CENTRE FOR SECURITY STUDIES | **ISSUE BRIEF**

November 2022

CHALLENGES TO ECONOMIC SECURITY IN SRI LANKA

Shilpa Santhosh

Edited by: Ishani Sharma

About the author

Shilpa Santhosh is a public policy postgraduate student at the Jindal School of Government and Public Policy and is a Research Intern at the Centre for Security Studies, JSIA.

About the Centre for Security Studies

The Centre for Security Studies (CSS) was established in 2020 as the Jindal School of International Affairs' first student-run research centre under the aegis of Prof Dr Pankaj K Jha. Researchers at CSS – through in-depth analysis briefs and events, reports, policy briefs and print publications – explore both regional and thematic topics in the broader field of international security studies. The concept of international security has been expanded to reflect not merely the study of state security, but also include topics like ethnic, sectarian and religious conflict; civil wars and state failure; cyber and space warfare; resource related security issues; the proliferation of weapons of mass destruction; defence economics and also the role of ethics or morality in the formulation of security policies. The complexity of these matters is what the Centre for Security Studies attempts to unfold. Please refer to www.cssjsia.com for further details, and follow the Centre's social media platforms for critical news and research updates:

www.linkedin.com/company/jindal-centre-for-security-studies/

www.instagram.com/css_jsia/

https://twitter.com/Css_Jsia

Important disclaimer

All views expressed in this publication belong to the author and do not reflect the opinions or positions of the Centre for Security Studies. While researchers and editors at CSS strive towards any instances, CSS as an organisation does not take any responsibility for any instance of plagiarism committed by any authors. The onus to ensure plagiarism-free work lies with authors themselves.

IB2211001

Introduction

Sri Lanka, once hailed as an island country for its cultural diversity and development models, is now tangled in layers of economic destruction. The 2019 economic crisis that hit them continues to worsen with every passing day. Even with the change in power and continuous protests by their citizens, the current scenario in Sri Lanka is even worse than how it was in 2019. Though the beginning of this economic stagnation was believed to be brought in by the COVID-19 pandemic, reports and research papers suggest otherwise. COVID-19 acted more like a catalyst that added to the existing economic struggles that were left by the civil war that ended in 2009. Sri Lanka was then met with the 2008 Global Financial crisis which drained its resources even further, plummeting the country to a new low in terms of monetary value and worth.

Though many external factors led to Sri Lanka's current economic crunch, there are undeniably some challenges that the Lankan government need to overcome to revive their economy back to normalcy. This paper will discuss the various challenges that the Lankan government has to overcome to attain economic security in Sri Lanka.

Sri Lanka's Tryst with their Economy: A Throwback

The Sri Lankan economy, home to nearly 22 million people is no short of legacy and richness. The island nation got its independence in 1948 and unlike its neighbouring countries, the Lankans were not devoid of resources. They had most of their resources to themselves with a relatively well-equipped economy that could soar high if given the right push in select sectors. All these made Sri Lanka one of the south Asian countries with so much potential with its numbers well and above the other south Asian countries. Colombo was also a major port in the international shipping lanes faction and this connected Sri Lanka's name in the western sphere as well.

In KM De Silvia's words, "*Sri Lanka was an oasis of stability, peace and order*".

However, this image was turned upside down by the 1960s when the Lankan numbers in terms of their GDP and per capita started falling, levelling with its Asian counterparts. The Sri Lankan economy was still stable by the late 1970s, with growth that satisfied their plans and targets. But what was in store for the Lankan economy was a vicious circle of political unrest, external shocks and incomplete reforms. Historians and policymakers failed to understand where Sri Lanka had slipped into the current bandwagon. Though the reasons for it are plenty, it is still a puzzle to see a rich nation's downfall albeit such suitable economic and social conditions.

It will be a herculean task for the Lankan government to spearhead this economic plunge and go back to normalcy. Here are some of the key challenges to achieving economic security in Sri Lanka.

Key Challenges to Economic Security

Of all the major reasons, some issues stand taller than others and they would be a little bit more challenging for Sri Lanka to overcome.

Controlling Political Turmoil and Bringing in Political Stability

Sri Lanka is currently immersed in political instability and internal conflicts with a new president taking charge this year due to severe internal unrest which was triggered by the economic instability. The Rajapaksa brothers received extreme backlash for plummeting the country's economy into the drains but Sri Lanka's political unrest does not begin with the Rajapaksa brothers. Rather, it goes decades back.

One of the major causes of political instability in Sri Lanka is the frequent clashes between the Sinhalese and Tamil. The two groups have often contested positions of power within the country. The power struggle where the Sinhalese tried to establish their dominance over other classes led to the Civil war on the Lankan island. The Civil war, which lasted for 26 years from 1983 – 2009 set the Lankan government back by decades. The war not only had long-lasting effects on their economy but also divided people of all helms into two main factions - the Sinhalese and the Tamil. This predominant divide was visible in the administrative faction as well.

The Mahinda Rajapaksha government which held power from 2005-2015 initiated neo-liberal economic reforms, borrowing $2.6 billion from the IMF to finance their agendas and plans. Even with funds flowing in from all directions, the administration could not handle the ever-increasing debt and by 2019, the public debt of Sri Lanka amounted to 86.6% of the total GDP, further increasing to 94% in 2020 and 119% by 2021.

All this set in motion the narrative that those in power are draining the country's resources and wealth. More like, the Rajapaksa family was blamed for the country's downfall. The Rajapaksha brothers once they came to power, started giving out other positions of administration to their family members and many sources even trace that funds from their budget were misappropriated. They were also brutally criticised for their lack of involvement in saving their economy. Though the Rajapaksa brothers won the 2020 elections, they were forced to give up their offices by the end of July 2022. With their leaving, Ranil Wickremesinghe took power as their president. Even now, with the new head of state, the political uprisings in Sri Lanka have not decreased and the government is also struggling to deal with the political tensions. The Sri Lankan government must move past this hurdle of political instability to gain some sort of economic footing, as a nation cannot move forward devoid of its citizen's trust.

Exports, Access to International Markets and Production

Sri Lanka is currently experiencing the twin deficit phenomenon where the excess demand in the domestic markets increases the imports, catering to inflation. This, in turn, makes their domestic commodities in international markets less competitive and demanding. The twin deficits on the current and fiscal accounts have made the country overly reliant on foreign debt, in turn leading to a Balance of Trade (BOT) deficit where more goods were imported than exported. The twin deficit phenomena that struck Sri Lanka is due to their ever-increasing deficits in both their current account and budget, putting the government in a tough spot to act on their economic instability.

Sri Lanka's Balance of Trade (2000-2021)

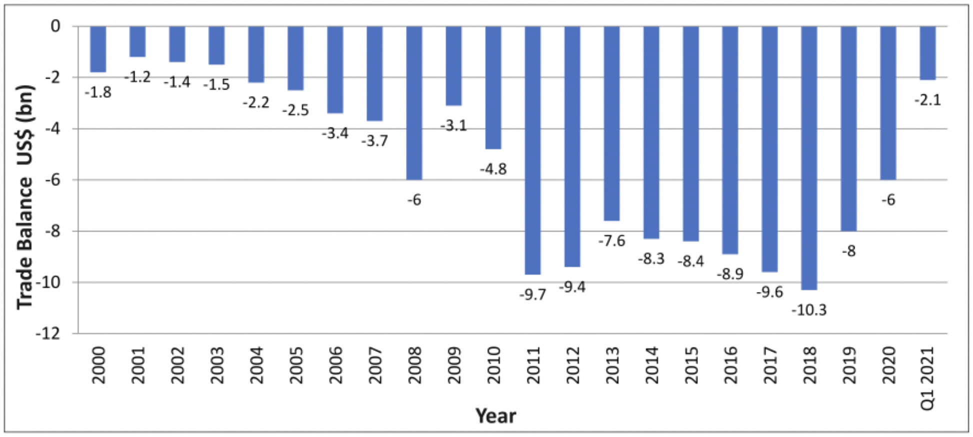

Fig 1: Graph represents Sri Lanka's BOT deficits over the past years

*(**Source**: Central Bank of Sri Lanka)*

Fig 1 traces the Lankan Balance of Trade with a consistent deficit from 2000 to 2021. The deficits in BOT are due to two primary reasons. First, a boost in capital surpluses increases investment and releases liquidity which in turn increases consumer demand, leading to current account deficits via increased imports. Secondly, capital inflows lead to the appreciation of the Lankan currency, making imports cheaper and exports more expensive. Therefore, the surge in imports and fall in exports cause the deficits to widen.

The major exports from Sri Lanka are garments and tea. Sri Lanka used to export $5.42 billion worth of garments to the global market every year but because of the ongoing financial crisis, global brands have relocated their orders from Sri Lanka to India.

The over-reliance on imported goods has also resulted in reduced production within the country. As the domestic market struggles to survive in this debt-ridden island country, the production levels of various industries have hit rock bottom.

Due to all these and other external reasons, Sri Lanka lost access to international financial markets in 2020 after sub-standard credit ratings. Without any access to these markets, the Lankan government continues to pay for the imports from their official reserves and bank loans. Official reserves dropped from $7.6 billion in 2019 to less than $400 million in June 2022.

For the Lankan government to kickstart their economy, they need to improve its import-export situation by focusing more on its domestic production. And finally, they need to get their access pass to the international markets again.

Financial Sector Imbalances and Forex Liquidity Crunches

As the imports kept on soaring, the demand for exports fell, leading to a dip in revenue generation of tea, spices and other sectors that primarily focussed on exports. The soaring imports of essential items like sugar, wheat and other essentials lead to an increase in the demand for FOREX. The demand for FOREX led to the Lankan currency depreciation, with the Sri Lankan currency falling by 7.3% in 2021. This in turn increased the import costs, leading to inflation. As a result of this, markets started panicking, with consumers losing their confidence and people started hoarding commodities. To control market instability and curb hoarding, the Lankan government imposed curfews and restrictions which then lead to a further imbalance of the markets, setting in more shocks across various industries, and leading to a decline in Sri Lanka's external and internal economic performance.

As a ripple effect of all these, the Sri Lankan Rupee (LKR)- US exchange rate reached an all-time high of US $1= 371.21 on May 2022.

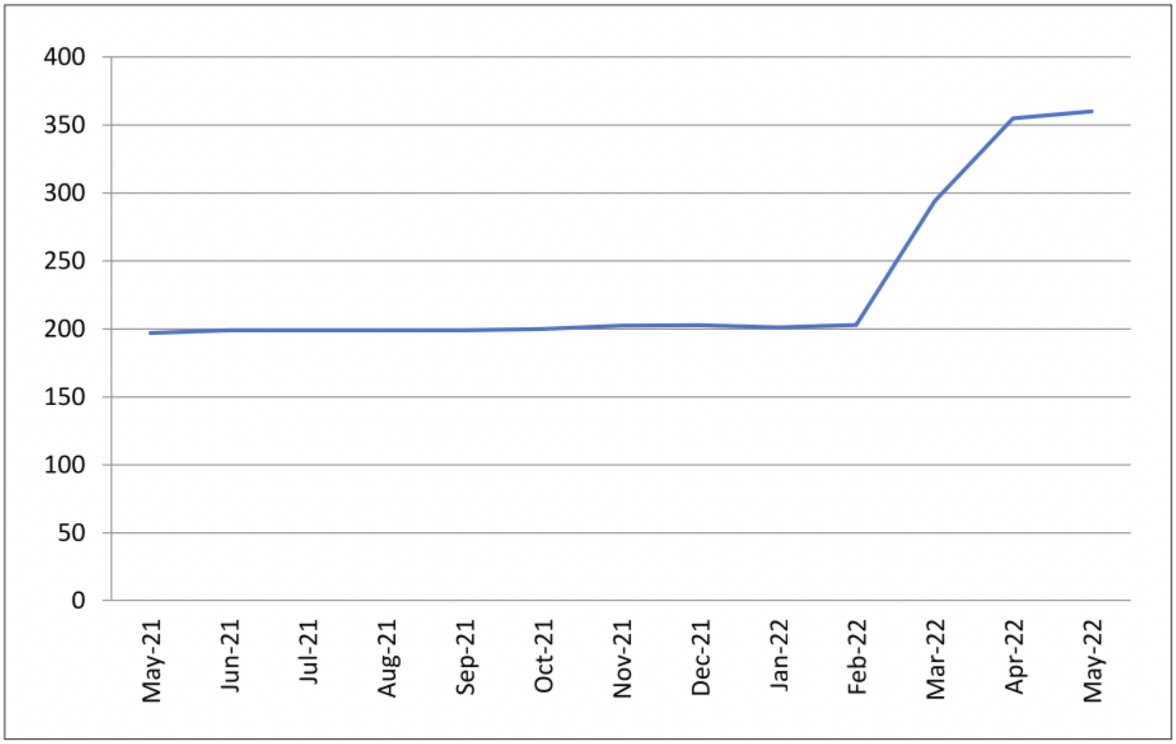

Fig 2: The Graph depicts the value of LKR against USD

*(**Source**: XE Currency Converter)*

The Lankan government need to work on settling their imports-exports balance and only then can they fix the issue of FOREX crunches. This will be another major challenge for the government before attaining complete economic security.

Chemical Fertilizers and the Agriculture Sector

Considering the reliance of Sri Lanka on agriculture for food, fodder and revenue, the sudden move to organic agricultural practices took a big hit. This is one of the major reasons why the island nation moved into another low of economic stagnation. In April 2021, the Lankan government banned all sorts of artificial fertilizers to promote organic farming. Along with them, agro-fertilizers were also banned. The reasoning provided by the then government was health concerns. Health issues spinning out of the use of artificial fertilizers and pesticides were cited as a cause of concern and the government passed the law considering this. This had a very sudden and apparent change in the agriculture sector where production suddenly dipped, owing to the ban. Production of tea, spices and other goods came to a halt and the farmers were left clueless as to how to go about their farming practises and how to adapt to the newly suggested organic farming methods. On top of this, the farmers also severely lacked funds to carry out their farming practices in a very "organic" way.

This pushed the government to import even more goods as the production of the existing goods within the island nation came to a standstill. Consequently, this led to the over-reliance of the Lankan government on imports, simultaneously putting pressure on the monetary losses. By the end of 2021, the government did revoke the ban but the damage was already done. The ban caused rice production to fall by 20% in 6 months, leaving nearly 33% of the agricultural land unused. This sudden out-of-the-blue organic policy pushed the economic recession to another low and left a deep scar on its agriculture sector. To attain economic stability, the Lankan government would have to make amends to the agriculture sector by trying to revive back their domestic production and this will mean that they would have to implement sophisticated policies.

Troubled Tourism Sector

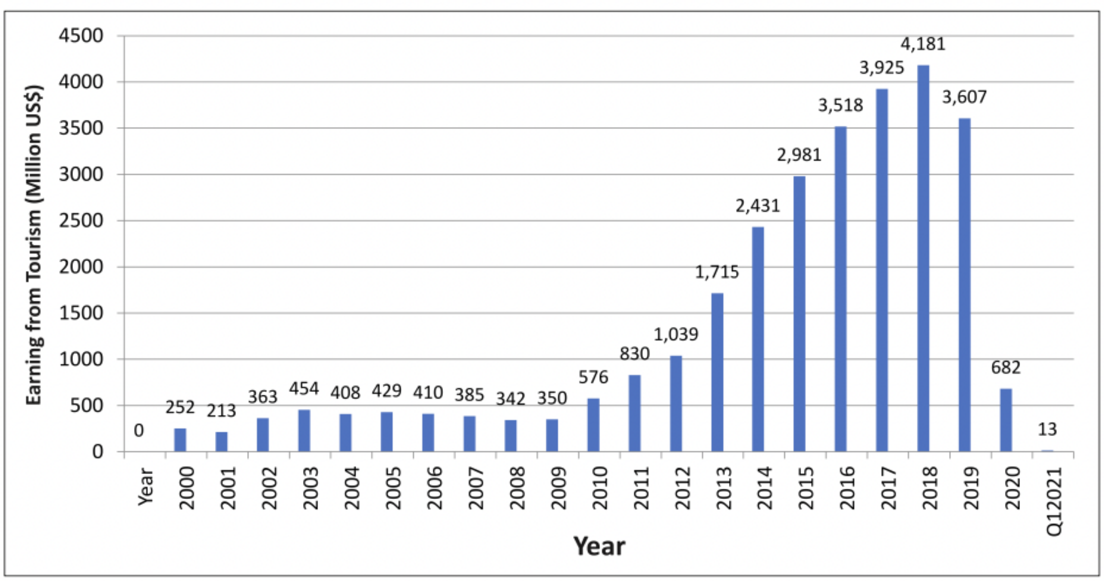

Fig 3: Bar graph tracing the earnings from tourism from the years 2000-2021

*(**Source**: Central bank of Sri Lanka and SLTDA)*

The island nation got a major share of its income from its tourism sector. A country so rich in its flora and fauna took no time to monetise it. The tourism sector also held a major share of employment within the country. Almost 403,000 people were employed in Sri Lanka's tourism sector in 2019. The country's dire economic condition has often influenced affected the tourism sector vastly. From Fig 3, one can easily understand how Sri Lanka's tourism sector faced an all-time low throughout the years. However, this narrative changed during 2014-2019 when tourism slowly started gaining momentum but that also was short-lived as covid disrupted it. Since the pandemic, the country has struggled to revive back their tourism industry because of their economic inability to do so. Besides the pandemic, another factor that tampered with Sri Lanka's tourism sector was the Easter bombings of 2019. It destroyed the safety net that the country used to have, scaring off the tourists as an unsafe location.

Reviving back the tourism sector for the Lankan government would be no easy job but if done properly, the boost it can give to the economy would be unimaginable.

Rising Ageing Population and Declining Remittances

With all the external sector imbalances, Sri Lanka's remittances have also fallen. With fewer people migrating to foreign countries, it is a multi-faceted problem. Foreign remittances are another major source of revenue for the island nation. The cause for the dip in remittances can also be correlated to the tourism sector and the easter bombing issue of 2019.

One easy way for the country to get back on the path of economic recovery is to improve their remittances and along with it, encourage the working youth to be active economic citizens. But the latter poses a secondary issue. Sri Lanka currently has a rising ageing population-this wouldn't be an immediate issue but the repercussions of it will be visible in a few years. Sri Lanka will also have to consider this pressing issue before taking any economic decision.

Conclusion

Although Sri Lanka has a long way to go in achieving economic stability, one cannot call it a far-fetched dream as embers of hope still burn for the island government. The government must learn how to manage their credit and not extinguish their contingent funds to the brink. Lessons for Sri Lanka are aplenty but the baton to learn and act upon it is on the Sri Lankan government. With a new president at its helm, one can hope for changes and while making amends to fix past mistakes, they must consider these key challenges as they play a crucial role.

Bibliography

Athukorala, Prema-Chandra, Edimon Ginting, Hal Hill, and Utsav Kumar. 2017. *The Sri Lankan Economy: Charting a New Course*.

George, AS Hovan, A Shaji George, and T Baskar. 2022. Review of *Sri Lanka's Economic Crisis: A Brief Overview*. *Partners Universal International Research Journal (PUIRJ)* 01 (02): 1–11. https://doi.org/DOI:10.5281/zenodo.6726553.

N, Sebastian. 2022. "The Island State in Unrest: Emergent Economic and Political Crisis in Sri Lanka." *National Council of Churches in India*.

"Observer Research Foundation. 2022. Review of Understanding the Economic Issues in Sri Lanka's Current Debacle. Soumya Bhowmick. May 2022

Sivesan, Sivanandamoorthy. 2020. "Beyond Collapse: The Message of COVID–19 to the Sri Lankan Tourism Industry." Journal of Tourismology, January. https://doi.org/10.26650/jot.2020.6.2.0007.

World Bank. 2022. "Overview." World Bank. 2022. https://www.worldbank.org/en/country/srilanka/overview.