



Author: Niraj Neupane (Chartered Accountant, MA Economics)

FISCAL STABILITY OF NATIONS: SRI LANKAN ECONOMIC CRISIS

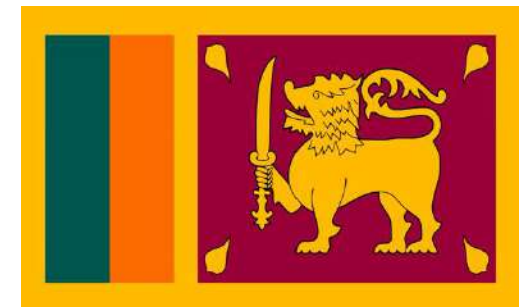


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ECONOMIC CRISES CAUSING FACTORS

1. **External Debt:** High levels of external debt can pose a significant risk to a country's fiscal stability. If a nation struggles to meet its debt obligations, it may face a debt crisis.
2. **Balance of Payments Issues:** A persistent trade deficit, where a country imports more than it exports, can lead to a depletion of foreign exchange reserves and pressure on the currency.
3. **Political Instability:** Political instability or uncertainty can negatively impact investor confidence and economic performance. Consistent and effective policies are crucial for economic stability.

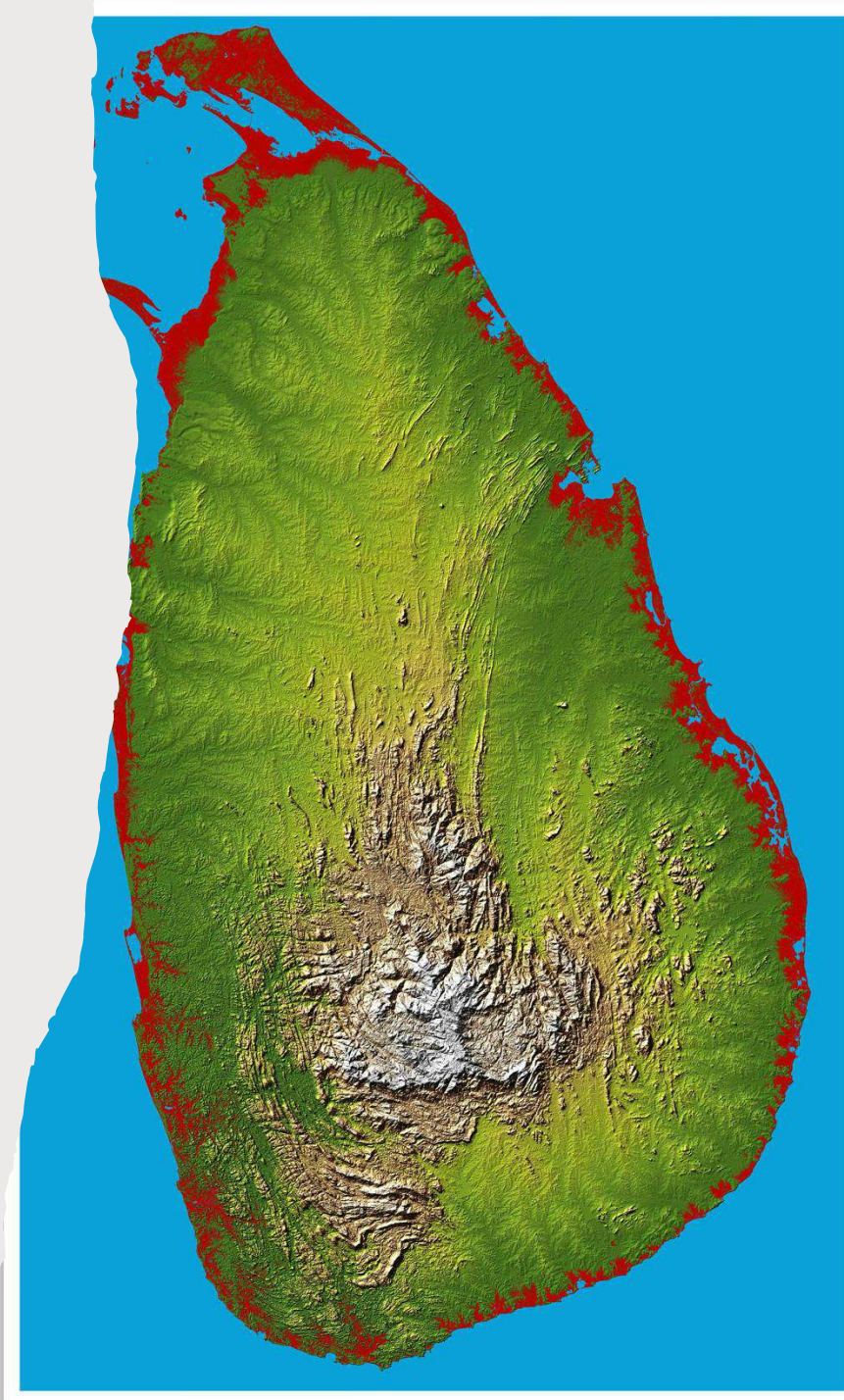


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4. **Currency Depreciation:** A rapid depreciation of the national currency can lead to higher inflation and make it more challenging to service foreign debt.
5. **Inflationary Pressures:** High and uncontrollable inflation can erode the purchasing power of the currency and negatively impact the overall economy.
6. **External Shocks:** Events such as natural disasters, global economic downturns, or other external shocks can adversely affect a nation's economy.
7. **Structural Issues:** Issues such as inefficient governance, corruption, and inadequate infrastructure can hinder economic development and stability.

BACKGROUND

1. According to W. A. Wijewardena, a former Deputy Governor of the Central Bank of Sri Lanka, the country was a long way into an economic crisis in 2015.
2. Prime Minister Ranil Wickremesinghe in 2015 had presented a strong economic policy to address the situation, government could not pushed policy through Parliament, that lead further policy confusion in the coming months.
3. The Institute of Policy Studies of Sri Lanka's 2014 State of the Economy Report highlighted hot money, worrying borrowing practices, temporary and superficial quick-fixes and monopoly of foreign direct investment flow into the hospitality sector.



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4. The 2019 Central Bank Bill was drafted to make the Central Bank independent from political influence by banning the Treasury Secretary and any member of the Government from becoming members of the Monetary Board.
5. Money printing was also to be banned under this bill, as it states: "The Central Bank shall not purchase securities issued by the government, by any government-owned entity, or any other public entity in the primary market."
6. Many experts compared Lebanon's economic situation with that of Sri Lanka and had warned that Sri Lanka too was on the way to defaulting on its sovereign bonds.
7. To reduce the inflation and control the economy crisis in April 2022, Weerasinghe was appointed as the 17th Governor of the Central Bank of Sri Lanka (CBSL).

SRI LANKA ECONOMIC CRISIS

1. The Sri Lankan economic crisis is an ongoing crisis in Sri Lanka that started in 2019. It is the country's worst economic crisis since its independence in 1948.
2. It has led to unprecedented levels of inflation, near-depletion of foreign exchange reserves, shortages of medical supplies, and an increase in prices of basic commodities.
3. The crisis is said to have begun due to multiple compounding factors like tax cuts, money creation, a nationwide policy to shift to organic or biological farming, the 2019 Sri Lanka Easter bombings, and the impact of the COVID-19 pandemic in Sri Lanka.



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4. The subsequent economic hardships resulted in the 2022 Sri Lankan protests. Sri Lanka received a lifeline in the form of an Indian line of credit amounting to \$4 billion. This substantial credit infusion served to cover the costs of importing essential goods and fuel.
5. Sri Lanka had been earmarked for sovereign default, as the remaining foreign exchange reserves of US\$1.9 billion as of March 2022 would not be sufficient to pay the country's foreign debt obligations for 2022, with \$4 billion to be repaid.
6. In April 2022, the Sri Lankan government announced that it was defaulting, making it the first sovereign default in Sri Lankan history since its independence in 1948 and the first state in the Asia-Pacific region to enter sovereign default in the 21st century.
7. In June 2022, then Prime Minister Ranil Wickremesinghe said in parliament that the economy had collapsed, leaving it unable to pay for essentials. In September 2022, a United Nations report said that the economic crisis is a result of officials' impunity for human rights abuses and economic crimes.
8. According to the Sri Lankan finance ministry, the country's foreign reserves had grown by 23.5% from US\$1.7 billion in September 2022 to US\$2.1 billion in February 2023, representing a US\$400 million increase.

CAUSES OF ECONOMIC CRISIS

1. *Tax cuts and money creation*
2. *External Debt*
3. *Debt trap*
4. *Fall of foreign remittances*
5. *Fall of Tourism*
6. *Agricultural crisis*
7. *Russia-Ukraine War*
8. *Corruption & Impunity*



1. Tax cuts and money creation

1. The Government of Sri Lanka under president Gotabaya Rajapaksa made large tax cuts that affected government revenue and fiscal policies, causing budget deficits to soar.
2. These cuts included increased tax-free thresholds that resulted in a 33.5% decline in registered taxpayers, reducing VAT to 8%, reducing corporate tax from 28% to 24%, the abolishment of the Pay As You Earn (PAYE) tax and the 2% “nation-building tax” which financed infrastructure development.
3. The massive loss of tax revenue resulted in rating agencies downgrading the sovereign credit rating making it harder to take more debt. In 2021 P. B. Jayasundera stated that President Rajapaksa was aware of the loss of revenue but considered it an "investment" and had no plans of increasing taxes for another 5 years.



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4. To cover government spending, the Central Bank began printing money in record amounts ignoring advice from the International Monetary Fund (IMF) to stop printing money and instead hike interest rates and raise taxes while cutting spending.
5. Former Finance Minister Mangala Samaraweera who noted that as the Sri Lankan government already had far less tax revenue relative to most countries which combined with its high debt load tax cuts would be dangerous.
6. Samaraweera predicted that "If these proposals are implemented like this not only will the entire country go bankrupt, but the entire country will become another Venezuela or another Greece."
7. On 6 April 2022, the CBSL allegedly printed 119.08 billion rupees, making it the highest reported amount printed on a single day by the CBSL for the year 2022. The total money added to financial markets for the year 2022 increased to Rs. 432.76 billion.

2. External Debt

- i. **Shift in Debt Source:** Until the mid-2000s, Sri Lanka's debt was mostly from multilateral lending agencies but shifted to foreign investors and lenders under Mahinda Rajapaksa's leadership.
- ii. **First International Sovereign Bond (2007):** Sri Lanka issued its first international sovereign bond in 2007 with high interest rates to attract investors, but funds were often directed toward vanity projects rather than essential national projects.
- iii. **Substantial Increase in Foreign Debt:** Sri Lanka's foreign debt grew from \$11.3 billion in 2005 to \$56.3 billion in 2020.
- iv. **Debt-to-GDP Surge:** Foreign debt, which was 42% of GDP in 2019, skyrocketed to 119% of GDP by 2021.



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- v. Excessive Borrowing Post-2008:** Sri Lanka took advantage of low global interest rates due to Western quantitative easing to borrow heavily through low-interest International Sovereign Bonds (ISBs).
- vi. Rising Borrowing Costs After 2013:** As the US wound down quantitative easing, Sri Lanka's borrowing costs sharply increased, doubling interest rates for short-term loans and significantly raising long-term rates.
- vii. Economic Emergency in 2021:** By 2021, falling foreign reserves, inflation from rising food prices, and a drop in tourism income pushed Sri Lanka toward bankruptcy.
- viii. Debt Default in 2022:** Despite warnings, the government repaid a \$500 million ISB in January 2022 but eventually defaulted on \$51 billion in external debt in April 2022 due to insufficient reserves.

3. Debt trap

- i. **Debt-Trap Diplomacy Concerns:** The U.S. administrations of Trump and Biden, along with the Institute for Security and Development Policy, raised concerns about Chinese debt-trap diplomacy in Sri Lanka, although Mahinda Rajapaksa denied this, stating China gave concessionary loans for infrastructure.
- ii. **Deborah Bräutigam's Dispute:** Bräutigam challenged the term "debt-trap diplomacy," citing that the Hambantota Port project was based on a Canadian feasibility study and stating that Sri Lanka did not default on Chinese loans. She emphasized that the port was not a major factor in Sri Lanka's financial distress.
- iii. **Strategic-Trap Diplomacy:** Sri Lankan academic Asanga Abeyagoonasekera coined the term "strategic-trap diplomacy," highlighting the strategic risks of Chinese involvement in Sri Lanka, first mentioned in a 2021 interview with Voice of America.



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- iv. Chatham House's Conclusion:** A 2020 Chatham House paper attributed Sri Lanka's debt crisis to domestic policy decisions and Western lending, rather than Chinese government policies, despite the focus on Chinese involvement.
- v. Sri Lanka's Debt Composition:** The Lowy Institute reported that Sri Lanka's debt is mainly held by international capital markets (47%), multilateral banks (22%), and Japan (10%), rather than China, debunking claims of a Chinese debt trap.
- vi. Public Perception:** Cartoons in local media and Indian observers highlighted Sri Lanka's financial struggles, with concerns about projects like the Colombo Port exacerbating the debt crisis.

4. Fall of foreign remittances

- i. **Currency Pegging and Money Printing:** Under Governor Cabraal, the Central Bank of Sri Lanka tried to maintain a pegged exchange rate for the rupee while printing money heavily, leading to a significant depreciation of the rupee in the unofficial market.
- ii. **Credibility and Remittance Crisis:** The official pegged rate of Rs. 200 to the dollar was far below the market rate (Rs. 248+), damaging Sri Lanka's credibility with lenders and causing a 61% drop in official remittances as foreign workers used unofficial channels.



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- iii. Controversial Policies:** Cabraal threatened to freeze bank accounts using unofficial money channels and imposed strict dollar conversion rules on exporters and residents, sparking further concerns about a remittance-like crisis for export earnings.
- iv. Criticism of "Cabraalnomics 2.0":** Former Deputy Governor W.A. Wijewardana criticized these policies, arguing that they undermined the Central Bank's authority as exporters and workers shifted to the black market, worsening the forex shortage.

5. Tourism

- i. **Tourism's Significance:** Sri Lanka's tourism sector contributed over 10% to the country's GDP, making it a crucial part of the economy.
- ii. **Impact of Easter Bombings and COVID-19:** The 2019 Easter bombings severely impacted tourism, and the COVID-19 pandemic further hindered recovery efforts.
- iii. **Tourism Revenue Decline:** Tourism earnings fell from \$4.4 billion in 2018 (5.6% of GDP) to just 0.8% of GDP in 2020 due to the pandemic.
- iv. **Failed Economic Recovery Prediction:** In April 2021, the World Bank incorrectly predicted that Sri Lanka's economy would recover despite the pandemic's toll, though challenges persisted.



6. Agricultural crisis

- i. **Self-Sufficiency in Rice:** Sri Lanka was self-sufficient in rice, importing only specialty rice like Basmati. In April 2021, President Gotabaya Rajapaksa banned inorganic fertilizers and agrochemicals, mandating organic farming across the country.
- ii. **Ignored Warnings:** While the program was supported by advisors, the scientific and farming communities warned of farming collapse and a financial crisis, especially in the tea industry, due to currency devaluation and low yields.
- iii. **Impact on Tea Industry:** The tea industry, crucial to Sri Lanka's economy, faced severe challenges, with organic farming being ten times more expensive and yielding only half the normal output.



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- iii. **Chemical Fertilizer and CKDu:** Rajapaksa and his advisors linked chemical fertilizers to chronic kidney disease (CKDu), but scientific research suggested water hardness from fluoride and magnesium, combined with high heat, as the likely cause.
- iv. **Severe Economic Crisis:** The fertilizer and pesticide ban triggered a severe economic crisis, with concerns over food shortages and loss of income for farmers.
- v. **Abandonment of Organic Plan:** In November 2021, following rising food prices and public protests, the government abandoned its goal of becoming the world's first organic farming nation.
- vi. **Yala Season Failure:** By May 2022, the government predicted a 50% failure in Yala season cultivation due to fertilizer shortages, warning that rice stocks would last only until September.

7. Russia-Ukraine War

- i. **Russian Invasion's Impact:** The 2022 Russian invasion of Ukraine worsened Sri Lanka's already struggling economy.
- ii. **Hit to Tea Exports and Tourism:** Russia, Sri Lanka's second-largest tea export market, and the reliance on Russian and Ukrainian tourists severely impacted both sectors due to the war.
- iii. **Economic Recovery Stalled:** The conflict disrupted Sri Lanka's path to economic recovery, as both the tea and tourism sectors were heavily affected.
- iv. **Zelensky's Accusation:** On 13 July, Ukrainian President Volodymyr Zelensky blamed Russia for exacerbating Sri Lanka's economic crisis, contributing to the global food crisis and fueling inflation.



8. Corruption & Impunity

- i. **UN Report Findings (September 2022):** A UN report indicated that the Sri Lankan government's impunity for human rights violations and economic crimes significantly contributes to the country's ongoing economic crisis.
- ii. **Corruption Perceptions Index Ranking:** Sri Lanka's government ranks 102nd out of 180 countries on Transparency International's Corruption Perceptions Index (CPI), reflecting widespread corruption and inefficiency within public institutions.
- iii. **Impact of Government Corruption:** Systemic corruption within the Sri Lankan government is linked to misappropriation of public funds, inefficient resource allocation, and a failure to effectively address economic challenges, deepening the crisis.
- iv. **Erosion of Public Trust:** The government's perceived corruption undermines public trust, making it difficult to implement effective reforms and exacerbating the financial instability facing the nation.



IMPACTS OF ECONOMIC CRISIS



1. *Electricity and fuel shortages*
2. *Education and Health*
3. *Inflation*
4. *Tourism*
5. *Exports*
6. *Entertainment and sports*
7. *Diplomatic relations*



1. Electricity and fuel shortages

- i. Consumption Declines:** Sri Lanka's economic crisis has led to significant declines in electricity, fuel, and cooking gas consumption due to shortages.
- ii. Government Measures:** Finance Minister Basil Rajapaksa urged all government authorities to turn off street lights until at least the end of March 2022 as a measure to conserve electricity.
- iii. Fuel Shortages and Long Queues:** Long queues at petrol stations became common, exacerbated by rising global oil prices, leading to severe fuel shortages across the country.
- iv. Daily Power Cuts:** To manage energy conservation, authorities imposed daily power cuts, initially lasting up to seven hours, which were later reduced to three hours by July 2022.



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- v. Military Deployment:** On 22 March 2022, the government ordered military personnel to be stationed at gas and fuel filling stations to manage public tensions and assist with fuel distribution.
- vi. Impact on Publications:** Due to paper shortages and rising costs, newspapers such as *The Island* and *Divaina* halted print publication and transitioned to e-papers.
- vii. Suspension of Fuel Sales:** On 28 June 2022, the government suspended fuel sales to non-essential vehicles, allowing only buses, trains, and vehicles for medical services and food transportation to access fuel.
- viii. Aviation Fuel Shortages:** The shortage of aviation fuel forced Sri Lankan Airlines to make refueling stopovers in Chennai, India, for long-haul flights, impacting other international airlines operating in and out of Sri Lanka.

2. Education and Health

- i. Postponement of Examinations:** In March 2022, several schools in Sri Lanka indefinitely postponed term and mid-year examinations due to paper shortages, primarily caused by a lack of foreign reserves to import paper.
- ii. School Reopening:** Government-owned public and state-approved private schools reopened on 25 July 2022 after being closed for a month due to fuel shortages.
- iii. Suspension of Surgeries:** On 29 March, scheduled surgeries at Peradeniya Teaching Hospital were suspended due to a shortage of medicines, with many other hospitals following suit and reducing routine surgeries and laboratory tests.



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- iv. Critical Medicine Shortages:** State-run hospitals reported running out of life-saving medicines, prompting the Sri Lanka Medical Council to warn of a catastrophic rise in deaths that could exceed the combined toll of COVID-19, the 2004 tsunami, and the Civil War without urgent replenishment of supplies.
- v. International Humanitarian Crisis Warning:** The Singapore Red Cross Society declared Sri Lanka's medical crisis an "unprecedented humanitarian crisis."
- vi. Medical Supply Shortages:** By 10 April, hospitals began to run out of essential medical supplies, including endotracheal tubes for newborns and children, while the Sri Lanka Medical Association reported that hospitals had no access to imported medical tools and vital drugs.
- vii. Reuse of Medical Equipment:** Doctors were forced to reuse old and used medical equipment due to shortages, and some performed surgeries using mobile phone lights.
- viii. Challenges in Rural Areas:** In rural regions, doctors faced extreme difficulties, stitching wounds in the dark due to rolling power cuts, and emergency drugs for treating heart attacks were also reported to be in short supply.

3. Inflation , Tourism & Exports

- i. **Current Inflation Rates:** As of February 2022, Sri Lanka faced an inflation rate of 17.5%. Food inflation was particularly severe, rising to 24.7%, while non-food items experienced an 11% increase.
- ii. **Significant Price Increases:** From February 2021 to February 2022, local red chilis surged by 60%, local potatoes by 74.8%, and Nadu rice by 64%, indicating a drastic rise in essential food costs.
- iii. **Traveler Warnings:** In March 2022, both the United Kingdom and Canada issued advisories to their citizens to exercise caution when traveling to Sri Lanka due to the deteriorating economic conditions.



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- iv. Impact on Tourist Arrivals:** The economic crisis, compounded by global events, led to a decline in tourist arrivals, which further strained the economy reliant on tourism.
- v. Textile Industry Impact:** Major textile brands, including Zara, Mango, and H&M, shifted their orders from Sri Lanka to India due to the prevailing economic crisis, affecting the country's export revenue.
- vi. Tea Export Surge to India:** As Sri Lanka's economic and political situation worsened, India saw a significant increase in overseas orders for tea products, capitalizing on Sri Lanka's challenges.

4. Entertainment and sports

- i. **Suspension of Foreign Channel Telecasts:** Leading internet protocol television service provider SLT PEO TV temporarily halted the broadcasting of foreign channels due to payment difficulties arising from the dollar crisis and the broader economic crisis in Sri Lanka.
- ii. **Indian Premier League Disruptions:** The 2022 edition of the Indian Premier League was stopped midway, as Sri Lanka struggled to make payments to the host broadcaster, Star Sports.
- iii. **Impact on Sports and Athletes:** The decline in dollar reserves severely affected the livelihoods of sportspeople in Sri Lanka, with many national sports associations unable to send teams to international events, including the upcoming Asian Games and Commonwealth Games.



5. Diplomatic relations

- i. **Closure of Diplomatic Missions:** In January 2022, Sri Lanka temporarily closed its High Commission in Nigeria and consulates in Germany and Cyprus due to a lack of foreign reserves, reflecting the strain on the country's diplomatic operations.
- ii. **Further Embassy Closures:** In March 2022, Sri Lanka's embassies in Iraq and Norway, as well as its consulate in Australia, were also closed, further indicating the challenges faced by the government in maintaining diplomatic relations amid the economic crisis.



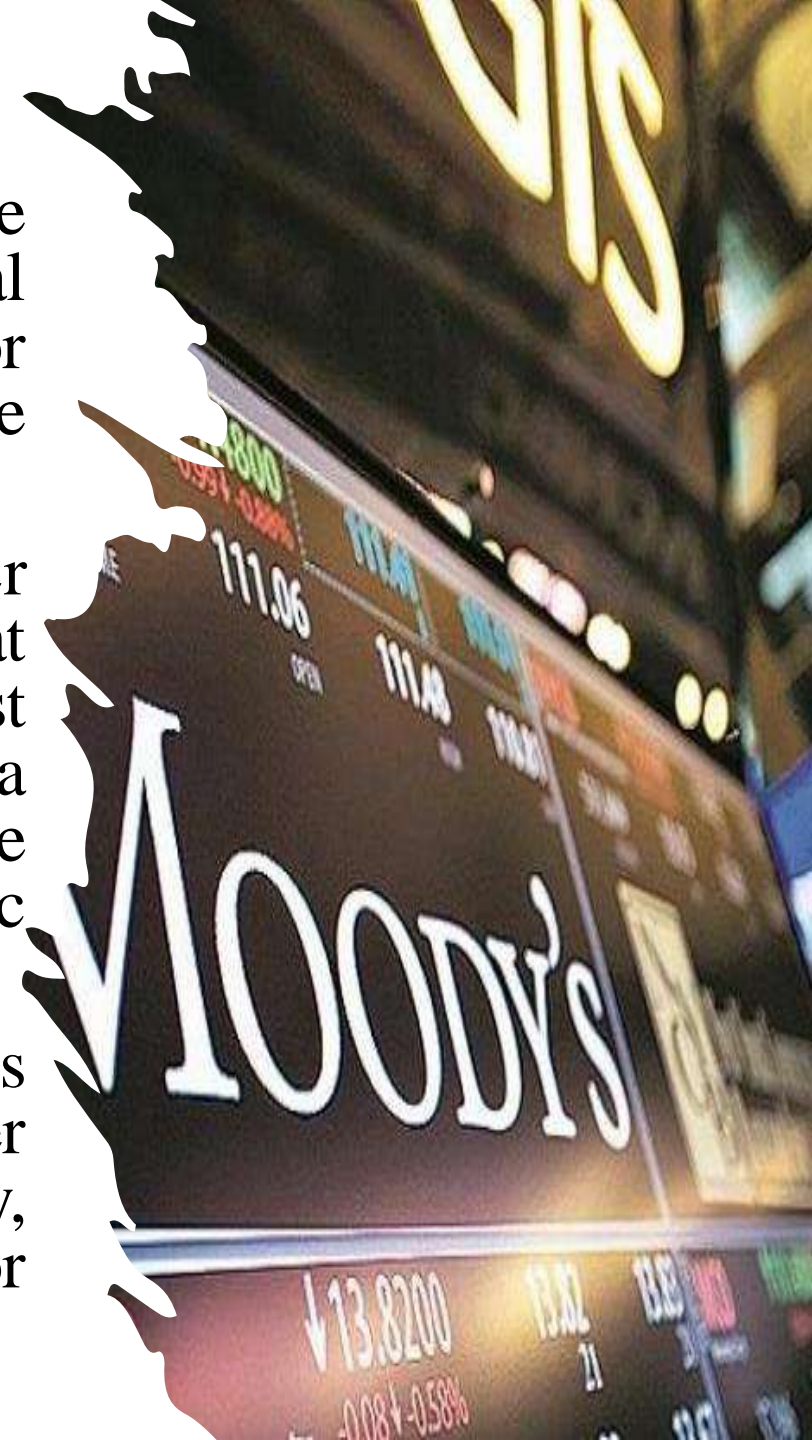
REACTIONS

- i. **Economic Appeals:** On 7 April 2022, 38 organizations from various sectors, including exporters, importers, manufacturers, shipping, logistics, and tourism, collectively requested the Sri Lankan parliament to restore political stability to prevent a catastrophic economic crisis.
- ii. **Business Concerns:** The Chamber of Young Lankan Entrepreneurs (COYLE) also appealed to the government on 7 April 2022, warning that failure to address the current political and economic crisis could lead to widespread business closures.



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- i. **Call for International Assistance:** Former Justice Minister Ali Sabry emphasized the need for political stability and called for an immediate bailout or moratorium from multilateral agencies such as the IMF, World Bank, and Asian Development Bank.
- ii. **Warning of Social Unrest:** On 8 April 2022, former World Bank official Shanta Devarajan warned that Sri Lanka faced a significant risk of social unrest and turmoil, suggesting the implementation of a cash transfer program to assist the poor and reduce subsidies on food and fuel to avoid economic collapse.
- iii. **Financial Instability Risks:** Moody's Investors Service warned that the wave of cabinet minister resignations would increase policy uncertainty, complicating efforts to obtain external financing or loans for the country.



PROTESTS

- i. **Spontaneous Protests:** In March 2022, spontaneous and organized protests by both political parties and non-partisan groups erupted across several areas in response to the government's mishandling of the economy.
- ii. **Opposition Demands:** The political opposition, particularly the United People's Force led by Sajith Premadasa, staged protests on 16 March, with tens of thousands of supporters demanding the president's resignation and immediate action to address the financial crisis.
- iii. **Fuel Shortages Incident:** On 30 March, locals in Bandarawela blocked the road during the opening ceremony of a sports ground, demanding fuel when Namal Rajapaksa arrived, forcing him to avoid the area and allowing the mayor to open the grounds instead.



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- iv. **Protests Against Power Cuts:** On 31 March, a large group gathered around President Gotabaya Rajapaksa's residence in Mirihana to protest against power cuts that had reached over 12 hours a day.
- v. **Escalation of Violence:** The protest, initially peaceful, turned violent when police responded with tear gas and water cannons. Protesters retaliated by burning a bus carrying riot control troops, leading the government to declare a curfew in Colombo.
- vi. **Protests on Kandy-Colombo Road:** Simultaneous protests were reported on the Kandy-Colombo Road, where protesters blocked the route. The government accused them of being members of an extremist group and began arresting individuals involved.



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- vii. Candlelight and Car Horn Protests:** Candlelight vigils continued in several areas, along with car horn-tooting protests as citizens expressed their discontent with the government.
- viii. Destruction of Rajapaksa Home:** In May 2022, amid escalating protests, demonstrators set fire to the Rajapaksa family home. Following this, Mahinda Rajapaksa resigned as Prime Minister, but President Gotabaya Rajapaksa refused to step down, leading to continued protests.
- ix. Storming of the Presidential Residence:** On 9 July 2022, President Rajapaksa fled his official residence in Colombo before protesters breached police barricades and entered the premises. Protesters were seen occupying the mansion and even swimming in the president's pool.
- x. Evacuation by Navy:** Rajapaksa and his wife were evacuated from the President's House on the morning of 9 July by the navy. They boarded the SLNS Gajabahu, which sailed within Sri Lankan territorial waters, allowing Rajapaksa to maintain communications while avoiding the protesters.



INTERNATIONAL MONETARY FUND

- i. IMF Loan Arrangements:** Since 1950, Sri Lanka has entered into 16 loan arrangements with the International Monetary Fund (IMF), with recent bailouts occurring in 2009 and 2016. However, the IMF did not accurately predict the severity of the subsequent economic crisis.
- ii. Declining Foreign Reserves:** As of February 2022, Sri Lanka's foreign reserves had dropped to \$2.36 billion, while the country faced foreign debt obligations totalling \$7 billion, including \$1 billion in sovereign bonds due for repayment by July 2022.
- iii. Debt Restructuring Plans:** In response to its financial difficulties, the Sri Lankan government planned to hire a global law firm for technical support and assistance with debt restructuring.



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- iv. **IMF Delegation Visit:** A delegation from the IMF visited Sri Lanka from 7 to 20 December 2021 to assess and review the country's economic policies. The IMF declared that Sri Lanka's public debt was unsustainable and advised the government against printing money to prevent further monetary instability, although it praised the country's vaccination drive for mitigating the pandemic's impact.
- v. **Currency Devaluation:** On 7 March 2022, Ajith Nivard Cabraal reported that the banking regulator was effectively devaluing the national currency, with the official rupee rate reaching a historic low of Rs. 229.99 against the US Dollar.
- vi. **IMF Loan Conditions:** The International Monetary Fund (IMF) initially stated that any loans to Sri Lanka would require assurances of debt sustainability. The IMF also considered using its Rapid Financing Instrument (RFI) to assist Sri Lanka, similar to how it supported other countries during the COVID-19 pandemic.

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- vii. Support for Negotiations:** The IMF welcomed the Sri Lankan government's decisions to negotiate with creditors, pledging support to help mitigate the ongoing economic crisis following successful initial technical discussions between Finance Minister Ali Sabry and IMF officials in Washington.
- viii. Bridge Financing Discussions:** In addition to assistance from the IMF and World Bank, Sri Lanka is negotiating \$1.5 billion in bridge financing with India to facilitate imports and is also seeking financial aid from China, Japan, and the Asian Development Bank.
- ix. World Bank Assistance:** The World Bank has agreed to provide \$600 million in financial relief to Sri Lanka, with \$400 million to be released shortly as part of the first phase of assistance.
- x. IMF Delegation Visit:** On 20 June, an IMF delegation arrived in Colombo to discuss a potential rescue package. The IMF expressed hope for a resolution to Sri Lanka's political turmoil, which would allow for the resumption of talks regarding the bailout package.



FOREIGN SUPPORT

- i. **Indian Financial Assistance:** In January 2022, India pledged a total of **\$2.415 billion** to help Sri Lanka address severe financial constraints caused by external debt payments and a shortage of US dollars.
- ii. **Currency Swap and Credit Lines:** India extended a **\$400 million** currency swap under the SAARC arrangement and deferred an Asian Clearing Union settlement of about **\$500 million**. Additionally, India provided a new **\$500 million** line of credit specifically for the purchase of petroleum products.
- iii. **Credit Line for Essentials:** On **17 March 2022**, Sri Lanka received a **\$1 billion** credit line from India, which was activated following a formal credit agreement during Finance Minister Basil Rajapaksa's visit to New Delhi. This funding was designated for urgently needed essential items such as food and medicine.



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- iv. **Support for Tamil Communities:** Tamil Nadu Chief Minister M. K. Stalin proposed strategies to supply essential commodities like rice, cereals, and life-saving drugs to Tamil communities in Sri Lanka's North, East, and Central Provinces.
- v. **Rice and Fuel Shipments:** On **2 April 2022**, reports indicated that Indian traders had begun loading **40,000 tonnes** of rice for shipment to Sri Lanka. By **6 April**, India had sent **270,000 tonnes** of fuel, although some shipments faced bureaucratic hurdles.
- vi. **Singapore's Humanitarian Aid:** The Government of Singapore announced a **\$100,000** relief package to support the Singapore Red Cross's humanitarian fundraising efforts for vulnerable communities in Sri Lanka.
- vii. **Chinese Emergency Assistance:** In June 2022, Chinese Foreign Ministry spokesman Zhao Lijian stated that China would provide **500 million yuan** (approximately **\$74.2 million**) in emergency assistance to Sri Lanka.



GOVERNMENT RESPONSES

- i. **Initial Denial of Crisis:** The Rajapaksa Government initially denied the existence of an economic crisis and refused to seek assistance from the IMF. CBSL Governor Cabraal criticized the rating downgrades by Moody's as unwarranted and reckless.
- ii. **Acknowledgment of Crisis:** By March 2022, the government acknowledged the crisis but denied responsibility. President Gotabaya Rajapaksa blamed critics for creating the crisis, a sentiment echoed by the Central Bank under Cabraal, which pointed fingers at the media, opposition reports, rating agencies, and the COVID-19 pandemic.
- iii. **Monetary Policy Response:** On 8 April 2022, the Central Bank of Sri Lanka implemented a contractionary monetary policy to address soaring inflation by raising both the Standing Lending Facility Rate and Standing Deposit Facility Rate by **700 basis points**.



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- iv. **Fiscal Policy Adjustments:** On **30 April 2022**, Finance Minister Ali Sabry announced plans to increase taxes, admitting that the tax cuts made in 2019 were a mistake. He stated that the **8% VAT** was "definitely not sustainable" and suggested a rate of **(13–14)%**.
- v. **Fuel Policy Changes:** In **June 2022**, the Power and Energy Minister announced that the government would allow companies from oil-producing countries to import and sell fuel, aiming to resolve the energy crisis stemming from a market dominated by the state-owned Ceylon Petroleum Corporation (CPC) and the Indian government-owned Lanka IOC, which held an **80%-20%** market share, respectively.
- vi. **New Market Entrants:** In **March 2023**, three corporations—United Petroleum, Sinopec, and RM Parks in collaboration with Shell—were permitted to enter the Sri Lankan fuel market to increase competition and alleviate the energy crisis.



TIME-LINES

MARCH–APRIL 2022

Political Turmoil: The ruling coalition in Sri Lanka lost its majority, leading to increased political instability, including resignations of cabinet ministers. The government's controversial shift to organic farming was reversed due to falling agricultural output and resulting food shortages.

Currency Decline: As of **6 April**, the Sri Lankan rupee reached a record low, becoming the worst-performing currency globally, with **US\$1** trading at **Rs. 355**.

Debt Default Announcement: On **12 April**, the Government of Sri Lanka announced steps to temporarily default on all external debts amounting to **\$51 billion** to avoid a hard default, ending its record of consistently meeting external debt obligations.

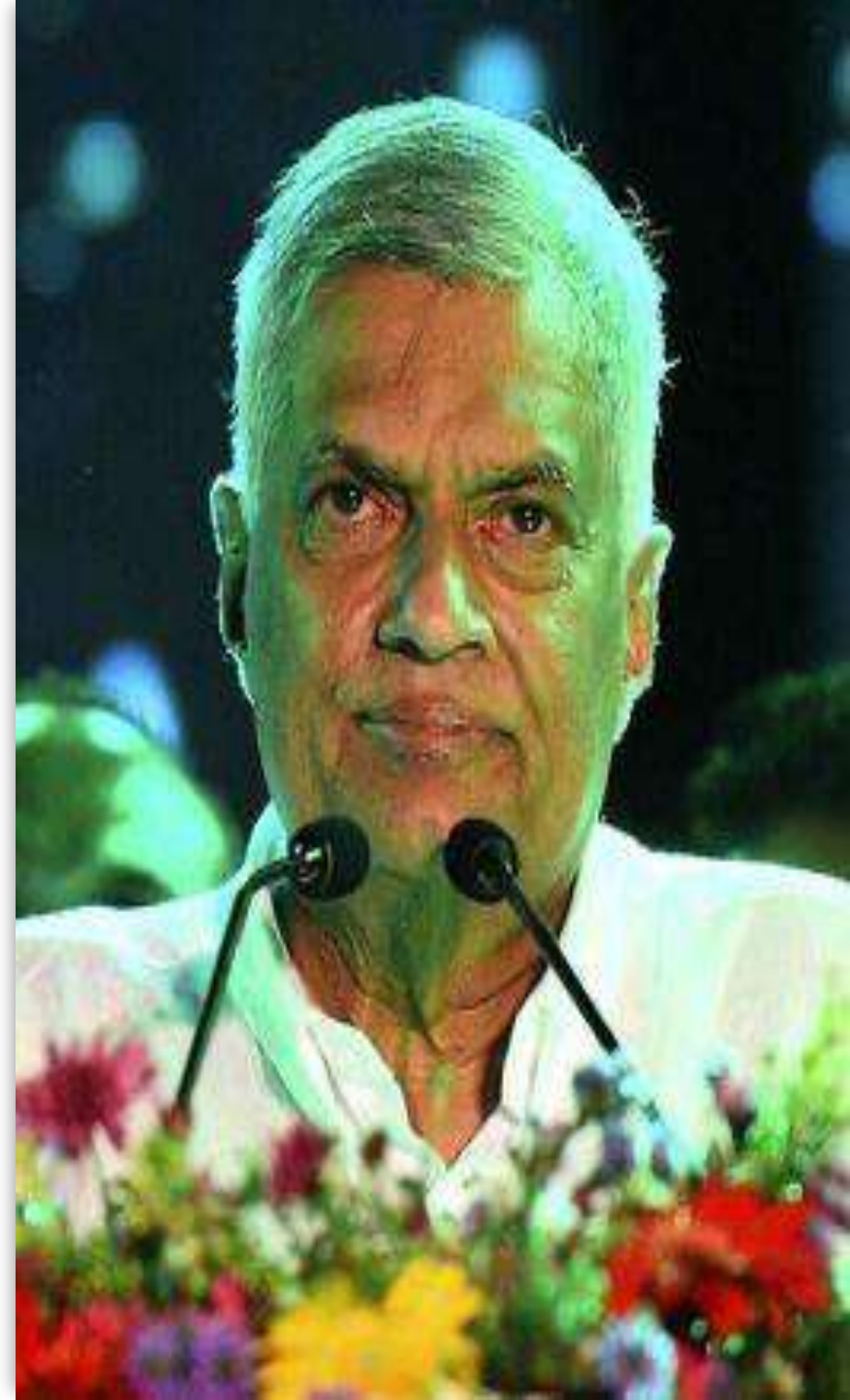


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MAY 2022

Resignation of PM: On 9 May, Prime Minister Mahinda Rajapaksa resigned amid violent protests related to the economic crisis, stating his intention to facilitate the formation of an interim unity government to address public unrest caused by shortages of fuel and essential goods.

New PM's Statement: Newly appointed Prime Minister **Ranil Wickremesinghe** disclosed that the government had no usable dollar reserves, highlighting difficulties in securing even **\$1 million**. The revenue forecast of **Rs. 3.3 trillion** fell short of the total government expenditure of **Rs. 4 trillion**, resulting in a deficit of approximately **Rs. 2.4 trillion**. He warned that inflation would continue to rise, describing the situation as "the most difficult" period Sri Lankans have faced.



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NOVEMBER 2022

Economic Improvement: By November 2022, Sri Lanka's economic conditions showed significant improvement, with the inflation rate declining notably.

- Tourist arrivals began to pick up, contributing to approximately **\$1 billion** in revenue in the first **10 months** of the year.
- Power cuts were reduced, and despite ongoing job losses and economic contraction, public sentiment towards Prime Minister Wickremesinghe became more favourable following the departure of Gotabaya Rajapaksa.
- The government's budget for the next fiscal year aimed to increase taxes as a strategy to mitigate the economic crisis through self-financing.



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MARCH 2023

IMF Approval: In March 2023, the **IMF Executive Board** approved a **\$3 billion** bailout under a new **Extended Fund Facility (EFF)** arrangement for Sri Lanka.

- The first tranche of **\$330 million** was released soon after, with an additional **\$3.75 billion** anticipated from the **World Bank, Asian Development Bank**, and other lenders.
- The Wickremesinghe administration implemented several reforms, including significant tax increases and debt restructuring measures, which faced considerable public backlash.



CONT.

NOVEMBER 2023

Debt Restructuring Developments: Sri Lanka made substantial progress in restructuring its foreign debt, reaching an 'agreement in principle' with **India** and the **Paris Club of creditors** (including Japan) to align debt treatment parameters with the IMF's EFF arrangement.

- China, as Sri Lanka's largest bilateral creditor, separately agreed to restructure **\$4.2 billion** in debt.
- Despite these developments, concerns arose among other major creditors regarding preferential terms, prompting calls for equitable treatment in the restructuring discussions.
- The IMF's disbursement of the **\$330 million** tranche from the bailout remains contingent on achieving consensus among all creditors.



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