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AN ANALYSIS OF THE SRI LANKAN ECONOMY IN THE CONTEXT OF THE CRISIS

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ABSTRACT

Sri Lanka has been facing an economic crisis for the last five years, causing significant misery for its people and presenting the government with its most significant task. Lanka is now facing an economic and political crisis characterized by rising prices and intermittent protests around the nation. Sri Lanka's government is asking its people living overseas to remit money back home. Thirteen Sri Lankan banks are under negative rating scrutiny. Sri Lanka has failed to meet its obligations on $51 billion of foreign debt. Conflict is emerging on the idyllic island. No food is provided. At least 500,000 Sri Lankans have recently experienced a decline into poverty. There is a shortage of gasoline, medications, and crucial procedures are being postponed. Doctors suggest that the economic crisis in Sri Lanka might result in more fatalities than those caused by COVID-19. Daily power outages and widespread demonstrations are occurring in the streets. The lack of electricity and the failure to get clean drinking water have caused major challenges in delivering emergency healthcare services. The safety net programs have been disrupted. The issue in Sri Lanka transcends beyond being only an economic disaster. This is undoubtedly a humanitarian issue. How did the government of Lanka lose all its money? This study article aims to address these concerns. Furthermore, the author of the article provides a detailed analysis of the situation and the factors contributing to the economic crisis.

Keywords: - Economic Crisis, Sri Lanka, Political, causes.

INTRODUCTION

An economic crisis refers to instances when certain financial institutions or assets see a significant and unexpected decrease in value. During the 19th and early 20th centuries, several financial crises were linked to banking panics, with many recessions occurring simultaneously with these panics. Financial crises may also refer to occurrences such as stock market crashes, the collapse of financial booms, currency crises, and sovereign defaults. Several economists have proposed ideas on the development and prevention of financial crises. Despite the lack of agreement, financial crises continue to happen often worldwide.

Multiple causes are responsible for the ongoing economic crisis in Lanka from 2019 to 2022. Factors such as economic mismanagement, increasing foreign debt, declining foreign reserves, devalued currency, and rising prices contribute to the situation. In addition to tax reductions, monetary expansion, and a national move towards organic and biological farming, additional factors contributing to the crisis were the Easter bomb attacks and the impact of the COVID-19 virus. The coalition administration has lost its majority since March-April 2022, leading to increased political turmoil and the resignation of ministers. Following a decrease in production and a food scarcity, the transition to organic farming has been halted. Sri Lanka is at risk of a sovereign default in 2022 due to insufficient foreign currency reserves to cover its external debt commitments. The government has an obligation to repay a sovereign bond to an overseas entity in 2022. Multiple debts, both local and international, are due for repayment in 2022. The Sri Lankan rupee sank to its lowest in April 2022, as the world's worst-performing currency, with the US dollar trading in Sri Lankan rupee.

In April 2022, the Sri Lankan government published a report stating that it has decided to temporarily default on all its foreign debt to avoid a hard default. Sri Lanka's flawless history of repaying its foreign debt has been disrupted by the recent declaration. The Governor of the Central Bank of Sri Lanka (CBSL) said that Sri Lanka will restructure its debt to prevent a severe default. Analyses of government policy initiatives, international geopolitical and economic trends, and the consequences from the Russia-Ukraine war suggest that there is uncertainty surrounding the Sri Lankan economy. This article will cover the origins, effects, and repercussions of the crisis. This essay aims to investigate how web-based mass media has reported on Sri Lanka's progression into the economic crisis that has developed over the previous several years.

OVERVIEW OF ECONOMIC CRISIS

The global financial crisis, which had been developing, began to manifest its impact in mid-2007 and continued into 2008. Stock markets globally have declined, significant financial organizations have failed or been acquired, and even the most affluent countries have implemented rescue plans to support their financial systems. Many are worried that the individuals causing financial issues are the ones receiving bailouts, yet a worldwide financial collapse will impact almost everyone in our interconnected society. The issue may have been prevented if proponents of the existing economic models were not so outspoken, powerful, and dismissive of others' perspectives and worries. An economic crisis refers to instances when certain financial institutions or assets see a significant and unexpected decrease in value. During the 19th and early 20th centuries, several financial crises were linked to banking panics, with many recessions occurring simultaneously with these panics. Financial crises may also refer to events like stock market collapses, the collapse of financial booms, currency crises, and sovereign defaults. Several economists have proposed ideas on the development and prevention of financial crises. Despite the lack of agreement, financial crises continue to happen often worldwide.

Several interpretations exist concerning the situation in Sri Lanka. There is an issue in the nation. Aside from policy, there are political issues beyond of Sri Lanka's influence that are sometimes attributed to destiny. The Sri Lankan people believes that China is accountable for numerous issues in Sri Lanka. Let's start with the policy. The current scenario is a consequence of years of mismanagement. Sri Lanka has a basic dilemma. The nation has a trade imbalance due to imports surpassing exports and expenditures exceeding profits. Furthermore, there is a fiscal imbalance. There is a dual debt. It is a perfect formula for catastrophe. Sri Lanka's reaction to this calamity has been calamitous. It has expanded its debt rather than decreasing its deficit. Colombo borrowed a substantial sum of money from other governments and entities. Sri Lanka's debt to GDP ratio is now 111%, indicating that the country's debt exceeds its annual economic output. In 2019, the Asian Development Bank highlighted this problem. The country was reported to have a budget deficit and insufficient output of tradable products and services.

ECONOMIC CRISIS IN SRI LANKA

During the first decade of the 21st century, the globe faced an unprecedented economic crisis that some believe has no historical parallel. The banking system's collapse, crucial for countries' economic activity, has led to various issues like unemployment, halted development, closure of industrial and business entities, decreased living standards, and a decline in global trade. The first indication of the worldwide economic crisis emerged in the U.S. home market sector in 2008. Since then, it has been disseminating to almost every country worldwide, including both developed and developing nations. Initially optimistic about avoiding the worst consequences of the depression, we are now seeing indications that we will also be impacted by it. Our economy is focused on export-import activities. We export various products like as tea, rubber, coconut, spices, ready-made clothing, and jewelry to generate the required foreign currency for the country's imports. The nations purchasing these items from us have been significantly impacted, leading to a continuous drop in demand. The plantation industry is starting to be affected by the crisis. Local industries have laid off their employees due to a lack of demand for their products on the global market. Migrant workers overseas are a significant sector that contributes important foreign money to their home country, crucial for its economic progress. They have also been at risk of losing their jobs due to the impending economic crisis in the nations where they are employed. Sri Lanka's economy has been vulnerable to the deteriorating global crisis due to this circumstance. In light of the negative impacts of the global economic crisis, we must develop our own solutions to overcome this stressful moment. Throughout history, there are many instances that show overcoming obstacles is achievable with confidence and bravery. If Japan and Germany, which were reduced to wreckage by the Second World War, could emerge, in a short time, as huge economic powers, we can limit the effect of the crisis if the government implements right budgetary measures and the country is armed with desire to conquer the challenge. Private sector businesses should not hastily close down due to a drop in demand for their goods in the global market. It is necessary to cut workers under the current situation. However, they should not consider a total closure. Efforts should be made to decrease overhead costs and daily operational expenditures via alternative solutions, allowing businesses to resume operations whenever circumstances improve.

Alternatively, they should transition to manufacturing products that may be sold in local markets (Annual Report, 2008). The internet has great potential to support struggling companies. Currently, the prevailing tendency is that a majority of office work is outsourced. There are several benefits to this approach of doing tasks. There is no need to maintain large offices and allocate funds to infrastructure. Tasks may be completed much more cost-effectively by hiring remote workers. Strikes do not interrupt the seamless workflow, and management is not required to provide EPF, ETF, and other additional benefits when outsourcing. Offices must keep a minimal skeleton staff under this arrangement. Why don't our local entrepreneurs approach this situation with a constructive mindset to overcome stress instead of permanently closing their businesses? It is time for us to consider our priorities. What is our primary focus? To exist as a country. It is necessary to distinguish between what is vital and what is not essential. It is crucial to save all foreign cash during this critical era to use it for necessary imports crucial for national existence. Observe your surroundings, and you will see the abundance of unnecessary commodities that have saturated the market. Even young schoolchildren are equipped with cell phones. Are these items crucial for their education? We need to reassess the open market policy in order to save foreign exchange and withstand this crisis. Leadership should set an example by doing what they teach, rather than just instructing others. Initially, they should reduce their spending and then encourage the general public to do the same. By refraining from indulging in leisurely trips overseas, the nation may save a significant sum of foreign currency during this period of shortage. This crisis has prompted us to conduct a timely assessment of nationalism against internationalism. Some argue that nationalism is outdated in today's interconnected world shaped by rapid advancements in digital technology. I do not intend to dispute this claim. We should not let internationalism dominate our national identity and create unnecessary dependence on the international community. It suggests we should strive to be self-sufficient wherever possible. If we behave this way, the nation can overcome this disaster, and the whole country will support the government if it believes that the leadership's intentions are focused on the overall welfare of the population. The impact of the economic crisis on South Asia. Sri Lanka's GDP decreased by 10.2%, a greater rate than India's.

UNDERLYING CAUSES OF ECONOMIC CRISIS

Some pessimistic views suggest that the current financial crisis could be the most significant since the 1930s, resulting in a severe decline in market activity, output, and employment, taking approximately a decade for global economies to recover. The present crisis differs from previous such disasters due to the increased interconnectedness among financial institutions. The crisis originated with low-quality home loans in the US, which escalated due to interdependence among banks lending money. Those institutions relied on other institutions. The crisis rapidly escalated and impacted financial institutions worldwide due to the global financial system being compromised by escalating risk-taking in pursuit of higher returns, and the utilization of complex tools like asset-backed securities and structured credit products. Both the markets and regulators were not fully cognizant of the potential risks posed by these practices to the stability of the financial system. Initially, decision-makers did not take the phenomena seriously. However, the rapid pace of economic and financial globalization in the last decade outpaced policy and regulatory adjustments, resulting in a banking crisis that affected many industrialized nations. The crisis escalated globally due to the absence of an international regulatory framework for financial institutions. Currently, these institutions function globally without an international regulatory framework. The crisis spreading internationally is not due to a flawed regulatory framework but rather because there is no global framework in place. This lack might result in a widespread crisis, prompting decision-makers to respond by creating global laws and adjusting national ones (Ajith Nivard, 2008).

CAUSES OF THE CRISIS IN SRI LANKA

Tax reductions and money creation

In 2019, ran for the presidential election. The administration plans to reduce taxes if they win the election and guarantee a decrease in the tax burden for individuals. How would the nation generate revenue in this scenario? Neither the people nor the current government showed concern. In November 2019, the current administration was elected with over 52% of the vote, leading to a subsequent implementation of substantial tax reductions. Sri Lanka's current president's implementation of significant tax reductions has led to a decline in government income and budgetary strategies, causing a substantial increase in budget deficits. The reforms included raising tax-free thresholds, which led to a 33.5% fall in the number of taxpayers, lowering VAT to 8%, decreasing corporation tax from 28% to 24%, abolishing the Pay As You Earn (PAYE) tax, and implementing a 2% "nation-building tax" to fund infrastructure development. The significant decrease in tax income has led rating agencies to lower the sovereign credit rating, which has made it more difficult to acquire further debt. The rating agencies voiced their worry. As a result, Sri Lanka's treasury will soon be depleted, and the government may face a financial crisis. As a result, investors withdrew from Sri Lanka, making it difficult for the government to get into global markets. The current President acknowledged the income loss in 2021 but saw it as a "investment" and plans not to raise taxes for another five years. The Central Bank started printing money rapidly to fund government spending, against the IMF's recommendation to stop printing money and instead increase interest rates and taxes while cutting expenses. The IMF warned that persistent money printing would lead to economic catastrophe. The CBSL reportedly printed 119.08 billion rupees in April 2022, the most amount printed on a single day for the whole year. In 2022, the total capital infused into the financial markets increased to Rs. 432.76 billion.

The external debt of Sri Lanka

Sri Lanka's foreign debt has increased twofold between 2010 and 2020. The foreign debt was at 42% of the GDP in 2019, but it has increased to 119% of the GDP in 2021. Sri Lanka anticipates repaying $4 billion to its creditors by the end of 2022, with government reserves totaling $2.3 billion as of April 2022. Commentaries accusing China of causing a financial crisis have been refuted by the Australian Lowy Institute, stating that Sri Lanka is not trapped in Chinese debt since China's share of the country's overall debt was just 10% in April 2021. Sri Lanka owes the bulk of its foreign debt to international capital markets, which make up 47% of the total debt stock. International development banks own an additional 22% of Sri Lanka's foreign debt, while Japan holds 10%. In January 2022, the President's office stated its intention to ask China to delay its debt obligations during discussions with the foreign minister. China has not issued a formal response as of March 2022. In 2020, a Global credit ratings organization said that Sri Lanka did not have enough funding sources to meet its debt payment obligations, which were estimated to be just over US$4.0 billion in 2021. Bellwether states that for Sri Lanka to address its financial issues in servicing its debt, the success of Treasury auctions is crucial. Once this is done, the foreign exchange issue will be immediately rectified. The government is accumulating more debt due to unsuccessful auctions of Treasury notes containing newly created cash. Bellwether suggests resolving the debt crisis in Sri Lanka by implementing a reliable fiscal plan, monetary policies, a tax increase to repay debt, reducing interest rates, and opening imports to increase tax revenue for the government. Raising interest rates and reducing domestic lending are excellent methods for acquiring dollars to repay foreign debt, but it is not feasible to sustain these actions over several years. Investors might recover trust if their foreign reserves expand after repaying debt, but it would be a challenging procedure with uncertain success due to present beliefs.

In September 2021, the government declared an economic emergency due to a depreciating national currency, increasing inflation caused by increased food costs, and pandemic-related limitations on tourism leading to a decrease in revenue. Sri Lanka's foreign reserves decreased to $1.9 billion in March 2022, which is inadequate to cover foreign debt payments of $4 billion and an ISB-International Sovereign Bond payment of $1 billion for 2022. The National Consumer Price Index (NCP) reported that the national inflation rate, as measured by the National Inflation Rate (NIR), increased to 17.5% in February 2022. The government disregarded the advice of economic analysts and specialists by repaying US $ 500 million in International Sovereign Bonds due in January, 2022, instead of postponing the payment to maintain foreign reserves. Sri Lanka said on April 12, 2022, that it would default on its foreign debt of $51 billion.

Agriculture crisis Sri Lanka

In April 2021, the present administration committed another mistake. Sri Lanka has declared a policy to only allow organic farming while prohibiting the use of artificial and agrochemical fertilizers. The government deems this to be advantageous for health. Several commentators expressed skepticism. Many people recognized that the primary problem was inadequate money, rather than health-related issues. Sri Lanka was conserving foreign reserves by prohibiting the importation of fertilizers. Nevertheless, this had an effect on agricultural productivity. The decline in tea output caused only by the fertilizer prohibition led to losses up to millions of dollars. Moreover, the government had to import rice because of a 20% decline in rice output in the first half of the year. Tea producers said that the industry is in a serious condition, asserting that organic cultivation is ten times more expensive and produces half the output compared to conventional farming. Despite receiving approval from its adviser, the project disregarded concerns from the scientific and agrarian sectors. They cautioned about a potential collapse in the agricultural sector due to the depreciation of the national currency, which had a detrimental impact on the tea business. The prohibition of artificial fertilizers and pesticides has led to a severe economic crisis, as the public anticipates a lack of revenue and food. The government dropped its aim to become the world's first organic-farming country in 2021 due to high food costs and protests. Despite the cancellation of these restrictions, the prohibition on urea imports remains in place. Sri Lanka intends to ration vital products during peacetime.

Tourism Sector Sri Lanka

The tourist sector in Sri Lanka had adverse impacts due to the Easter bombings of 2019 and the subsequent COVID-19 epidemic. If borders were blocked, visitors stopped coming, leading to a decline in tourism earnings. The tourist sector in Sri Lanka accounts for 13% of the nation's GDP. Tourists also contribute to the inflow of foreign currency. In 2020, Sri Lanka only received 173,000 visitors compared to 2018. The figure was 2.3 million. You observe the opening. In 2021, Sri Lanka's tourist earnings decreased to USD 2.8 billion. In April 2021, World Bank research said that despite the adverse effects of the COVID-19 epidemic on Sri Lanka's economy and its population, the economy is expected to rebound in 2021, but obstacles persist. Evidence of recuperation is already apparent. Encouraging proper taxes is essential to foster self-sufficiency and reduce dependence on foreign debt in the future. The existing social protection programs designed to aid those jobless as a result of the financial crisis have been considered effective. Economists suggest that the Sri Lankan economy needs an export-driven development plan, in addition to a well-organized taxation system, to overcome the present debt problem and achieve complete financial recovery.

Tea exports and tourism have been affected by the Russian-Ukrainian war

Sri Lanka's economic circumstances are now slow owing to the continued hostile situation between Russia and Ukraine resulting from the Russian-Ukrainian War. Sri Lanka has had increased economic difficulties as a result of the 2022 Russian invasion of Ukraine, given that Russia is the second largest market for Sri Lanka's tea exports. Sri Lanka's tourist business relies significantly on visitors from Russia and Ukraine. The Ukrainian crisis has halted economic progress in Sri Lanka, negatively impacting both the tea and tourist industries.

SRI LANKA'S STANCE ON THESE MATTERS

There is no one-size-fits-all solution for every sort of crisis, not only for Sri Lanka but for all nations facing a particular issue. The most effective approach to deal with such situations is to strategically use the negative impacts on the combination of policy elements in order to minimize the economic consequences. Sri Lanka needs to focus on: i) Preventing growing and potentially unsustainable deficits; ii) Increasing interest rates slightly to keep inflation low, in contrast to the policy in crisis-affected developed economies; iii) Implementing a cautious investment policy, particularly for large and somewhat risky state-funded manufacturing projects; iv) Enhancing and closely monitoring the domestic financial system, even if it appears stable and unaffected by contagion. Prevention is the most appropriate approach under current circumstances, rather than focusing on treating. Experts in the area agree that during a financial crisis with potential effects on the real economy, decision makers should prioritize avoiding populist actions. It is advised that measures should be conducted at three distinct levels based on the severity of the crisis and its consequences. 1. The IMF's suggested vulnerability indicators for the financial sector will provide a comprehensive overview of a country's financial and banking industry. It is advisable to employ inerrability metrics, even if the remainder of the industry is underdeveloped or relatively isolated from the global financial system. 2. Central Bank's actions to control the exchange rate and inflation. Exchange rate stability is vital for managing the economic impact of deteriorating terms of trade and declining exports.

Managing inflation may also assist in reducing the economic repercussions, especially in situations with credit issues. The IMF has suggested vulnerability indicators to oversee the government, financial, household, and business sectors. In times of economic strain, issues in one industry can have a ripple effect on other industries. Fears over the budget imbalance might potentially cause a sudden decrease in the exchange rate or erode trust in banks holding government debt, ultimately resulting in a financial crisis.

CONCLUSION

Lanka's government should implement measures to stimulate the economic recovery of the whole nation after the shortage of essential goods is resolved. The government has to collaborate with Tamil political leaders to create a plan for economic development in the eastern and northern regions affected by the civil conflict, particularly in areas heavily hit by the current situation. To limit borrowing, particularly sovereign borrowing from foreign sources, it is advisable to boost domestic tax collections and cut government expenditure. Stringent procedures are required to restructure the management of grants and subsidies. Indian assistance: India should not let the Chinese to gain control of expanding areas of territory in Sri Lanka. India should provide Sri Lanka with financial aid, policy suggestions, and investment opportunities from Indian business owners. Indian enterprises should establish supply chains that link the Indian and Sri Lankan economies, including the sale of tea and information technology services. India should lead Sri Lanka towards realizing its potential and benefiting from a stable neighbourhood. The Sri Lankan authorities need to prevent the present situation from being used to further smuggling and trafficking operations or incite sentiments in the nation. Turning a crisis into an opportunity: Strained ties between Sri Lanka and India are not possible. India has the obligation as a bigger nation. It is necessary to demonstrate patience and consistently and closely interact with Sri Lanka. It is crucial to improve development operations focused on people while avoiding any involvement in Lanka's internal problems. Sri Lanka is eager to implement significant financial and regulatory reforms due to the economic crisis. These measures aim to decrease the likelihood of a future crisis and minimize the effects of any future catastrophe, and they deserve full support from the public. The Sri Lankan government should implement the procedures stated above to facilitate the economic revival of the whole nation. Hoping for an early improvement in the foreign currency position via scheduled inflows from bilateral partners and future foreign exchange inflows without debt. Foreign currency receipts from the tourist sector and remittances are expected to increase soon. The inhabitants of Lanka are likely to get economic respite in the near future.

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