



ECONOMIC CRISIS IN SRI LANKA: AN OVERVIEW

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Abstract

Sri Lanka is passing through an acute economic crisis due to drain in foreign reserves which in turn has led in shortages of fuel, food, electricity, medicines, cement and other items in the country. Sri Lanka's expenditure was more than its national income. Due to lack of foreign currency, country was not in a condition to pay for imports of staple foods and fuel, leading to acute shortages and very high prices. Sri Lankan government is hopeful that with the policy measures initiated so far and with the relief from covid-19 situation, it would overcome the crisis soon. This paper throws light on the economic crisis of Sri Lanka, causes for crisis, impact of crisis on the people and on the country, foreign countries aid to Sri Lanka, Galle face struggle against dynastic rule, role of government and measures to overcome economic crisis.

Keywords: Acute Economic Crisis, Covid-19, Foreign Currency, Foreign Countries Aid, Galle Face Struggle

1. Introduction

The term economic crisis is applied to a variety of situations in which some financial institutions or assets suddenly lose their value. In the 19th and early 20th centuries, many financial crises were associated with banking panics and many recessions coincided with these panics. Other situations that are often called financial crises include stock market crashes and the bursting of other financial bubbles, currency crises, and sovereign defaults (Shibly, 2013). Developing countries were facing sovereign debt crisis and one among them is Sri Lanka. Sri Lanka's economy has been collapsed. It is suffering with ballooning debt, shrinking foreign reserves and there is no money for basic necessities. Sri Lanka's government mismanaged the funds as they spent more than National Income. Moreover, they allowed deep tax cut and destroyed the economy. In July, Human Rights Watch interviewed 20 people in Colombo who were struggling to get by on dwindling incomes, with inflation over 50 percent, and some necessities nearly unobtainable at times ("Sri Lanka: Economic crisis puts rights in peril", 2022).

History of Sri Lanka

Sri Lanka is an island country in the Indian Ocean being the 17th smallest country in Asia, located in the southeast of India. A country with a wide variety of cultures, beautiful and historical places, stunning natural wonders, and moreover its highest literacy rate. It is one of the nations which became independent on the 4th February, 1948 when Senanayake became the first Prime Minister. Sri Lanka is also called the pearl of the Indian Ocean (Dhangar, 2022).

1.1 Objective of the study

- ✚ To study the causes of economic crisis in Sri Lanka.
- ✚ To examine the impact of crisis on the people and on the country (Sri Lanka).
- ✚ To know the foreign countries, aid to Sri Lanka.
- ✚ To study the role of government (Sri Lanka).
- ✚ To study the measures to overcome economic crisis.

1.2 Research Methodology

The study is a qualitative research and data has been collected purely from secondary sources. They include research papers, books, newspapers, journals, reviews, and online resources.

1.3 Research Methodology

George, et al., (2022) in Partners Universal International Research Journal in June 2022 in their research paper titled, “Sri Lanka's Economic Crisis: A Brief Overview”, stated that Sri Lanka's economic crisis, has begun three years ago and it has given a greatest challenge to the people and the government. Sri Lanka is experiencing a severe economic, political, and inflation crisis. The ideal island is in trouble. Food, fuel, an adequate quantity of electricity, medications, etc. are unavailable. Over the past six months, at least 500,000 more Sri Lankans have plunged into poverty. Even life-saving surgery are being delayed because of a scarcity of medications and medical necessities. According to doctors, economic crisis-related deaths are more than Covid-19-related deaths. The provision of emergency health services has been significantly hampered. There is much more going on in Sri Lanka than just an economic downturn. This paper's authors claimed that a humanitarian catastrophe exists. They also stated that corruption, mismanagement of funds, Russia and Ukraine, wrong decision making with regards to funds are the reasons for economic crisis in Sri Lanka. Researchers stated that Sri Lankan government has to focus on proper decision making with regard to funds management, maintain reserves, and etc. They also stated that it would be better to increase domestic tax revenues and reduce government spending to restrict borrowing, especially sovereign borrowing from foreign sources.

Bhowmick (2022) in her writings states that although Sri Lanka was a low-income country in the 1970s, it gradually improved its economy. The mismanagement of Sri Lanka's economy has rendered the country's economy permanently crippled. This is the reason behind the current economic crisis. Additionally, he claims that Sri Lanka's economic problem has been worsened by the Covid-19 outbreak. The conflict between Ukraine and Russia, lower tax

structure in 2019, a sudden shift towards organic farming, a decline in tourism, and growing external debt are the reasons for the economic crisis in Sri Lanka.

1.4 Research Gap

While reviewing the above-mentioned review of literature, it was observed that there is a scarcity of studies examining the basic causes of economic crisis, impact of crisis on the people and on the country, people's protest against the government, foreign countries' aid to Sri Lanka, research related to the Galle Face struggle in 2022 is new to the research field, and measures to overcome the economic crisis in Sri Lanka must be studied. In this way, an article is written for this study to analyse the answers. Therefore, this research article attempts to bridge the meaningful knowledge gap in the research literature (Krishnamohan&Rifasha, 2023).

The Sri Lankan economy has been facing a crisis owing to a serious Balance of payment problem. Its foreign exchange reserves are depleting rapidly and it is becoming increasingly difficult for the country to import essential consumption goods (Sri Lanka's Economic Crisis, 2022). The current Sri Lankan economic crisis is the product of the historical imbalances in the economic structure, the International Monetary Fund (IMF)'s loan-related conditionalities and the misguided policies of authoritarian rulers (Sri Lanka's Economic Crisis, 2022).



Image1: Economic Crisis



Image 2: Central Bank of Sri Lanka

2. Causes for Economic Crisis in Sri Lanka

- ✚ The pandemic (Covid-19) induced slowdown
- ✚ The growing cost of borrowing
- ✚ Russia's invasion of Ukraine
- ✚ Covid-19 impact on Tourism sector
- ✚ Deep tax cuts in the nation
- ✚ Unemployment in the country
- ✚ Corruption at the high level
- ✚ Agricultural crisis (only allowing organic farming, banning inorganic fertilizers and argo chemicals-based fertilizers)
- ✚ National expenditure was more than national income which led to shortage of funds in the economy.

3. Impact of Economic Crisis on Sri Lanka

In 2021, the Sri Lankan Government officially declared the worst economic crisis in the country in 73 years. There was no fuel, food, electricity, cooking gas, medicines etc. Moreover, the prices of basic necessities available has been increased drastically. Sri Lanka is struggling to import goods due to its precarious foreign exchange reserves and mounting debt. In August 2021, a food emergency was declared and inflation for food is increased by 24.7% and non-food is 11%. Many restaurants were closed due to increase in the price of food. Due to lack of paper exams were postponed. The education of the students got affected very badly because of lack of foreign reserve to import paper. Sri Lanka is struggling with high inflation owing to the debt trap that it has found itself in. Due to shortage in medicines, surgeries were suspended and many other hospitals reduced large number of laboratory tests. Few state-run hospitals reported to be running out of life saving medicines. Sri Lanka's tourism revenue got worsen and crisis led textiles brands like Zara, mango & H&M to divert from Sri Lanka to India to place orders. Moreover, the telecast of entertainment and sports channel was suspended due to payment difficulties and also diplomatic relations were closed due to lack of foreign reserves.

4. World Bank Warns Developing Countries

World Bank warns of debt crisis for developing countries. 107 countries are at severe exposure to risk of Ukraine war. These 107 countries may encounter one of the three risks i.e., increase in food prices, increase in energy prices and increase in tougher financial countries. Among 107 countries, 69 countries can face all the three risks. In 69 countries, 25 are from Africa, 25 are from Asia Pacific and 19 are from Latin America. World Bank says 12 dozen developing countries could prove unable to serve their debt crisis (WION, 2022). Sri Lanka's crisis can mutate. The entire developing countries are at risk.



Image 3: Sri Lanka's Economic Crisis



Image 4: Sri Lanka's Food Emergency

5. Foreign Countries Aid to Sri Lanka

India committed a total of US\$2.415 billion in January, 2022 to help Sri Lanka get through severe financial obstacles brought on by paying off its foreign debt and a short of US dollars for trade. Sri Lanka obtained a US\$1 billion credit line from India on March 17, 2022 acting as a lifeline for the island nation to purchase critically needed necessities including food and

medicine. According to a report from 2 April, 2022 Indian traders have begun packing 40,000 tonnes of rice for immediate delivery to Sri Lanka. India had delivered 270,000 MT of gasoline to Sri Lanka as of April 6. India granted a new line of credit worth \$500 million for the purchase of petroleum products (Wikipedia contributors,2023). There were administrative challenges associated with certain shipments. The Singaporean government announced that it would give the Singapore Red Cross US\$100,000 in seed money as part of a relief package to aid in its public fundraising efforts for Sri Lanka's most vulnerable populations. The World Bank will provide \$300–\$600 in assistance to Sri Lanka for the purchasing of medicine and other necessities. India has given Sri Lanka a loan of almost \$300 billion since January, 2022.

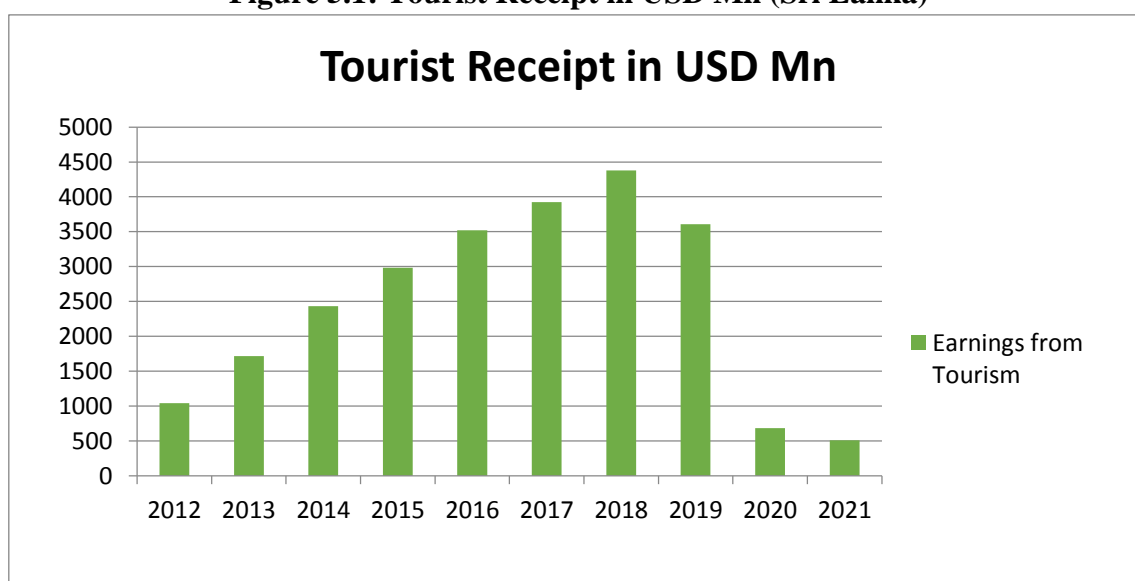
6. Results and Discussions

6.1 Tourism is the sector which makes revenue to the government

Table 5.1: Earnings from Tourism in USD Mn (Sri Lanka)

Tourist Receipts in USD Mn	
years	Earnings from Tourism
2012	1038.7
2013	1715.5
2014	2431.1
2015	2980.7
2016	3518.5
2017	3924.9
2018	4380.6
2019	3606.9
2020	682.4
2021	506.9

Figure 5.1: Tourist Receipt in USD Mn (Sri Lanka)



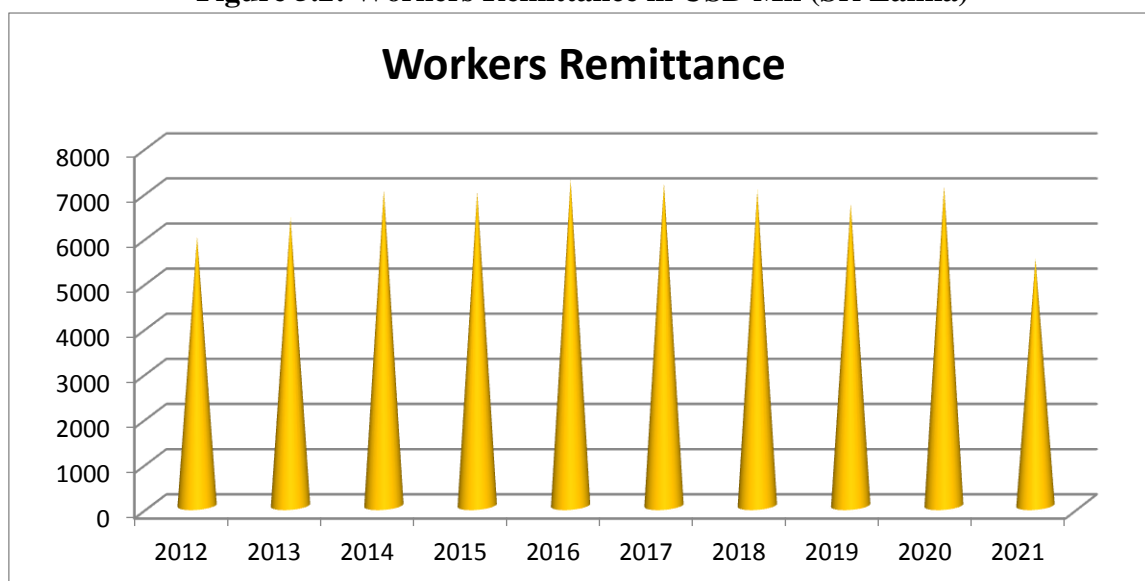
Interpretation: From the figure 1 it has been observed that in the year 2012 the receipt from tourism was \$1038.7 and in 2018 it increased to \$4380.6. Further it has been noticed that revenue has come down to \$682.4 in the year 2020 and \$506.9 in the year 2021. It has been analysed that the decline in the tourism revenue was due to covid-19 pandemic travel restrictions. Tourism helps in boosting the revenue of the economy and job opportunities. Tourism develops infrastructures and builds a cultural exchange between foreigners and citizens (*External Sector | Central Bank of Sri Lanka*).

6.2 Workers' remittance was defined in the Balance of Payments and International Investment Position Manual as transfer made by migrants employed and resident in the compiling economy to their relatives in their country of origin.

Table 5.2: Workers Remittance in USD Mn (Sri Lanka)

workers Remittance in Sri Lanka in USD Mn	
years	workers Remittance
2012	5985.3
2013	6407
2014	7017.8
2015	6980.3
2016	7241.5
2017	7164
2018	7015.4
2019	6717.2
2020	7103.9
2021	5491.5

Figure 5.2: Workers Remittance in USD Mn (Sri Lanka)



Interpretation: From the figure 2 it has been observed that in 2012 the workers remittance was \$5985.3 and in 2016 it was \$7164. In the year 2021 it has declined to due to massive unemployment problem. It has been further observed that in 2021 it declined to \$5491.5 and

it represents the largest source of foreign income decline for many developing economies (*External Sector / Central Bank of Sri Lanka*).

6.3 Inflation

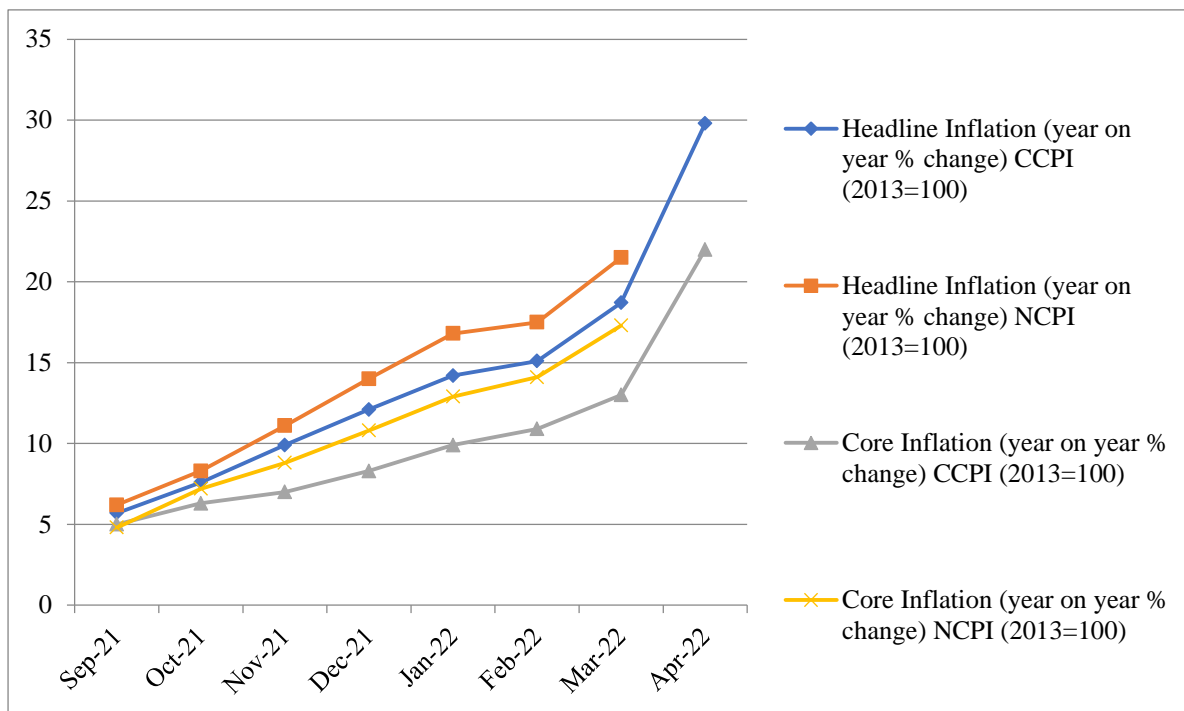
Inflation means increase in prices over a given period of time. Inflation is a measure, such as the overall increase in prices or the increase in the cost of living in a country. Headline inflation is the raw inflation figure reported through the Consumer Price Index (CPI). The CPI determines inflation by calculating the prices on a fixed basket of goods. Core inflation removes the CPI components that can reflect large amounts of volatility from month to month. Core inflation means change in the costs of goods and services and it excludes food and energy sectors. Food and energy prices are exempted during calculation as their prices can be highly volatile. The Department of Census and Statistics (DCS) has been releasing Colombo Consumer Price Index (CCPI) covering the urban areas of Colombo district. The latest Consumer Price Index (CPI) released by the DCS is National Consumer Price Index (NCPI).

Table 5.3: Sri Lanka Inflation Rate (Central Bank of Sri Lanka, 2022)

Month		Sep 21	Oct 21	Nov 21	Dec 21	Jan 22	Feb 22	Mar 22	Apr 22
Headline Inflation (Year on year % change)	CCPI (2013=100)	5.7	7.6	9.9	12.1	14.2	15.1	18.7	29.8
	NCPI (2013=100)	6.2	8.3	11.1	14.0	16.8	17.5	21.5	-
Core Inflation (Year on year % change)	CCPI (2013=100)	5.0	6.3	7.0	8.3	9.9	10.9	13.0	22.0
	NCPI (2013=100)	4.8	7.2	8.8	10.8	12.9	14.1	17.3	-

Source: Department of Census and Statistics

Figure 5.3: Sri Lanka Inflation Rate (Central Bank of Sri Lanka, 2022)



Interpretation: From the Figure 3 it has been observed that headline inflation (CCPI) has rapidly increased from 5.7 in September, 2021 to 29.8 in April, 2022. Headline inflation (NCPI) increased from 6.2 in September, 2021 to 21.5 on March, 2022. Core inflation (CCPI) has increased from 5.0 in September, 2021 to 22.0 in April, 2022 it has been observed that core inflation (NCPI) has increased from 4.8 in September 2021 to 17.3 in March 2022. This increase is due to lack of foreign currency reserves which led the country unable to pay for imports of staple foods and fuel, leading to shortages of essential items and increase in prices.

Table 5.4: Monetary Sector Developments (Provisional) (Central Bank of Sri Lanka, 2022)

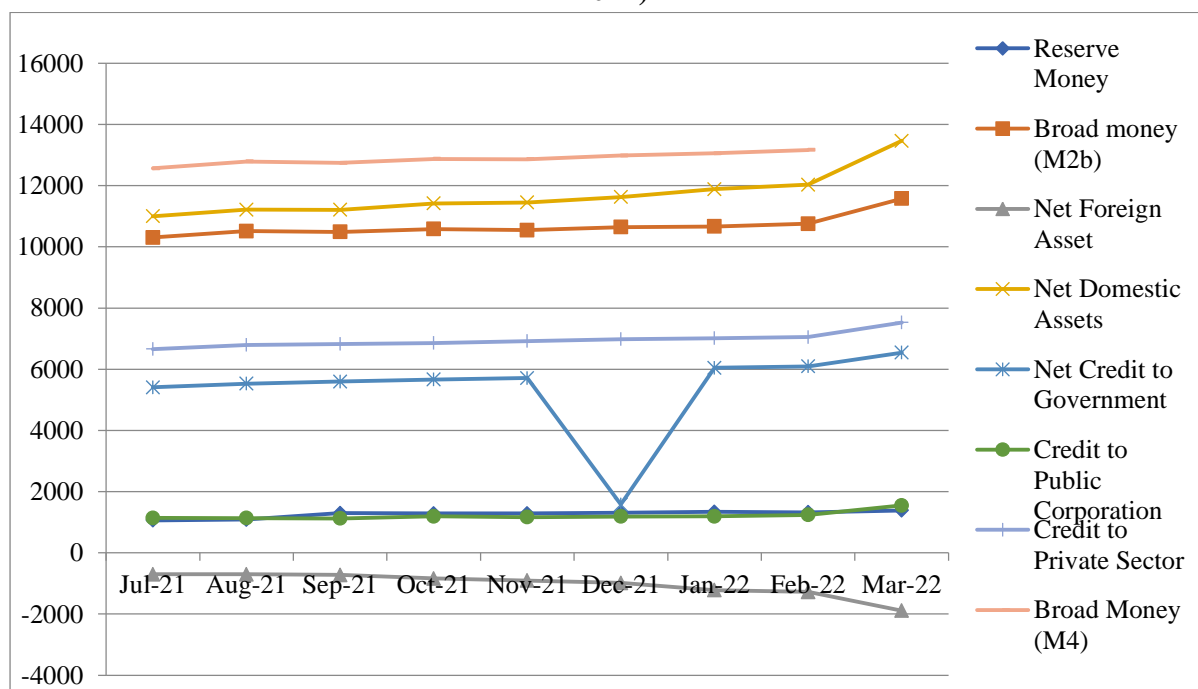
Indicator	Outstanding Amount (Rs. billion)								
	Jul 21	Aug 21	Sep 21	Oct 21	Nov 21	Dec 21	Jan 22	Feb 22	Mar 22 (a)
Free-form Ship Reserve Money	1,064	1,089	1,296	1,286	1,288	1,306	1,337	1,324	1,387
Broad Money (M _{2b})	10,304	10,514	10,488	10,582	10,546	10,647	10,668	10,755	11,575
Net Foreign Assets (NFA)	(699)	(701)	(722)	(837)	(906)	(982)	(1,216)	(1,275)	(1,889)
Net Domestic Assets (NDA)	11,003	11,215	11,210	11,418	11,452	11,629	11,883	12,030	13,464
Net Credit to the Government (NCG)	5,411	5,531	5,595	5,665	5,714	5,832	6,045	6,094	6,543
Credit to Public Corporations / SOBEs	1,141	1,137	1,123	1,194	1,185	1,188	1,192	1,238	1,548
Credit to the Private Sector	6,661	6,796	6,825	6,860	6,920	6,981	7,017	7,051	7,529
Broad Money (M ₄)	12,563	12,790	12,742	12,873	12,862	12,985	13,058 (b)	13,167	-

(a) The sharp depreciation of the Sri Lanka rupee in March 2022 remains the key reason for the augmentation of monetary and credit aggregates in rupee terms in March 2022

(b) Revised

Source: Central Bank of Sri Lanka

Figure 5.4: Monetary Sector Developments (Provisional) (Central Bank of Sri Lanka, 2022)



Interpretation: From the figure 4, it has been observed that expansion of broad money growth has been weighed down by the contraction in net foreign assets (NFA) of the banking system. It is envisaged that the elevated interest rate structure would attract more deposits into the banking system. However, the expansion of domestic credit, particularly to the

private sector, would remain restrained due to the pass through of the significantly tight monetary policy measures. Meanwhile, yields on government securities, which increased considerably in the recent past, are expected to moderate and stabilise at lower levels in the period ahead with the necessary fiscal adjustments together with renewed efforts to restore political stability in the country.

7. Galle Face struggle against Dynastic rule

Unfortunately, Sri Lanka has not adopted the rule of law or respected fundamental rights even after the civil conflict ended in 2009. The fundamental rights of the minority population were violated while the pluralistic worldview was denied. Politically speaking, ethnic and religious ideas grew to encompass the political culture.

The Rajapaksa family used the extension of win the 2020 parliamentary elections and take control of the government in the 2019 presidential election. When the Rajapaksa family came to power, they posed a threat to minorities and their fundamental rights. The Galle Face Struggle has demonstrated the negative effects of the Rajapaksa family's rule over Sri Lanka without taking into account and honouring the fundamental rights of the minority population as well as Sri Lankans as a whole. Owing to the lack of essential necessities like fuel and petrol, Sri Lankans organised rallies to draw attention to their constitutional rights. Sri Lankans joined them in their fight against the government, and organisations and lawyers supported them in their fight for basic necessities. Moreover, no action was taken by the government to resolve the fundamental right issues of Sri Lankans.

People in Sri Lanka have insisted that the "restriction by the rulers on taking them to the streets to fight for their democratic rights" is a violation of their fundamental rights, and National and International Human Rights Organisations, nations and organisations that respect human rights have raised their voices in opposition.

Along with other individuals and organisations, the Galle Face protesters attempted to "structurally transform" Sri Lanka's political culture. The movement also highlighted problems with economic and social inequity as well as human rights in Sri Lanka. For the Galle Face Protest, a large number of students, political parties, labour unions, artists, civil society activists, and independent youth came together.

The government established by President Gotabaya Rajapaksa, Prime Minister Mahinda Rajapaksa, Basil Rajapaksa, and their allies was called into question by the Galle Face demonstrators, who demanded its dissolution and the transfer of power to the next generation. They appeared to think that by doing this, they could bring about systemic change. Up until people are certain that fundamental goals and future well-being are guaranteed by constitutional amendments and it is crucial to concentrate on this effort.

In order to keep the country running smoothly, the main goals of this conflict are to restrict the president's power, establish a parliamentary system of government, hold officials accountable, change the electoral system, and prevent corrupt politicians from being elected to parliament (Constantine, 2022).

Economic Crisis in Sri Lanka is Driving People Into:

- Below the poverty line
- Scarcity of food
- Lack of education
- Lack of medical services
- Poor standard of living

8. Measures to overcome Economic Crisis in Sri Lanka

- ✚ Sri Lanka should increase accountability and transparency, review terms of lending with certain creditors and it has to increase agricultural productivity to cope up financially.
- ✚ It has to manage borrowings and lending better. Creditors should offer contingent plans and pause repayments during financial difficulties.
- ✚ Sri Lanka has to introduce better ways to manage shocks. Low-income nations vulnerable to external crisis and high proportion of debt is in foreign currency. They have to develop mechanism to insulate nations from shocks.
- ✚ It has to reduce borrowings; improve tax collection and they should increase job opportunities in non-farming sectors.
- ✚ Proper measures must be taken to solve a problem that goes unreported, it prone to long unregulated hours, low pay and low productivity.
- ✚ Good education has to be provided to Sri Lankans to use their skills for industrialization, tourism and agricultural sectors.
- ✚ It would be best to raise domestic tax revenue and shrink government expenditure to limit borrowing, particularly sovereign borrowing from external sources.
- ✚ Sri Lankan government should focus and work with banks, financial institutions and establish social protection system.
- ✚ They should obtain debt relief and also ensure fair taxation and address corruption of government.
- ✚ They have to emerge from the current economic crisis and improve long-term growth prospects, Sri Lanka needs to enhance fiscal and debt sustainability, and implement growth enhancing structural reforms.

Debt crisis is a security issue. Relief comes too little or too late. We need pre-emptive action. Any crisis can have a domino effect and it is an unstoppable chain reaction. Sri Lanka may be beginning. There is no saying where it ends.

9. Message to Other Developing Countries

Developing countries have to focus on implementing economic policies and procedure. They have to reduce borrowing from other countries and they have to concentrate on increasing exports compared to imports. Developing nations should focus on developing infrastructure, tourism, foreign reserves, tax policies, agricultural sector, etc.

10. Conclusion

The Sri Lankan government is hopeful and positive that the foreign reserves will improve soon. It is expected that the foreign exchange earnings from the tourism sector and agriculture improves soon. It is also expected that employment and investment in trade improves. If government stabilize with financial solution, then work and life could return to normal condition. Sri Lanka has to focus on accountability, transparency, and proper management of foreign reserves. Sri Lanka needs help from International Monetary Fund and World Bank to come out of economic crisis. It needs support from countries like India, China and the U.S and also needs large-scale, long-term economic restructuring for better future.

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