farming communities. They warned of a collapse in the farming sector because of the devaluation of the national currency, which negatively affected the tea industry. Consequently, the banning of chemical-fertilizers and pesticides has caused a serious economic crisis, since the population expects to stay without income and no food [30,31]. Amidst

soaring food prices and protests against the plan, the government abandoned its plan to become the world's first organic-farming nation in 2021[31]. Although some of the measures were cancelled, urea imports remain prohibited. There are plans for Sri Lanka to ration essential goods during peacetime [32].

#### 4.4 The Sri Lankan Tourism Sector

The tourism industry in Sri Lanka was negatively affected by the Easter bombings of 2019 and the COVID-19 pandemic that followed[33]. In the event that borders were closed, tourists completely ceased to arrive, resulting in a decrease in tourism-related revenues. Sri Lanka's tourism industry contributes 13 per cent of the country's GDP. Tourists are also a source of foreign exchange. In 2020, Sri Lanka managed to welcome just 173,000 tourists 2018. The number was 2.3 million. You see the gap by 2021, Sri Lanka's tourism revenue was down to USD 2.8 billion. A World Bank report from April 2021 stated that, despite the negative impact of the COVID-19 pandemic on Sri Lanka's economy and the lives of its people, the economy will recover in 2021, though challenges remain. Positive signs of recovery are already evident. Proper taxation has been encouraged in order to build self-reliance and avoid high dependency on foreign debt in the future. The current social protection initiatives intended to assist those who are unemployed due to the debt crisis have been deemed successful. In addition to a properly structured taxation system, the Sri Lankan economy would require, according to economists, an export-driven growth strategy in order to recover from the current debt crisis, and it was hoped that the country would achieve a full financial recovery [34].

#### 4.5 Tea exports and tourism have been affected by the Russian–Ukrainian war

Because of the ongoing tense situation between Russia and Ukraine due to the Russian–Ukrainian War, Sri Lanka's economic conditions are already sluggish [35]. Due to the Russian invasion of Ukraine in 2022, Sri Lanka has suffered further economic

hardship, as Russia is the second biggest market for Sri Lanka's tea exports. Additionally, Sri Lanka's tourism industry is heavily dependent on these two nations, as the majority of visitors arrive from either Russia or Ukraine [36]. As a result, the Ukrainian crisis has put a halt to economic recovery in Sri Lanka, which has been adversely affected by both the tea and tourism sectors[37].

### 5 IMPACTS OF THE SRI LANKAN CRISIS

Due to the rising price of basic commodities, shortages of essential goods, as well as rolling blackouts, the President has been forced to declare a national emergency. In the last several years, Sri Lanka has suffered from historically low government revenues, poorly timed tax cuts, as well as the Covid-19 outbreak, which has adversely affected the country's lucrative tourism industry and foreign remittances. Sri Lanka's government declared the most severe economic crisis the nation has experienced in the past seventy-three years. Food shortages were announced in August 2021. The government, however, denied that there were shortages of food. The country's energy minister admitted that the crisis could result in a financial catastrophe. At the beginning of April 2022, the new governor of the (CBSL) was appointed. The ruling coalition was defeated in parliament when a majority of 41 parliamentarians left the coalition on 5 April. Curfews were also imposed by the government after protests became violent.

#### 5.1 Power and fuel insufficiencies experienced by Sri Lanka

The economic crisis has led to a decline in electricity, fuel as well as cooking gas consumption, due to a shortage of these resources. A financial minister has instructed all government offices to turn off all streetlights until the end of March 2022 in an effort to conserve electricity. The shortage of cooking gas has forced the closure of nearly 1000 bakeries. Recent months have seen long lines forming in front of petrol stations. An increase in the price of crude oil has aggravated the situation further. The authorities throughout the country have

imposed daily power cuts in order to conserve energy. To reduce tensions among people waiting in lines and to simplify fuel distribution, the government instructed the military to station soldiers at various gas and fuel filling stations in March 2022. A total of four individuals were killed due to fatigue as well as violence during this time. A daily seven-hour power outage was experienced during March 2022, which increased to ten hours by the end of the month and to fifteen hours at the beginning of April. Because of a shortage of paper and the escalating price of paper, daily newspapers ceased printing and began publishing e-papers instead. Hydroelectricity generation in Sri Lanka has also been adversely affected.

#### 5.2 Sri Lanka's Inflation

As Sri Lanka encounters an unforeseen economic crisis, the rising cost of living burns a hole in Sri Lankans' pockets. In Sri Lanka, the overall rate of inflation for February 2022, inflation was 17.5 per cent [38]. The year on year increase in inflation for food was 24.7 percent while non-food items saw an 11 per cent rate[39].

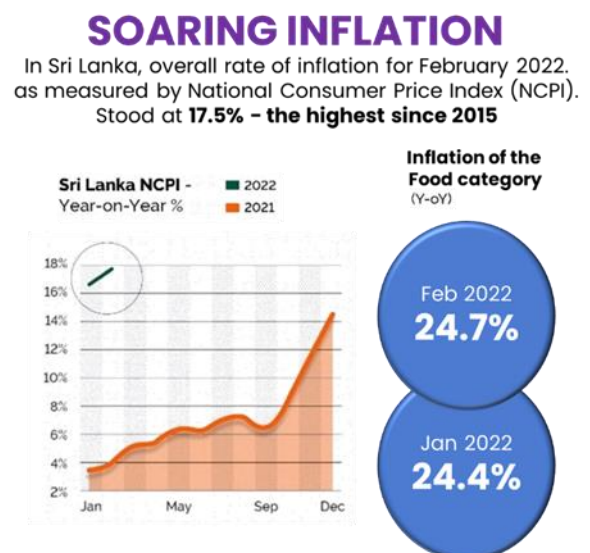


Fig -1: Soaring Inflation (Source: News18 Creative)

The year on year change (Feb 2021 to Feb 2022) for local red chilis increased by 60 percent, local



potato's by 74.8 percent and Nadu rice by 64 percent [40].

### 5.3 The Impact of Sri Lanka's education system

Assume the person has no reason to celebrate after finding out that exams have been cancelled [41]. The exams, which are part of the continuous assessment system for students in the country, have been indefinitely postponed. Many Sri Lankan schools announced in March 2022 that they would postpone their term, mid-year examinations for an indefinite period due to paper shortages in the entire country, mainly caused by a shortage of foreign reserves to purchase paper [21,43]. Due to an insufficient supply of printing paper as well as ink ribbons, term examinations were scheduled to take place whole Island on 28 March 2022, however this date was either completely cancelled or postponed [44]. Almost 4.5 million students in Sri Lanka will be affected by the financial crisis [41]. Unfortunately, ongoing power outages have severely impacted online learning and teaching. Besides the pandemic, the power crisis has had a detrimental effect on students physically and psychologically [42].

### 5.4 Sri Lanka's medical sector and its impact

Doctors in Sri Lanka have warned that a huge number of people may die as the country's healthcare system teeters on the brink of collapse due to crippling power cuts and a shortage of essential medications. Due to an insufficient supply of medicines, all scheduled operations at the (PTH) Peradeniya Teaching Hospital have been cancelled [45]. In many other hospitals, routine surgeries have also been suspended and a significant number of laboratory diagnostic tests have been reduced. In addition, there was a shortage of emergency life-saving drugs in other state-run hospitals [46]. It was stated by the (MCSL)–Medical Council of Sri Lanka that there are likely to be a large number of deaths which will surpass the combined death tolls

from COVID-19, the 2004 tsunami as well as the Civil War if supplies are not replenished in a short period of time. [47]. Singapore Red Cross society declared the Lanka medical crisis an unexpected humanitarian crisis [48].

As a result, hospitals were running short of endotracheal tubes to ventilate newborns, infants, as well as children. Doctors requested that foreign Lankan communities donate neonatal ETTs of various sizes [49]. All hospitals in Lanka no longer have access to imported medical equipment or essential drugs, according to the (SLMA)–Sri Lanka Medical Association [50]. The hospitals were pressed to the point that they sterilized and re-used endotracheal tubes to provide oxygen to newborns' lungs. Due to the shortage of new medical equipment, doctors have been compelled to reuse old and already used equipment to treat patients. The light from mobile phones has also been reported to have been used by doctors to perform medical procedures [51]. Because of rolling power cuts, rural doctors have also been compelled to stitch injuries in the darkness. There are also reports that there are short supplies of emergency medications for the treatment of heart attacks [52].

### 5.5 The tourism sector and its impact

Besides the remittances of its workers, Sri Lanka's tourism industry is the third-largest source of foreign exchange for the country. Additionally, this industry is a large employer and a significant contributor to foreign revenue for the government. As a result of the worst financial crisis the country has ever faced, the tourism industry has been badly affected. The United Kingdom, Canada, and India cautioned their citizens to pay attention to the ongoing economic instability in Lanka [53]. Some countries in Europe and Canada urged their citizens to keep water, food, and fuel on hand in case of long-term disruptions, to ensure that adequate supplies of medicines are on hand because they may not be readily available, and to monitor local



media for the most recent updates. After Russia and India, the UK is Lanka's third-largest contributor of inbound tourists. Sri Lanka's tourism industry contributes approximately 5 per cent of the country's GDP. The major markets are India, UK, and China. As a result of the economic crisis, the tourism sector was severely affected.

## 5.6 Impacts on the export sector

Due to the current economic situation in Sri Lanka, leading textile companies, including Zara, Mango, and H&M, have shifted their attention from Lanka to Asian countries, including India, Bangladesh, Cambodia, and Vietnam, where they have placed their orders [54]. India has experienced a rapid increase in export orders for its textiles and tea after the economic and political conditions in Sri Lanka deteriorated. As a result, India's export market has greatly increased [54]. As export demand has diverted from Lanka to India due to the economic and political crisis in the island nation, the textile capital of Tirupur, Tamil Nadu and the tea gardens in Assam and southern India are seeing an increase in orders from overseas. The main exports from Sri Lanka are garments and tea. Sri Lanka exports USD 5.42 billion worth of garments each year to the global market. Because of the ongoing crisis, global brands have relocated some of their orders from Sri Lanka to India. Sri Lanka's export sector has been severely impacted.

## 5.7 The impact of the economic crisis on entertainment and sports

Due to the dollar crisis and the economic crisis in Sri Lanka, SLT PEO TV, Sri Lanka's largest internet protocol television service provider, has temporarily halted and suspended transmission of foreign channels [55]. In addition, the Indian Premier League 2022, was also suspended midway due to inability to pay the host broadcaster, Star Sports [56]. In addition to the plummeting dollar reserves, many sports associations in Sri Lanka have been

unable to send their teams to international sporting events, especially since upcoming multi-sporting events such as the Asian Games and Commonwealth Games are just around the corner [57]. The economic crisis is expected to have an increasingly detrimental impact on the entertainment industry, along with other media services.

## 6. CONCLUSIONS

The government of Lanka should take steps for the economic recovery of the whole country once the scarcity of certain basic commodities comes to an end. The government must also cooperate with Tamil political leadership to establish a roadmap for economic growth in the civil war-impacted eastern and northern regions, between areas severely struck by the ongoing crisis. It would be better to increase domestic tax revenues and reduce government spending to restrict borrowing, especially sovereign borrowing from foreign sources. Strict measures must be taken for restructuring the administration of grants and subsidies. India's Aid: It would be entirely inappropriate for India to allow the Chinese to take control over the growing portions of Sri Lankan land. India should offer Sri Lanka financial assistance, policy recommendations and investment from Indian entrepreneurs. Indian companies must build supply chains which connect the Indian as well as Sri Lankan economies with goods and services including the export of tea to Information technology services. India, instead of any other country, must help guide Sri Lanka on the path to achieving its potential to reaping the benefits of a stable neighbourhood. The Lankan authorities must ensure that the current crisis will not be used to intensify smuggling activities as well as trafficking or stir up emotions in the country. Crisis as an Opportunity: Both Sri Lanka and India cannot have strained relations. As a much larger country, the responsibility is on India. It must be very patient and



engage Sri Lanka even further periodically and closely. Further, it is important to enhance people-centric development activities while carefully staying away from any interference in Lanka's internal affairs. As a consequence of the economic crisis, Sri Lanka is keen to put in place major financial and regulatory reform measures. These reforms will reduce the chances of a future crisis and will mitigate the impact of whatever crisis will occur and is deserving of people's full support [58]. Sri Lanka's government should take the above-mentioned steps for the economic recovery of the whole country. It hopes the foreign exchange situation will improve early with the realization of the planned inflows from bilateral partners, and debtless creating foreign exchange inflows in the future. It is anticipated foreign exchange revenues from the tourism industry and remittances will be improved in the near future. It is expected that the people of Lanka will feel economic relief in the foreseeable future [58].

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