

# **Economic Crisis in Sri Lanka: An Analytical Study**

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## **Abstract**

**The fluctuation of the economy is an ordinary thing after the covid-19 pandemic. In this article, we hardly try to point out the reason for the economic crises of many countries. Here we try to mention that Organic farming, VAT reduction, and the covid-19 pandemic are responsible for the economic crisis in Sri Lanka. On the other side in Venezuela, expenditure on subsidiaries has been responsible for the economic crisis and the excessive note currency issued by the central bank of Argentina is responsible for the economic crisis in Argentina the and current account deficit is a factor in the economic crisis in Turkey and Pakistan, this article aims to realize various countries that they have to learn from the mistake made by the Sri Lanka, Venezuela, and Argentina government.**

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## **INTRODUCTION**

Sri Lanka is experiencing a serious economic crisis. Sri Lanka declared an emergency. Social Media websites have been restricted and a curfew has been declared across the island by Govt. of Sri Lanka. Earlier, the people come on the road for food, fuel, gas cylinders, milk, paper medicine, and electricity scarce in the country. Due to a lack of supply and more demand, the price is increasing rapidly. Recently people entered the present house. The economy is now turning into a humanitarian crisis; we can say that there is a crucial condition in Sri Lanka.

## **REASONS FOR THIS CONDITIONS**

- 1. Falling Foreign Reserve** – Sri Lanka’s foreign currency reserves plunged 70 % since Jan

2020 around \$ 2.3 billion by Feb which is a fall of \$ 779 million from Dec 2021. In case that a country has a small foreign currency reserve it is difficult for it to import goods with the present level of currency reserves in Sri Lanka. Sri Lanka asks for goods from rest of the world for one month need only. Apart from this, there is a payment of \$ 4 million dues from Sri Lanka. In India, we think of imported goods as luxury items.

2. **Depreciation of Sri Lankan Rupee** – Due to rising in foreign currency, the value of the Sri Lanka rupee has collapsed. This incidence is called depreciation. In case of depreciation, it refers to decreasing the value of the domestic currency in terms of trade. The rate at which one country's currency is interchanged with other country's currency is called the currency exchange rate. This rate is decided by the factors of supply and demand of currency. If it is increased in value, it is term as the strength of the currency. Currency depreciation points out to a decline in the value of a domestic currency in terms of foreign exchange because of global trade the dollar is a common currency in the world, so the demand is always there. So, when there is a decrease in the supply of dollars due to some reason, then we have to pay more money to buy dollars, on the one hand, the dollar strengthens, and on the other hand, the value of domestic currency decline such as decline of Sri Lankan rupee. The more and more the Sri Lankan rupee becomes weak the more and more dollars become strong.
3. **Falling Sri Lanka Tourism** – In 2018, Sri Lanka was the world's finest destination for tourism. Large number of foreign visitors arrived in this country. It is approximated that 2.3 million foreign visitors visited Sri Lanka. Due to these phenomena supply of foreign currency also increase. It is estimated that country gets 12% - 13% of GDP from tourism industry.

In April 2019, there were several bomb attacks in the country. On the occasion of Easter day, it was bombed. Their churches and some hotels were marked many cities. More than 250 people were killed in the bomb blast 45 of them were overseas nationals. So, you can imagine how does this one-day terror attack wreck the tourism? Eight suicide attackers were Sri Lankan natives related with a local Islamic terrorist group that was responsible for bombings and alarming situation is that covid-19 Pandemic is also contributing in shrinking of tourism all around the world. Sri Lanka's tourism was also collapsed by the Pandemic in 2020.<sup>1</sup>

## **GOVT. OF SRI LANKA'S STEP**

The Govt. of Sri Lanka also made mistake. Gotabaya Rajapaksa, the President of Sri Lanka won the election in 2019 and come into power in this Presidential crusade, he had to cut down the VAT to half for economic growth, there was a strategic logic behind this reason. If people pay small amount of tax, they would expand more with a boost in consumption there would be economic growth. This concluded successfully in many occasions but it needs to be accomplished with the exact timing and with the good planning after concerning these circumstances. This tax rate applied on 1<sup>st</sup> Dec 2019. Three months later, it was the covid-19 pandemic strike. The sense was that people would consume extra with a tax rebate but with the lockdown and people were incapable to go out to consume things. There was no hike in consumption and none in economic growth either. Govt. had to suffer vast revenue loss. Sri Lanka's public borrowing kept on augmenting in 2019; the debt was 94% of GDP by 2021 and it had embraced to 119% of GDP.

## **STRUCTURAL CHANGE IN AGRICULTURE**

The President of Sri Lanka in his election campaign spoke about that we expect that our country will reach the target of attaining 100% organic agriculture. There was a nationwide prohibition on synthetic fertilizers and pesticides. He wanted the country to overnight become a country that applies entirely organic agriculture. Govt. thought to save some money by prohibiting imports of these goods. Such resolution is termed as bold decision by the fans of president. However, such types of dynamic decisions are good for the health of economy but we should keep in mind how to face the challenges which will come in this part.

Actual change in the country occurs calmly and with planning. If any country adopts organic farming entirely, in the short-term productivity is not good. It is said that in the short term, the yield may fall by 20% to 30% because of not using fertilizers and pesticides. Sri Lanka was a country that was self-sufficient in rice production but after the ban within 6 months the government had to expand more than \$ 400 million to import rice. Sri Lanka was known as big tea producer and the tea used to be exported to rest of the world due to this Sri Lanka government got major sources of foreign currency. The ban destroyed the tea crop too; on contrary, there is a gray market for even the main items (rice, sugar & pulses).

Foreign borrowing has all the time been an issue for Sri Lanka historically. In 2017 Sri Lanka's

total borrowing was \$ 64 billion. 95% of the government fund went to debt refund in 2020 the debt was \$ 51 billion and Sri Lanka charged a restriction on its import. So that foreign currency may be saved to refund this debt. Now, the conversion rate has fallen to \$ 1 about LKR 300. As the value of their currency is falling, their import is becoming more and more expensive consequently which cause additional inflation.

### **SOLUTION GIVEN TO RECOVER CRISIS<sup>2</sup>**

1. **Delay the idea of Organic Farming** – Sri Lanka’s Government should leave the decision of organic farming that was taken before this condition. Agriculture production has been reduced significantly. Countries where organic farming has been successful. They have taken it slowly not (wholly). Farming as before will increase production along with this the export of various agricultural-related items will also increase as a result of which Sri Lanka will also earn foreign exchange which is very necessary for this adverse situation.
2. **Economic help by International Institutions-** At this time Sri Lanka is in dire need of foreign exchange because due to lack of foreign exchange, the imports in Sri Lanka have almost come to an end. Due to this, there has been a huge increase in energy prices, especially the price of petroleum. This affects other goods and as a result, other items have also become expensive. Financial assistance should be given to Sri Lanka by international institutions like the World Bank IMF, Asian Development Bank, and other institutions. So that Sri Lanka can control the situation by increasing its import. Apart from this, financial help should be given to Sri Lanka by developed countries so that peace can be maintained there.
3. **Ban black marketing** – It is believed that black marketing is also a reason for inflation in Sri Lanka. Some people have thrown the country into a quagmire in the pursuit of black marketing and earning huge profits. It is well known that artificial shortage of goods is shown in black marketing that a theoretical rule is to increase the prices when the supply is less. The Sri Lanka Govt. could not take any concrete action on black marketing and the result is in front of everyone the government should strictly control black marketing so that artificial supply does not decrease and the price level could not rise.
3. **Adherence to Secularism** – Learning from the bombings at a church that took place in April 2019 in which hundreds of people were killed, about 50 people were foreigners among them. Secularism should be followed properly means all religions should be

respected because we know that tourism is a major part of Sri Lanka's GDP. If Sri Lanka can't provide a safe environment for all the people, then tourism will be ruined. Therefore, Sri Lanka Govt. must follow secularism strictly; if anyone violates it, then he should be punished severely to prevent the recurrence of such incidence. Such a message will encourage tourism there; this will increase the foreign rescue of Sri Lanka.

4. **Slight increase in Tax** – The Sri Lanka PM, while addressing the people in a campaign for political power said that now people will have to pay only half of the Vat the logic behind this was that due to the reduction of tax, their purchasing power will increase, which will increase their demand. There will be growth but its result is way opposite to the expectation with all these measures. If there is a slight increase in tax, the latter, then the revenue of the government will be reduced and the dependence of the country on others will be less that is the burden of less borrowing of Sri Lankan government.
5. **Previous Economic Crisis Case Study** – Let's throw light on the background of the economic crisis of other countries and also know what were the reasons for this
6. **Economic Crisis in Venezuela** – Venezuela considered being the world's largest oil reserve country was also caught in a very big economic crisis. When Hugo Chavez became president in 1999, Government's revenue has been increased in oil prices which were used by the Government of Venezuela to subsidize people and social activities when the revenue was low, the Government used to borrow and spend it on social activities.
7. Nicolas Maduro became the president of Venezuela in 2013. The Government used to spend in the same way its GDP growth became negative in 2014 which decreased by 19.6% in 2018. Venezuelan Central Bank issued new currency notes to run the Government's spending. The result was that the level of inflation increased very rapidly because the Government there did not spend on production capacity, but only on social activities due to which inflation started to take a formidable form. Apart from this, the US Government also put a lot of sanctions on Venezuela, due to which Venezuela started having more problems in international trade the debt and hyperinflation collapsed the Venezuelan economy.
8. **Economic Crisis in Argentina** – If we talk about the economic crisis of Argentina. The reason for the crisis is the excessive legal tender money issued by the Central Bank of Argentina. So, the money supply increased rapidly. Because Argentina Government made a

deficit budget so the fiscal deficit increased to fulfill this deficit, Argentina borrowed debt also.

9. **Economic Crisis in Turkey and Pakistan** – The crisis was caused by the excessive current account deficit in Turkey. Similarly due to the huge current account deficit in Pakistan.<sup>3</sup>

## **LESSON TO INDIA ECONOMIC CRISIS**

Many times, we found that government whether it's central or state and even some political parties make persistent attempt to get power. Further they made lots of expenditure in unproductive work like an expansion on religious institution, providing goods free of cost.<sup>4</sup> The government often forgives everyone's loan which adversely affects the ability of people to work.

## **CONCLUSION**

To avoid the economic crisis equal care must be taken equal all areas along with the loan should also be taken from the limit. While currency notes do not exceed the limit along with maximum attention should be given to the big task which is the production capacity so that the forces of demand and supply are in balance. Also import and export should not remain in much imbalance. The other major finding of the study reveals that there exists long-run causality from imports to GDP or simply it is found that imports are found to be significant in explaining the GDP growth in the long run. About 22 million small island countries Sri Lanka, most of the people left the home country, at present Sri Lanka's debt of GDP Ratio is more than 100%.<sup>5</sup> Lanka is stuck in a vicious cycle due to the dictatorship of the Rajapaksa now threatening and political stability of the country. Even though Sri Lanka has taken 16-time assistance from the international monetary fund but Sri Lanka could not recover from this situation.

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