
The economic crisis faced by island nation- Sri Lanka: An empirical study

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Abstract:

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 food, fuel, medication, cement, and other necessary products. Sri Lanka is in the midst of a severe economic crisis as a result of the country's depletion of foreign reserves, which has resulted in food, gasoline, pharmaceutical, cement, and other essential supplies shortages. As a consequence of the policy initiatives taken thus far and the improvement in the COVID-19 situation, the Sri Lankan government is optimistic that the crisis would be addressed shortly. Even though the circumstances on the ground and analyses of the government's policy measures imply that Sri Lankans would not receive economic respite anytime soon, global geopolitical-economic trends, particularly in the aftermath of the Russia–Ukraine war, suggest otherwise. In Sri Lanka, public resistance to the government's handling of the matter is steadily growing. The declining economic growth is the subject of this research study.

Keywords: Economy, crisis, issues, and challenges.

Introduction

Sri Lanka's economic crisis is unique in the island nation's history. The crisis has been marked by high inflation and severe fuel and energy shortages. Economic growth has been hampered by high foreign debt, dwindling foreign currency reserves, currency depreciation, and a series of lockdowns. Aside from the effect of the COVID-19 pandemic, the crisis was caused by mismanaged government finances and sick-timed tax reductions. India, China, and Bangladesh have all offered assistance to Sri Lanka in the face of the crisis. Sri Lanka may seek financial aid from the International Monetary Fund (IMF) to properly address the economic crisis.

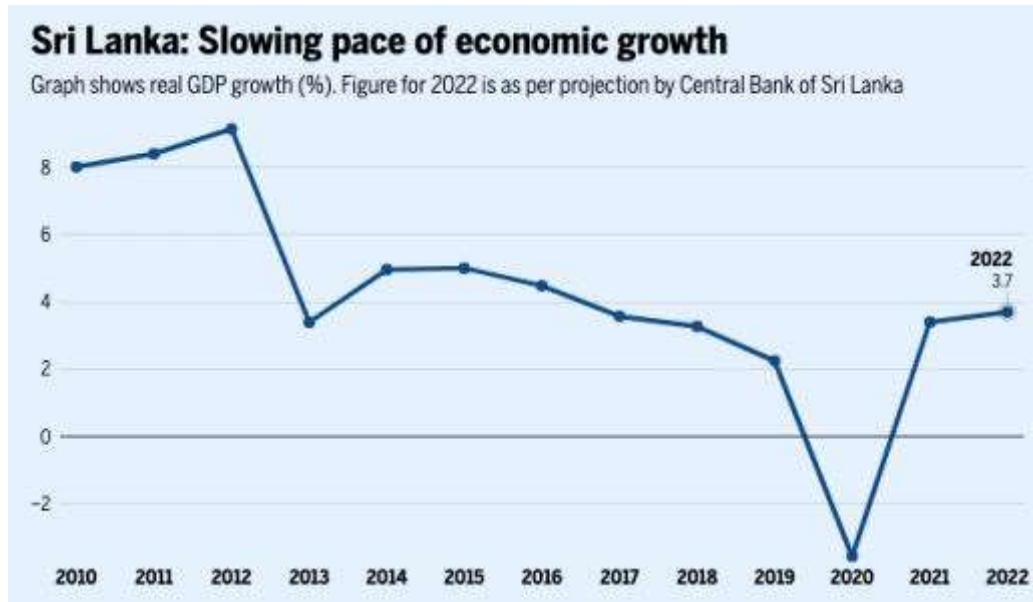
Current Status of the economy of island nation Sri Lanka:

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The growth of Sri Lanka’s economy slowed down to 1.8% in the fourth quarter of the FY2021-22, with annual growth of 3.7%. This is much lower than the projected growth of 5% by Sri Lanka’s Central Bank.



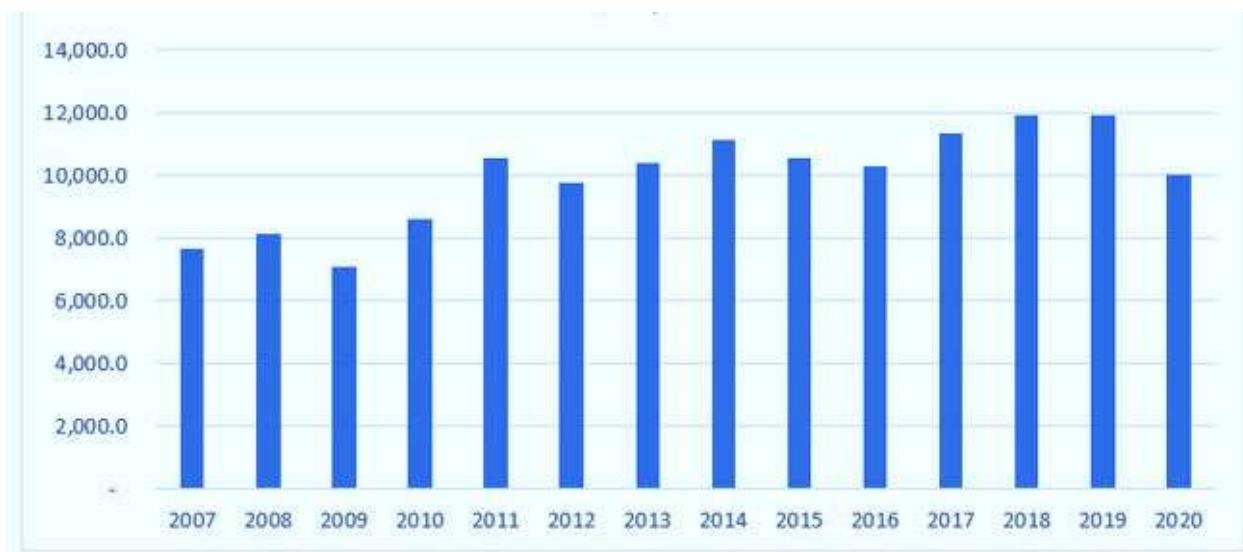
Sri Lanka is leftover with foreign reserves of only around US\$ 02.31 billion as of February 2022. It faces debt payments of about US\$ 04 billion through the rest of the year, indicating rising susceptibility to defaulting on debt. The US\$ 04 billion debt includes a US\$ 1 billion worldwide sovereign bond that matures in July 2022.

Gross Official Reserves:



Source: CBSL (Central Bank of Sri Lanka)

Total Exports:



CBSL (Central Bank of Sri Lanka)

Because the government has been unable to obtain adequate funds due to unprecedented poor market circumstances, the CBSL has continued to provide liquidity from foreign reserves since April 8, 2020. 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 to July-2022 is estimated to be between \$5 and \$7 billion. ⁹ The current overseas crisis has worsened in recent years due to a decrease in foreign reserve inflows at a time when outflows are high.

The cost of basic necessities:

Basic essentials, even locally produced ones, have become unaffordable for many. Here's how much basic necessities now cost in Sri Lanka compared to 2019.

End March 2022: Sri Lankan Rupee (LKR) to US Dollar: LKR 290.4/\$.

The cost of basic necessities in Sri Lanka			
Products	Price (LKR) in March 2019	Price (LKR) in March 2022	(%) change
Coconut	50.4/each	91.39/each	81%

Onions	79.8/kg	158/kg	98%
Potatoes	156.7/kg	260.67/Kg	66%
Eggs	18.7/each	26.7/each	43%
Dried Fish	613.8/kg	445/kg	38%
Chicken	445/kg	690/kg	55%
Beef	979.1/kg	1454.55/kg	49%
Tomatoes	105.2/kg	310.42/kg	195%
Turmeric	659.9/ kg	3583.33/ kg	443%
Bread	62.4/450g	80/450g	28%
Lentils	149.8/kg	325.72/kg	117%
Chickpeas	239.6/kg	377.55/kg	58%
Rice	84.1/kg	162.52/kg	93%
Flour	94.33/kg	155.24/kg	65%

Source: Department of census and statistics (April 5, 2022).

Reasons behind the economic crisis:

Poor Economic Policy Decisions: When the current government had come to power in 2019, it promised to accelerate economic growth. To encourage consumption and economy, the government cut the value-added tax in half and eliminated certain other taxes. The tax cuts resulted in a loss of billions of rupees in tax revenue, putting further strain on the already deeply indebted economy's public finances.

The government aspired to be the first country in the world to fully embrace organic farming. As a result, chemical fertilizers were outlawed in April 2021. Chemical fertilizers, on the other hand, were employed by 90% of Sri Lankan farms. As a result of the transfer, food production was drastically reduced, resulting in sky-high prices.

COVID-19: The pandemic wreaked on Sri Lanka's tourism industry, which accounts for more than 12% of the country's overall economic output. Similarly, remittances from Sri Lankans working abroad have dropped. During the pandemic, Sri Lanka's national debt is estimated to have climbed from 94% of Gross Domestic Product (GDP) in the year 2019 to 119 % of GDP in 2021.

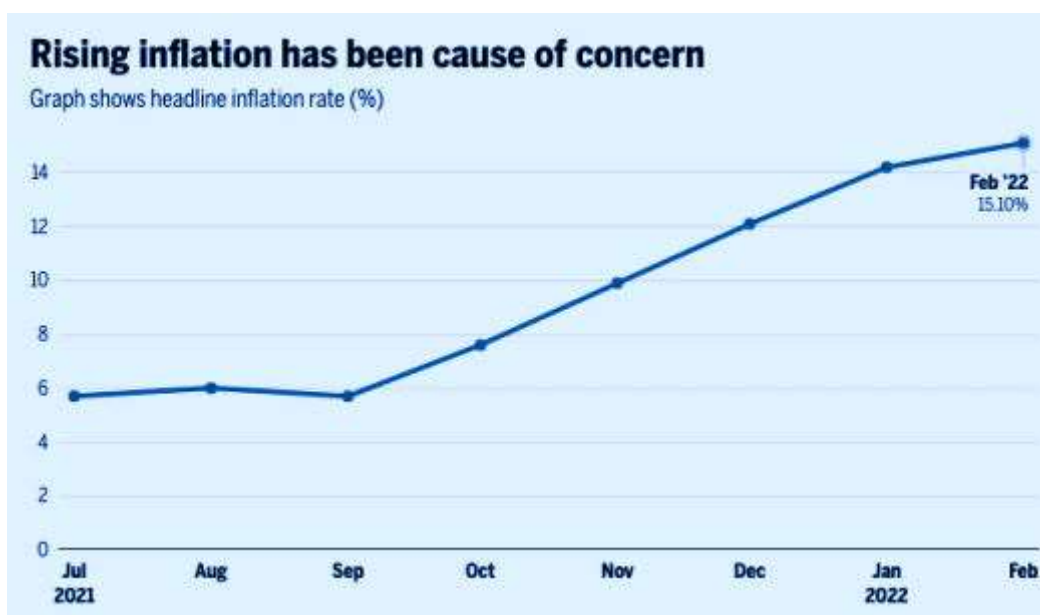
Diminishing Forex: Sri Lanka's FOREX reserves have fallen 70% in the past two years, from US\$ 08 billion in 2020 to about US\$ 2.31 billion. This has made it difficult to pay for necessary imports, including food and fuel. A critical shortfall in foreign currency has enhanced hardships for traders to finance their imports.

Global Fears/uncertainties: The crisis got intensified by the Russia-Ukraine war that has led to a steep hike in oil prices. The rising prices and depleting forex have led to a severe shortage of fuel.

What impact is being created by the crisis?

Job failures have become a typical occurrence in practically every home, resulting in **unemployment and poverty**. Furthermore, a decrease in earnings has resulted in a rise in poverty rates. The poverty rate based on a daily income of US\$ 3.20 grew to 11.7 percent in 2020, up from 9.2 percent the previous year, according to World Bank data..

Inflation is rising: In February 2022, retail inflation was 15.1 percent, while food inflation was 25.7 percent, the most in a decade. This has resulted in a serious food shortage. As of October 2021, a cup of tea costs Rs. 100, up from Rs. 25.



Fuel Shortages: Fuel shortages have resulted in long queues at petrol stations. Multiple thermal power plants have been forced to close due to a severe lack of diesel, resulting in rolling power outages across the country. In most locations, there are long power outages with only 4 hours of power every day.

The low level of water in reservoirs has exacerbated the electrical situation. Sri Lanka's electrical generation is dominated by hydroelectricity, which accounts for 40% of total generation.

Concerns about health: Doctor's appointments and medications have become more pricey. The majority of people have turned to self-medication. According to the WHO, this can lead to increased morbidity.

People's dissatisfaction: Thousands of people gathered on the main Galle Road in Colombo earlier this month to protest shortages and high pricing in Sri Lanka. Some of the protestors are demanding the resignation of the current President.

Forced Migration: The deteriorating situation would induce the native Sri Lankans to migrate to other countries like India, Maldives etc. for better opportunities and a stable environment.

Steps have been taken to combat the economic crisis:

Domestic Measures:

The Sri Lankan government has imposed import restrictions on several commodities that have been designated as "non-essential." Due to a paper scarcity, school exams were postponed indefinitely.

Last week, Sri Lanka sent troops to petrol stations in response to occasional protests by thousands of people waiting in line for fuel. To combat rising inflationary pressures, the country's central bank hiked interest rates.

The rupee has been devalued by up to 15% by Sri Lanka's central bank. It has imposed an exchange rate ceiling of 230 rupees per dollar, up from the previous ceiling of 200-203 rupees per dollar, which had been in place since October 2021.

The Central Bank announced a slew of measures in December, including an additional 10 rupees per dollar as an incentive. Remittances fell 61.6 percent to \$ 259 million in January from \$ 675 million a year earlier, indicating that the impact was modest.

International Measures:

To help it through the financial crisis, Sri Lanka has requested China to modify its debt repayments. China is also in negotiations with the government about providing another US\$ 2.5 billion in credit help.

After signing a US\$ 1 billion credit line with New Delhi earlier this month, Sri Lanka has requested an additional credit-line of US\$ 1 billion from India to purchase necessary products.

In addition to the credit lines, India earlier this year offered Sri Lanka a US\$ 400 million currency swap and a US\$ 500 million credit line for gasoline purchases.

Lies ahead:

First, Sri Lanka has shown **keen interest to negotiate with the International Monetary Fund** to prevent the looming Balance of Payment crisis. This deal should be brokered swiftly to provide sufficient cushion to the island nation.

Second, the country **should try to revive its key driving sectors like Tourism**. Proactive measures should be undertaken to make sure tourists are safe and secure in the nation. Tourism was severely hit even before the pandemic when the year 2019 Easter Sunday suicide bombings took place and killed 250+ people.

Third, while they work on building a **transshipmentcenter in Kerala** has begun, it is still in India's interest to help the country Sri Lanka come out of the economic crisis. Therefore it must extend more aid and resources to help the island nation.

Conclusion:

The economic crisis in Sri Lanka is a reminder to other countries to constantly introspect their economic policies at regular intervals. It provides a lesson to every nation regarding the adverse consequences that can arise due to ill-timed and irrational policy decisions.

India should further enhance its support to Sri Lanka if required. A peaceful and stable Sri Lanka is in India's long-term geopolitical interests.

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