**SRILANKA'S ECONOMIC CRISIS**

**Term project paper**

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1. **Executive summary**

Sri Lanka is in a state of severe economic crisis. This has been made worse by several causes. Tax cuts implemented by the government have resulted in significant declines in government revenue, resulting in budget deficits and credit rating downgrades. The country's foreign debt has also grown, making it difficult to access international markets and causing investor confidence to decrease. The Easter bombs and the COVID-19 pandemic have significantly impacted the tourism sector, which contributes significantly to GDP. Furthermore, the agriculture sector has suffered due to agrochemical fertilizer policy restrictions.

Several recommendations are made to address the situation. They are implementing critical economic reforms, ensuring appropriate tax collection, investing in infrastructure development, encouraging renewable energy sources, establishing online government records, enhancing agriculture and crop processing, and creating a better tourism structure. These measures aim to improve fiscal stability, boost economic growth, and attract investments to Sri Lanka.

1. **INTRODUCTION**

**2.1 History**

Sri Lanka is one of the most stunning islands in the world. It is previously known as Ceylon. It is a diverse country with three major ethnic groups, which are Sinhalese (75%), Indian Tamils(4.2%), and Sri Lankan Tamils(11%). There has been a significant economic crisis in Sri Lanka for the past few years, but it worsened recently. But the root cause is communal segregation in the country. The Ceylon Citizenship Act, which Sri Lanka's government passed in 1948 with the primary goal of excluding Indian Tamils from the country, is the main factor contributing to the country's communal segregation. Since they did not meet the two requirements for citizenship under the act, almost a million people were expelled from the country on purpose. Sinhalese began torturing Tamils to force them to leave the nation since they had government approval for their actions. After that, however, in 1960, there was an increase in rebels who began organizing groups to fight with the Sri Lankan government, and one of the rebels was Velupillai Prabhakaran. He founded the Liberation Tiger of Tamil Eelam (LTTE). This initiative was started primarily to establish an independent Tamil state in Sri Lanka's northern and eastern regions. After ten years, it grew significantly. When the LTTE and the government fought one another, a protracted civil war lasted for 26 years, from 1983 to 2009, until the Sri Lankan army killed Prabhakaran. Sri Lankan army won, but the damage was already done as 80,000 to 100,000 people lost their lives, and the economy was in minus. Instead of developing the country after independence, Sri Lanka wasted 26 years in a civil war, costing 200 billion dollars. After that, between 2010 and 2021, Sri Lanka experienced a substantial fiscal deficit, a heavy debt load, and a slowdown in economic development. The government carried out financial measures in 2015 to enhance fiscal viability, lower debt levels, and foster economic growth. However, the nation continued to experience a severe economic crisis in 2019, which was made worse by the COVID-19 epidemic in 2020.

**3. Causes**

**3.1 Tax Reductions and money creation**

The present government's tax-cutting policy in Sri Lanka impacts the country's economy. During the 2019 presidential campaign, the government promised tax cuts. After winning the election, it executed significant tax cuts, including raising tax-free thresholds, lowering VAT and corporate tax, and removing PAYE tax. These tax cuts, however, resulted in a considerable drop in government revenue, resulting in budget deficits and downgrades in the country's sovereign credit rating. To finance government spending, the Central Bank began creating money at an unprecedented rate, ignoring IMF guidance to hike interest rates and taxes while cutting expenditures. The IMF predicted that this policy would lead to the economy's downfall. The country's budgets are almost empty, and access to international markets has become difficult, leading to a loss in investor confidence. Despite these warnings, the current president views the income loss as an "investment" and has no intentions to raise taxes for the next five years.

**3.2 The external debt of Sri Lanka**

Sri Lanka's external debt has doubled between 2010 and 2020, with foreign debt increasing from 42% to 119% of GDP. China only holds about 10% of Sri Lanka's total foreign debt, most of which is owed to international financial markets. While Sri Lanka's government had $2.3 billion in reserves as of April 2022, it anticipates repaying its debtors $4 billion by the end of 2022. By March 2022, Sri Lanka's foreign reserves had decreased to $1.9 billion, insufficient to cover its $1 billion payment due on international sovereign bonds and its $4 billion in foreign debt commitments. In April 2022, Sri Lanka said it would default on its $51 billion foreign debt. To deal with its financial issues, Sri Lanka requires an effective budget strategy, monetary policies, higher taxes, and lower interest rates.

**3.3 Sri Lanka's Tourism Sector**

Sri Lanka's tourism is critical because it significantly contributes to the country's GDP. The 2019 Easter bombings and the COVID-19 epidemic severely affected Sri Lanka's tourism economy. This has led to a decline in tourism-related revenues, which constitute a source of foreign funding and account for 13% of the nation's GDP. 2.3 million tourists visited Sri Lanka in 2018, while just 173,000 did so in 2020. By 2021, the country's tourism revenue had dropped to USD 2.8 billion.

**3.4 Sri Lanka's agriculture crisis**

The Sri Lankan government said in April 2021 that it would only allow organic farming and ban inorganic and agrochemical fertilizers. Critics countered that the problem was inadequate import funding rather than the government's assertion that this would improve health. The restriction caused a 20% decline in rice production and a dip in tea production, costing millions of dollars in losses. Scientists and farmers worried that the regulation would lead to the collapse of the farming industry because organic farming was ten times more expensive and half as productive as conventional farming. The government abandoned its aim to establish the first organic farming nation in the world in 2021 due to protests and skyrocketing food prices.

1. **Recommendations**

**4.1 Economic Actions**

Significant economic reforms are required for Sri Lanka to pay off its debts and establish long-term sustainable prosperity. A lack of faith among immigrants in the financial system could have caused the payment fall. To resolve the current crisis, an independent Central Bank is necessary for currency stability and public confidence, as even the IMF suggests. To make long-term policy decisions, professionals should be included in Central Bank committees, and a set timeframe is required.

**4.2 Proper Tax Collection**

Tax collection is critical for the government to manage its finances and maintain economic stability. Proper tax collection means making sure that the government collects taxes more efficiently. It's essential to figure out how to motivate more individuals and companies to pay taxes without raising tax rates too much. This increases revenue and promotes economic stability.

**4.3 Infrastructure Development**

Infrastructure development means the government's efforts to improve roads, bridges, and buildings. These projects have two significant benefits. First, they improve people's lives by improving their standard of living and making business operations easier. Second, these projects build jobs, particularly for individuals with low incomes. These projects can be carried out utilizing the Public-Private Partnership (PPP) model, in which private enterprises contribute finances and skills alongside the government to decrease the financial load on the government.

**4.4 Renewable Energy (Wind and Solar Power)**

Solar and wind energy are viable alternatives to fossil fuels because they rely on renewable energy sources. Wind power is regarded as a cost-effective energy source. However, there are drawbacks to both types of energy. Solar energy has challenges integrating with the electricity system and breaking market restrictions. Wind power, however, is best suited for isolated places far from cities where electricity is required. There is significant potential for solar and wind energy plants, which can reduce fuel imports and improve Sri Lanka's trade balance. The government or private companies can set up these plants, and Collaborations with adjacent countries may also be considered to capitalize on these renewable energy sources.

**4.5 Create online government records**

Online access to all public records, including real estate-related ones, is necessary. In addition to reducing corruption, this could improve the statistics databases of the various ministries.

**4.6 Improving Agriculture and Crop Processing**

It can be helpful to promote agricultural and cash crop cultivation and transform raw materials into finished goods. For instance, rubber may be used to create tires and sandals, while spices can be changed into masalas. Growing crops for specific uses, such as furniture, fruits, or medicines, can be profitable and beneficial.

**4.7 Making a Better Tourism Structure**

There are two ways that the tourism sector might be set up. First, a group may oversee creating of regulations and promoting tourism worldwide. Secondly, it can create a council that will manage the localization of these policies. This may involve several activities, such as developing infrastructure for government-sponsored travel, accommodation, dining, and maintaining tourist attractions. The objective is to improve tourism and guarantee a great visitor experience through a coordinated strategy.

**5. Resources**

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