

Economic Meltdown and Small Economies

^[1] Neha Mudali

^[1] Banking and financial services, Institute of Public Enterprise

Abstract— Small countries and small economies have been hit disproportionately during the Covid crises. Behind every crisis is a looming bankrupt economy. The case of Sri Lanka whose economy is in dire distress is taken as a case study in this paper. The study also points out the fallacy of dynastic rule which made corruption at high levels a rule rather than an exception. The study also points out the fallacies that printing of currency and large IMF loans. The dependence on only a few areas of national income can lead to severe crises such as tourism hit COVID in Sri Lanka.

Index Terms- LTTE, FDI, GDP.

I. INTRODUCTION

For the last three decades, Sri Lanka, a small country in the Indian Ocean just beyond Kerala across the sea, has been in a sea of troubles. The introduction of the Sinhala-only Act in 1956 triggered riots in Sri Lanka. Further discrimination against the Tamil population in Sri Lanka in cultural, political, economic areas led to some Tamils harbouring resentment against the Sinhalese groups and the Government. With the increasing hold of Sinhala speaking regime and dominance of Sinhala political representation, the Tamilians of Sri Lanka started feeling alienated since the preference was given to the Sinhala speakers; it led to the sense of conflict between two groups. The first and foremost problem was the fierce internal conflict in between the majority Sinhalese/Buddhists and the minority Tamils under the banner of Liberation of Tamil Tigers Eelam (LTTE). Beginning on 23 July 1983, it was an intermittent insurgency against the government by the Velupillai Prabhakaran-led Liberation Tigers of Tamil Eelam (LTTE, also known as the Tamil Tigers). The LTTE fought to create an independent Tamil state called Tamil Eelam in the north and east of the island, due to the continuous discrimination and violent persecution against Sri Lankan Tamils by the Sinhalese-dominated Sri Lanka government. This war could not be resolved amicably as the Tamil wanted their own country proposed to be called "Tamil Eelam". The leader of the civil war between the Governments led by its President Jayawardene resulted in much destruction and instability. In an effort to end the civil war, the Government of India tried its best but Prabhakaran was obstinate sensing victory. The Indo-Sri Lanka Peace Accord was an accord signed in Colombo on 29 July 1987, between Indian Prime Minister Rajiv Gandhi and Sri Lankan President J. R. Jayewardene. India, in a wrong move, sent its army to Sri Lanka called the India Peace Keeping Force (IPKF) as part of the agreement with the Sri Lanka Government. However the LTTE cadres were hardened both ideologically and militarily and knew the terrain of the land. The IPKF had no previous training in such a terrain and the LTTE gained an upper hand by indulging a guerrilla war. The LTTE were trained to first pick up the officers of the IPKF and India lost a lot of our

senior army commanders. The intense forest cover and the dissipation of the population and LTTE made it difficult for the Indian Army which was extra careful of harming civilians as it has come as a peace keeping force and not as an invading army. In fact, the IPKF was a peace keeping force and keeping that in mind, the use of large fire arms were not encouraged. The large Tamil population has been long exploited by the Buddhists and Sinhalese population and felt as second citizens in their own country. Their representation in the Parliament was not in proportion with their population; Most of the Tamils were relegated to the rural areas and hence faced a host of economic hardships for a long time. V. Prabhakaran, was a die-hard believer in the formation of a Tamil State. He had a substantial population of Tamils who almost worshipped him and the LTTE army, though small, was making substantial holdouts against the Sri Lanka Army. The major support to the LTTE, both in terms of military and money was from the Indian state of Tamil Nadu and its people and Sri Lankan expatriates.

II. DEMOGRAPHY

Sri Lanka nation has a total area of 65,610 square kilometres, with 64,630 square kilometres of land and 980 square kilometres of water. Its coastline is 1,340 kilometres long. It has a population of about 2.2 crores. This is comparable to the State of Delhi in size of population and to Assam or Jharkhand in terms of area. The sea distance between the two countries India and Sri Lanka is approximately 72 kilometres.

Independence from British rule succeeded when, on 4 February 1948, Ceylon was granted independence as the Dominion of Ceylon. Dominion status within the British Commonwealth was retained for the next 24 years until 22 May 1972 when it became a Republic and was renamed the Republic of Sri Lanka. Shri D. S. Senanayakee, the leader of the newly formed United National Party became the first Prime Minister of Sri Lanka. the Prime Minister retained the portfolios of External Affairs and Defence as the Minister of External Affairs and Defence. Sri Lanka became a Republic in 1972. *Sirimavo Bandaranaike was elected as the world's first female Prime Minister on 21 July 1960.*

Demographically, Buddhism is the major religion followed in Sri Lanka, with 70.2% of the population identifying as Buddhist. Of the remaining Sri Lankan population, 12.6% identify as Hindu, 9.7% identify as Muslim and 6.1% identify as Christian. Buddhism in Sri Lanka is predominantly practised by the Sinhalese people.

III. INDIA-SRI LANKA PEACE ACCORD

The Indo-Sri Lanka Peace Accord was signed on 29th July 1987 in Colombo between the then Indian Prime Minister Rajiv Gandhi and the then Sri Lankan President J R Jayewardene in an effort to bring the Sri Lankan civil war to an end. India agreed that the accord would be seen to be implemented by the Indian Peace Keeping Force. This was formed under the mandate of the 1987 Indo-Sri Lankan Accord that aimed to end the Sri Lankan Civil War between militant Sri Lankan Tamil nationalists such as the Liberation Tigers of Tamil Eelam and the Sri Lankan military. According to the terms of the accord, Sri Lankan forces would withdraw from the north and the Tamil rebels would disarm.

The IPKF began withdrawing from Sri Lanka in 1989, on the orders of the newly elected Sri Lankan President Ranasinghe Premadasa and following the election of the V. P. Singh government in India. The last IPKF contingents left Sri Lanka in March 1990. The IPKF was suffering from major armed casualties and support was waning for the LTTE. Both sides did not adhere to the terms of the Accord. Support for the LTTE in India dropped considerably in 1991, after the assassination of ex-Prime Minister Rajiv Gandhi by a female suicide bomber named Thenmozhi Rajaratnam. India had banned the LTTE after the assassination of former Prime Minister Rajiv Gandhi in 1991 during electioneering. Since then, the ban imposed on the group has been extended every five years. While some of the funding obtained by the LTTE is from legitimate fundraising, a significant portion is obtained through criminal activities, extortion among Tamil diaspora, involving sea piracy, human trafficking, drug trafficking and gunrunning. The 32-month presence of the IPKF in Sri Lanka resulted in the deaths of 1,165 Indian soldiers and over 5000 Sri Lankans. The cost for the Indian government was estimated at over ₹10.3 billion.

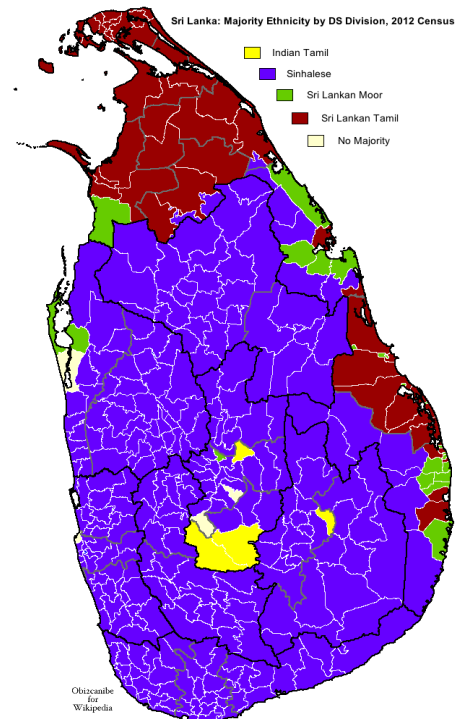


Figure 1

Source: https://en.wikipedia.org/wiki/Demographics_of_Sri_Lanka

Red area shows the approximate areas of Sri Lanka controlled by the LTTE and the Government, as of December 2005. The Tamil speakers are shown in Tamil Nadu and northern and eastern parts of Sri Lanka.

IV. 16 MAY 2009: SRI LANKA DECLARES VICTORY

Addressing the G11 summit in Jordan, President Mahinda Rajapaksa stated "my government, with the total commitment of our armed force has finally defeated the LTTE militarily". The long internal civil strife from 1983 to 2009 had broken the backbone of the economy.

V. DEBT REPAYMENT

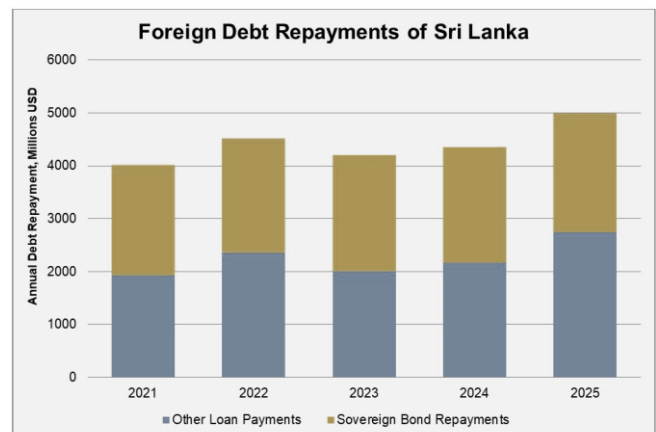


Figure 2 Foreign Debt Repayments of Sri Lanka Source – thediplomat.com

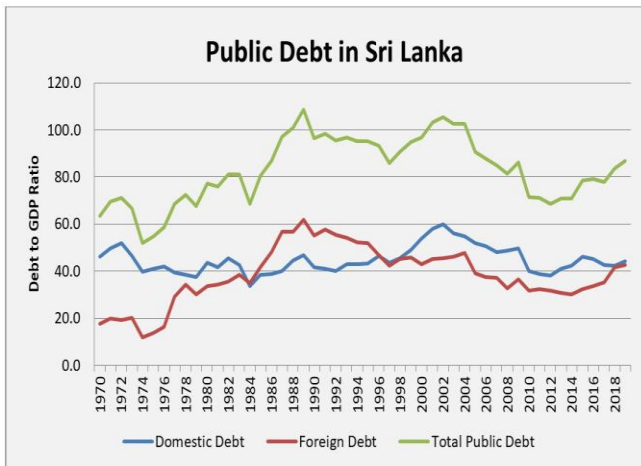


Figure 3 Public Debt in Sri Lanka Source- the diplomat.com

Sri Lanka’s foreign debt problem, which often leads to serious balance of payment (BOP) issues, is more than its massive borrowing from various foreign sources. The root causes of the ongoing crisis are found in structural weaknesses such as the contraction of trade, low tax revenue, and the lack of foreign direct investment (FDI). Failures to provide comprehensive and consistent, long-term solutions to address such weaknesses have resulted in the country running into serious BOP crises in every few years.

- The country has been relying heavily on foreign loans for development purposes over the last four decades due to immense investment in the military. Consequently, the Government had to borrow in international foreign markets and agencies. For instance, in 1989, Sri Lanka’s foreign debt (public debt only) amounted to 62 percent of its GDP. Government Debt to GDP in Sri Lanka averaged 71.06 percent of GDP from 1950 until 2021, reaching an all time high of 108.70 percent of GDP in 1989 and a record low of 16.30 percent of GDP in 1951. At the end of its civil war in 2009, Sri Lanka chose to focus on providing goods to its domestic market, instead of trying to boost foreign trade. This meant its income from exports to other countries remained low, while the bill for imports kept growing.
- Sri Lanka printed huge stock of money to pay salaries and this caused a further economic implosion. Sri Lankan Prime Minister Ranil Wickremesinghe said he is forced to print money to pay salaries for government employees. It started to print money extensively in February 2020, leading, coupled with other blunders, to the current economic implosion. Sri Lanka printed 1.2 trillion rupees in 2021 and, in the first quarter of 2022, it has printed 588 billion rupees. Between December 2019 and August 2021, Sri Lanka’s money supply increased by 42%. The inflation finally rose to 60% as Sri Lankans were forced to cut down on essentials and the value of the Sri Lanka dropped disproportionately.

Sri Lanka now imports \$3bn more than it exports every year, and that is why it ran out of foreign currency. At the end

of 2019, Sri Lanka had \$7.6bn in foreign currency reserves, which have dropped to around \$250m. Mr Rajapaksa also introduced big tax cuts in 2019, which lost the government more than \$1.4bn a year in revenues. Sri Lanka's foreign debt increased substantially, going from US\$11.3 billion in 2005 to \$56.3 billion in 2020. While foreign debt was about 42% of the GDP in 2019, it rose to 119% of its GDP in 2021. By February 2022, the country had only \$2.31 billion left in its reserves, yet faces debt repayments of around \$4 billion in 2022, which also includes a \$1 billion international sovereign bond (ISB) maturing in July. On 12 April 2022, Sri Lanka announced that it will be defaulting on its external debt of \$51 billion. Thus Sri Lanka is an international debt trap and is hard pressed to cut further funding within the country to repay the debts.

VI. TOURISM

The government blamed the Covid pandemic, which badly affected Sri Lanka's tourist trade - one of its biggest foreign currency earners. It also said tourists were frightened off by a series of deadly bomb attacks in 2019. However, many experts blame Mr Rajapaksa's economic policies. When the government decided to develop the tourism sector as a separate sector of the country's economy by establishing the Ceylon Tourist Bureau in 1966, there were 18,969 foreign tourist arrivals in Sri Lanka. There was an upward trend of tourist arrivals until 1982, with the exception of 1971. Between 1976 and 1982, tourist arrivals had increased by 24% per year. The tourist traffic in 1982 showed that there was a remarkable growth in the number of tourists, with 407,230 arrivals.^[9] However, with the beginning of the civil war in 1983, the growth of tourist arrivals declined and stagnated to around 300,000 – 500,000 arrivals annually.

The civil war that had lasted over 25 years ended in 2009 as LTTE separatists were defeated by government forces. In 2009 the tourist arrivals numbered 448,000, and in 2015, 1,798,380, showing over 300 percent growth in six years.

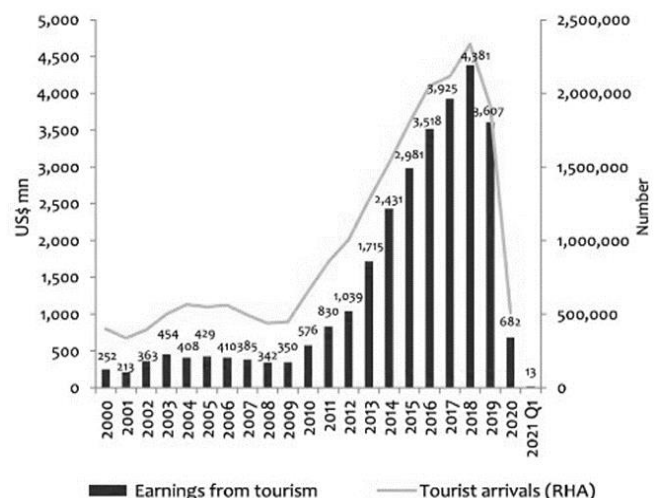


Figure 4 Tourism in Sri Lanka
Source- Central Bank of Sri Lanka and SLTDA

It is evident from the above data that there has been a massive drop in the tourist sector due to the Covid issue. There has been a huge drop of tourism from outside the nation. Sri Lanka boasts of one of the world's best wildlife reserves and Forbes ranks it as a top wildlife, biodiversity, safari and its 1600 kms of peaceful beaches of natural scenic beauty. The heritage museum is also robust with a heritage as old as 324 BC when Emperor Ashoka sends his daughter to propagate Buddhism throughout the world.

Such a massive drop in tourism has led to a catastrophic drop in income and employment which is given below Sri Lanka's high unemployment rate has been attributed to a mismatch of skills, to queuing for public sector jobs, and to stringent job security regulations and the huge drop in tourism arrivals. Tourism is the highest job creator in the world and such a drop in tourism can break the backbone of any nation if it puts all its eggs in one basket.

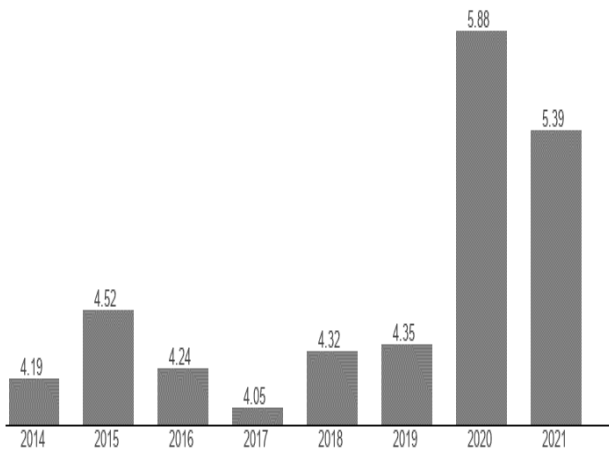


Figure 5 Graph shows Unemployment rate in Sri Lanka Source-theglobaleconomy

Crude oil and Exports

Like every other country Sri Lanka has been hit by the crude oil crises and its resulting high prices. The economic crises has resulted in declines in electricity, fuel and cooking gas consumption, resulting from shortages Long queues have formed in recent months in front of petrol filling stations. The surge in global oil prices further aggravated the fuel shortage In order to conserve energy, daily power cuts have been imposed by the authorities throughout the country. On 22 March 2022, the government ordered the military to post soldiers at various gas and fuel filling stations to curb the tensions among people who line up in queues and to ease the fuel distribution. Although all countries are suffering from the high prices due to the Ukrainian war, Sri Lanka has a huge repayment issue which makes it very difficult to pay in foreign exchange. For example, as of February 2022 inflation was 17.5%. The year on year increase inflation for food was 24.7% while non-food items saw an 11% rate.

The repercussions of the 2022 Russian invasion of Ukraine are considered to have affected the already sluggish

economic conditions of Sri Lanka. The invasion has further exacerbated the economic calamity of the country due to Russia being the second biggest market to Sri Lanka in tea exports and Sri Lanka's tourism sector is heavily reliant upon Russia and Ukraine, as most of the tourist arrivals are from the two nations.

As a result, the Ukrainian crisis has put a halt to the economic recovery of Sri Lanka with both the tea and tourism sectors having been hit hard. On 13 July, Ukrainian President Volodymyr Zelensky stated that Russia is accountable for the economic crisis in Sri Lanka, accusing Russia of exacerbating a global food crisis and fuelling inflation.

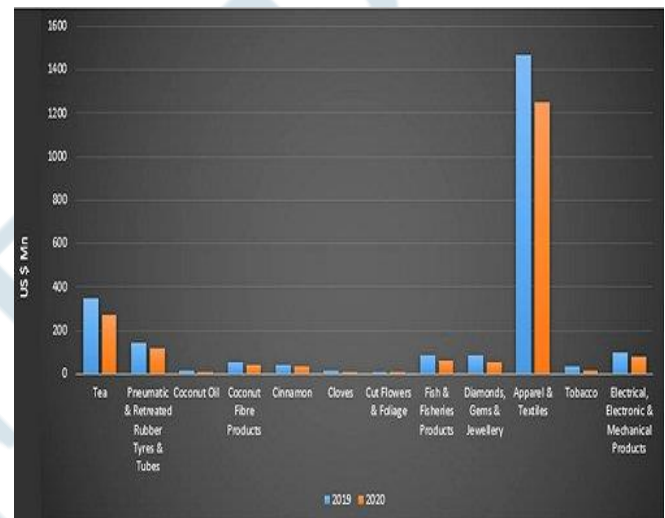


Figure 6 Sri Lanka Exports Source -globaltamilnews.net

A look at the exports clearly indicates the massive crisis of the Sri Lankan exports situation. Sri Lanka export earnings fall nearly 42 percent in March 2020 Sri Lanka's merchandize export earnings fell by 41.9 percent in March 2020 as the spread of COVID-19 in the country disrupted the production of merchandise, the Export Development Board (EDB) said. The year-on-year export earnings fell to US\$ 646 million from US\$ 1.112 billion recorded in March 2019. Apparel sector being the largest contributor has shown a 41 percent decline during the month of March 2020 compared to the same month in the previous year.

VII. ORGANIC FARMING

A shift to better farming practices is possible, but Sri Lanka's abrupt switch to organics offers a bitter lesson in how to change food systems in a sustainable way. Pandemic aside, that's not an atypical set of conditions for the collapse of a developing country like Sri Lanka. But in the spring of 2021, President Rajapaksa made an unusual decision: He banned synthetic fertilizer and pesticide imports practically overnight, forcing Sri Lanka's millions of farmers to go organic. It proved disastrous, as a group of Sri Lankan scientists and agriculture experts had warned. According to one estimate, the president's agrochemical ban was poised to save Sri Lanka the \$400 million it was spending yearly on

synthetic fertilizer, money it could use toward increasing imports of other goods. But Rajapaksa **also argued** that chemical fertilizers and pesticides were leading to “adverse health and environmental impacts” and that such industrial farming methods went against the country’s heritage of “sustainable food systems. There is a section of the Sri Lankan NGO society and civil society, which has been arguing for the spread of organic farming in Sri Lanka for quite a while. ... This has also been actively supported by many international groups. The agrochemical ban caused rice production to drop 20 percent in the six months after it was implemented, causing a country that had been self-sufficient in rice production to spend \$450 million on rice imports — much more than the \$400 million that would’ve been saved by banning fertilizer imports. The production of tea, Sri Lanka’s literal cash crop — it’s the country’s biggest export — fell by 18 percent. The government has had to spend hundreds of millions on subsidies and compensation to farmers in an effort to make up for the loss of productivity. While agrochemicals cause a host of environmental and public health problems, which in part inspired the ban, they also help farmers grow more food on less land, which is critical for small, developing countries like Sri Lanka that rely on agriculture for both sustenance and export income. Moving away from an agrochemical-heavy food system makes sense in a lot of ways, but the Sri Lanka example underscores the importance of being mindful of the economic, political, and social context of any reform.

Around five months into the ban, farmers were allowed to begin using synthetic fertilizers on tea and a few other crops while keeping the ban in place for others, but by that point, much of the damage was done. The blinkered organic rollout accelerated an economic crisis long in motion, but it also crystallized the stakes of the debate over conventional versus organic farming, demonstrating just how critical high-yield crops are in economies still based largely on agriculture.

India’s top organic scientist Vandana Shiva was involved in taking decisions to introduce organic farming and the results justify that a slow growth into organic farming is a must and at the same time customers must pay for the organic part of the produce. Organic yields are generally low and hence there is drastic shortfall in quantity. Furthermore the staple foods are not the commodity to introduce organic farming but rather new products are. The market survey must be done in a meticulous way to determine the price point of organic foods.

Political Crises and Dynastic Politics

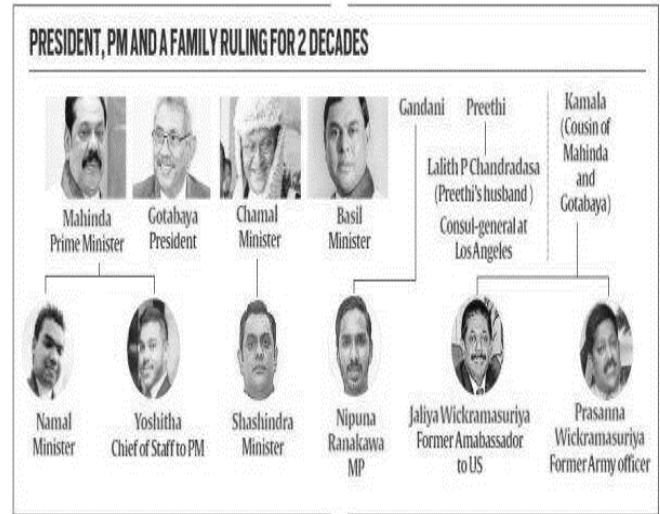


Figure 7 Rajpaksas family Source-TheIndianExpress

The Rajapaksha family dynasty has held onto power and has controlled Sri Lanka Politics since last two decades. The brother of the President, Mahinda Rajapaksa and former minister and the President as well as the Finance Minister has already resigned due to mass protests. The people protests are continuing over the continued tenure of President Mahinda Rajapaksa. Accounting to the sources, people close to power, have commented that the family has concentrated so much power and influence that it has come to resemble the country as an autocratic family business. Sources say that the family bitterness between the two brothers Gotabaya and Mahinda have descended into utter bitterness as they both clung to power. The entire cabinet has resigned and fled. Many cabinet members point to Basil Rajapaksha as the root of the entire problem and apparently the chief driver of the strategies and their implementation. His connection with media moghuls, background power brokers and having the unqualified faith of the President, he proved incompetent at running the economy, was charged with large corruption allegation and unaware that a financial meltdown was imminent. From 2005 when Mahinda Rajapaksa was elected as President and the family started to dominate the political landscape of the country. They first borrowed heavily to finance their war with LTTE which ended in 2009. Then the economy went into an infrastructure overdrive involved roads, airports, stadiums and power grids, the GDP grew from \$20 billion to \$80 billion but more than \$14bn was borrowed from foreign sources and in the entire process the Rajpaksa family was apparently mired in vast scale corruption from bribes to money laundering. There is considerable truth in the statement that Sri Lanka slid from a democracy to an autocratic state with power being accumulated with the Rajapaksha and his political and military cronies, who are involved in multiple financial economic crises. It is clear that Economic mismanagement by the Rajapaksa family has had a large hand in these crises.

VIII. CONCLUSION

Sri Lanka is experiencing an economic crisis stemming from an unsustainable debt load and perennial deficits on both the international balance of payments and the government budget, resulting in a severe shortage of foreign currency exchange (forex). Following months of escalating protests, and the May resignation of his brother Prime Minister Mahinda Rajapaksa, Sri Lankan President Gotabaya Rajapaksa fled the country on July 13. Sri Lanka's economy has hit rock bottom as it defaulted on international loans and is facing rampant fuel and food shortages, and the government imposed a state of emergency. Gotabaya's flight from the country leaves the government in further disarray.

Sri Lanka has always been helped by India in extending to it about 5 billion to shore up its foreign exchange, food aid, medical supplies, etc. China owns about 10% of Sri Lanka's foreign debt, which exceeds \$51 billion. As with this situation, India and China are keen to help Sri Lanka get out this crises by helping in return for some political concessions or autonomy to the Tamil Eelam question for which 2000 Indian Army heroes and a Prime Minister had to give their life. This is a possibly volatile issue but China, unlike India, has extended a large credit line for its two ports and has been handed over 77% of the ownership of its ports by Sri Lanka. India too is in balance of payment issue with respect to foreign exchange but Sri Lanka is now cut off from any Foreign Direct Investment (FDI). Unless and until the IMF, World Bank and Sri Lanka agree to a long term commitment of repayment, it is anybody's guess what will be outcome. In the meantime, newspapers are cut, examinations not held – all due to lack of paper. There is practically no-one at the top to take a decision and dynastic politics hold sway.

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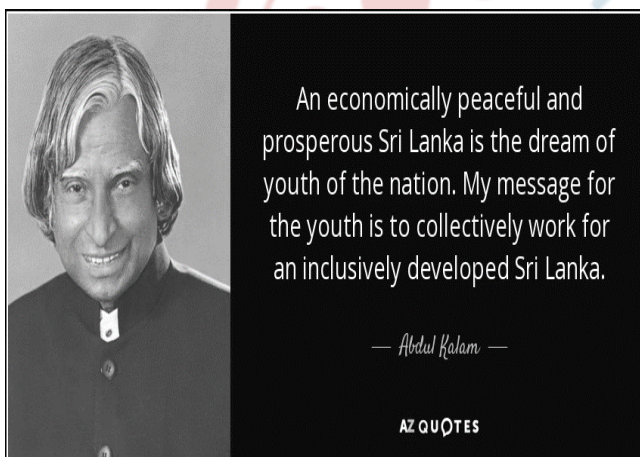


Figure 8 A quote by Abdul Kalam Sources - AZQuotes

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