

## SRI LANKAN ECONOMIC CRISES

The Sri Lankan economic crisis is an on going crisis in the island country of Sri Lanka that started in 2019 it is the worst economic crisis since its independence in 1948 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. The crisis is said to have begun due to multiple compounding factors like tax cuts, money creation, a nationwide policy to shift the organic or biological farming, the 2019 Sri Lanka Easter bombings, and the impact of the Covid-19 pandemic in Sri Lanka. The subsequent economic hardship resulted in the 2022 Sri Lankan has been earmarked protests, 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 was due to be repayed. An International Sovereign Bond repayment of \$1 Billion was due to be paid by the government in July 2022. Bloomberg reported that Sri Lanka has a total of \$8.6 billion in repayments due in 2022, including both local debt and foreign debt. In April 2022, the Sri Lankan government announced that it was defaulting marking it the first sovereign default in the 21st century. In June 2022, the Prime Minister Ranit Wickremesinghe said in parliament that the economy has 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.

### Background

Since 2010 Sri Lankan government Debt-to-GDP ratio gradually increased. Source Central Bank of Sri Lanka, 2021. According to W.A. Wijewardena, a former Deputy Governor of the Central Bank of Sri Lanka, the country was a

into an economic crisis 2015. The government that came into power in 2015 knew this and had been warned by the Institute of Policy Studies of Sri Lanka about a number of crises. While the then Prime Minister Ran Wickremesinghe in 2015 has presented a strong economic policy to address the situation, the Coalition government could not get the policy pushed through Parliament which would eventually result in further policy confusion in the coming months.

The government did not adequately address the economic warnings and emerging related activities such as constitutional reforms. Certain practices, including those used by the Ministry of Finance led by Ravi Karunaratne were globally focused upon election related economic decisions were posted such as excessive distribution of jobs. 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 investments flow into the hospitality sector.

Further political turmoil in 2018 worsened the economic outlook. By that time the government has carried out several reforms under an IMF supported program towards fiscal monetary consolidation and had successfully controlled inflation. These reforms included an automatic fuel pricing formula which significantly reduced fiscal risk proposed posed by state owned enterprise (SOEs) raised the value added tax (VAT) rate from 11 percent to 15 percent and broadened the VAT base by removing exemptions. Many of the reforms were reversed by the new government after the 2019 elections. Under Maithripala Sirisena administration, 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. 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. Then Central Bank Governor Indragit Coomaswamy noted Balance of Payments issues increased inflation and assets bubbles as reasons for the ban. The Sri Lanka Podujana Peramuna Party opposed an independent Central Bank and disallowed the bill as soon as they came to power.

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. Both nations had similar issues including deep economic crisis occurring after their successive governments piled up unsustainable debts following the end of civil wars.

### CAUSES

#### Tax cuts and money creation

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. 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.