**Case Study of Sri Lanka’s Economic Crisis**

Ramsha Munir

The conundrum that encircles Sri Lankan’s economy has shocked economists globally. What seemed like a thriving economy with tourism at its peak has crashed within months and left knocking at the doors of developed countries to save them. In recent events, President Gotabaya Rajapaksa fled the country leaving his presidential house up for citizens to enjoy the luxurious lifestyle. What’s seen in Sri Lanka is the start of a domino effect that will engulf all developing countries with worse outcomes for their economies. Sri Lankan government imposed an emergency when they were unable to fulfill expenditures of the country and had to ration products for survivability. The situation of Sri Lanka has been the consequence of years of unfeasible policies and political instability that has resulted in a sudden plummeting of the economy within days. The storm that brought Sri Lanka to its knees is a mixture of external debt, global pandemic, depleting foreign reserves, Ukraine-Russian war-induced oil price hike, tanking currency and politically influenced economic policies.

**How did it happen?**

The chain of events that resulted in the downfall of 22 million population goes back to unsustainable policies and political decisions that in time toppled the whole government structure. Sri Lanka has been gripped by political elite families like, the Rajapaksa family has dominated Sri Lankan politics since 2005 with president-elect Mahinda Rajapaksa and then his brother Gotabaya Rajapaksa in 2019[[1]](#footnote-1). The policy errors made by Gotabya to gain popularity among citizens through tax cuts were the building block toward the impending doom that shattered the economy in coming years. Sri Lanka has experienced macroeconomic instability, economic stagnation, volatile business environment, corruption, government mismanagement and deficit balance of payments for decades[[2]](#footnote-2) . Since 1990 the GDP rate is declining and revenue collection is minimum with policies to facilitate MNCs and wealthy families through tax reduction. The civil war of 2009 and frequent IMF loans since 1997 with the last one in 2016 have sunken its economy in debt. Heavy reliance on commercial borrowing and excessive imports with low exports have increased trade deficit substantially in recent years. The situation deteriorated further with 2019 tax cuts and later ban on fertilizers based on ‘organic drive’ of Gotabya policies in order to curb the health issues, which backfired with 50% decrease in agricultural yield leading to food crisis. Later, luxury items import were banned to save foreign reserves.

 In unexpected turn of events, Covid-19 pandemic plunged economies into freeze mode, which took the worst turn of events for Sri Lanka. 13% of Sri Lanka’s GDP was tourism, which totally shut down during lockdown stripping Sri Lankan economy a major contributor to its economy. The decrease in remittances also contributed to weakening of economy which increased debt, depleted foreign reserves, lowered GDP growth and unemployment. Prior to that, terrorist attacks on Easter of 2019 killed 269 people of which 45 were foreigners, which declined tourism up to 18%[[3]](#footnote-3), and tourism as a source of foreign reserves declined from 7.9 billion dollars to 1.6 billion dollars in 2021. The currency devalued significantly during pandemic and imports became more expensive than ever.

During 2022, the Ukraine-Russian war was another shock wave for Sri Lanka which later proved to be the downfall of its economy with surging prices of oil globally. Russia and Ukraine both are major exporters of wheat and with the ongoing war and sanctions imposed on Russia, imports of wheat are hampered in developing countries. The red flags for the Sri Lankan economy were there with increasing debt and depleting foreign reserves, and pyramid schemes to pay off previous debts by taking more loans, pushing Sri Lanka one step closer to awaiting predicament. The surge in global oil prices increased the prices of commodities and lack of foreign reserves, which took away the ability of government to get imports for necessary daily use items, pushing the economy to the edge. What seemed like a sudden event is making of long due mismanagement of government, bad policies, corrupt system, political instability and over-dependence on borrowing for infrastructure development projects.

What followed were a series of bottling up of Sri Lankan economy just a few weeks after the Ukraine- Russian war, running out ­­of paper and canceling all academic examinations. Oil prices were high and inflation exceeded up to 74% as Sri Lankan rupee plunged to 326 against dollar and reduced purchasing power parity of individuals. Sri Lanka has 110% public debt as its expenditures are in excess compared to revenues generated and 10% of that debt is held by China which was due and Chinese ignored the economic crisis which lurched in 15 hours per day power outage, 4 day work week, inability to supply food and medicines, oil shortage and inability to import basic necessities resulted in major population falling under the poverty line within weeks. Sri Lanka aimed to get an IMF bailout but couldn’t fulfill the prerequisites and cannot further implement structural adjustment plans of IMF, to an already freefalling economy. Citizens are furious at its government for not taking foreign assistance and Sri Lanka has taken loans from India and working on short-term loans to stabilize economy and recently protests have forced President Gotabya to flee the country. Oil prices hike has completely shut down transport and Sri Lanka is unable to import more oil due to shortage of foreign reserves.

Globally many countries are affected by pandemic and now Ukraine- Russia war and inflation has increased like never before. Pakistan with its weak management, political instability and inflation is predicted to be one of the dominos to fall among other countries. Pakistan’s per capita income has gone down, budget deficit increased with foreign reserves depleting and have again taken IMF bailout. Pakistan’s currency is in free fall and at 215 to a dollar and citizens are experiencing low purchasing power parity and high prices of oil and commodities. If things keep going in the same direction without any improvement in management and effective policies, it is feared that Pakistan’s economy will follow the fate of Sri Lanka.

The probable solution to economic crisis faced by Sri Lanka and Pakistan is to pause repayment of debt during days of crisis and find better ways to manage shocks to economy. It is, however, essential for trading countries to have high reserves of foreign currency to carry out imports and limit import of luxury goods and activities that deplete foreign reserves unnecessarily. There is a need for restructuring of unsustainable debt crisis and promoting an alternative to borrowing such as revenue generation through taxation. International financial institutes should facilitate poor countries and developing countries in times of global recession and come up with sustainable solutions for loans without further damaging the countries’ economies.

*Ramsha Munir works as a Research Associate at the NUST Institute of Policy Studies (NIPS. She can be reached at ramsha.ra@nust.edu.pk*

1. Kuruwita, Rathindra. "Sri Lanka Crisis: How Did We Get Here And What Comes Next?". *Aljazeera.Com*, 2022. https://www.aljazeera.com/news/2022/7/10/sri-lanka-protests-how-did-we-get-here-and-what-comes-next. [↑](#footnote-ref-1)
2. Attanayake, Chulanee. "Years Of Policy Failure And COVID Throw Sri Lanka Into Deep Crisis | East Asia Forum". *East Asia Forum*, 2022. https://www.eastasiaforum.org/2022/04/24/years-of-policy-failure-and-covid-throw-sri-lanka-into-deep-crisis/. [↑](#footnote-ref-2)
3. Yadav, Namrata, and Vinod Rai. "The Fallen Sri Lankan Rupee: Not Just Another Economic Crisis". *Isas.Nus.Edu.Sg*, 2022. https://www.isas.nus.edu.sg/papers/the-fallen-sri-lankan-rupee-not-just-another-economic-crisis/. [↑](#footnote-ref-3)