

# THE NEWS The Sri Lanka paradox

## [Part – II]

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Sri Lanka recorded a rapid increase in public debt-to-GDP ratio to 119 per cent from 42 per cent over a few years. Access to the international capital market was lost, export earnings plummeted, and import payments swelled up due to global price increases, prompting depletion of foreign exchange reserves to critically dangerous levels.

Export earnings from tourism – which were \$4.4 billion in 2018 or 5.6 per cent of GDP – dipped to 0.8 per cent of GDP. Remittances started drying up too, shrinking from \$612 million in April 2021 to \$205 million by February 2022. Petroleum prices tripled from \$40 a barrel to \$120 in a short span of time, making it almost difficult for the government to find the resources to place orders for replenishing or building stocks. As FDI was channeled mainly to cater to the domestic market demand, the profits were repatriated in foreign exchange thereby further putting pressure on the current account.

It is pertinent to mention here that, contrary to popular misperception, China has only 10 per cent share while international sovereign bonds account for 50 percent of the total external debt of Sri Lanka of \$51 billion. The ratio of external debt-to-GDP has risen from 30 per cent to 42.6 per cent. As the country fell into the middle-income category, it was no longer eligible to secure concessional loans from multilateral institutions and bilateral creditors and therefore the terms and conditions of the loans were market determined and depended on sovereign rating by credit rating agencies. Once the ratings were downgraded, rollover of sovereign bonds through new placements became difficult. Rajapaksa and his brothers were reluctant to approach the IMF as they considered the conditionalities required would be unacceptable politically. The country had no other option but to default on its external

service payments of \$7 billion for the rest of 2022 against reserves of only \$1.9 billion.

The third trigger was the decision to ban the imports and use of chemical fertilizers, and transition to organic fertilizers. This unwise decision has cost the country a fortune because two-thirds of the population depends on agriculture directly or indirectly. The output of the country's staple diet – rice – sank precipitously by 20 per cent and rice had to be imported at a time when the world prices were high, the country was short of foreign exchange and the Sri Lankan rupee was depreciating. Domestic rice prices to consumers recorded a hike of 50 per cent in seven months. Export earnings from tea also dried up as the industry suffered losses of \$425 million, further harming the balance of payments position. Other essential food items such as wheat, sugar, milk powder also suffered output decline and the demand for foreign exchange increased to import these commodities.

The sharp fall in rural incomes and erosion in the purchasing power of the urban consumers of food and other agricultural products created a lose-lose situation for everyone instead of the traditional winners and losers arising from public policy interventions. Depreciation of the currency by 75 per cent in March-June skyrocketed import costs, adding to inflationary pressures. Speculators, taking cognizance of the depleting reserves, entered the market to hoard foreign exchange and intensified the pace of the downward movement of the parity rate.

It would be fair to add that the period 2015-19 was also characterized by allegations of corruption and reckless spending and borrowing. So it was not only the Rajapaksas but the systemic corrosion of the body politic by the elite that has contributed to the present state of affairs in Sri Lanka. The cumulative effect of all these arbitrary, populist, flawed policies and mismanagement, nepotism, greed and wealth accumulation by the ruling classes, combined with adverse external economic circumstances, resulted in massive increases in prices and shortages of essential goods and services. Shortage of food and medicine, rationing of fuel, and loadshedding of electric power made daily life miserable for almost everyone – except the elite.

Headline inflation on a year-to-year basis hit a record high of 54.6 per cent in June 2022 as a result of imported inflation, supply shocks, fiscal profligacy and a loose and accommodating monetary policy. The misery faced by the citizens brought for the first time in the history of Sri Lanka all segments of the divided population – Tamils, Sinhalese, Muslims, Christians – together on a single platform to pursue a single point agenda: get rid of those who had inflicted this misery. This social cohesion precipitated the popular uprising, the occupation of the presidential palace, the resignation and the fleeing of Gotabaya from the country. The majoritarian rhetoric and authoritarian nationalist stance that the Rajapaksa family had exploited for their advantage for over a decade did not help them when the chips were down.

The Arab spring uprisings in the Middle East in the 2010s, the abrupt exit of Ashraf Ghani from Afghanistan after the Taliban takeover and the fleeing of an otherwise strong man in Sri Lanka should help highlight some bitter truths. In this world of instant communication and social media, rulers ought to be careful not to antagonize people to the point where their patience threshold reaches its brim and they have no other option but to mobilize themselves spontaneously but ruggedly to vent their pent up emotions against those who have abused power for personal benefits. At that time the distinctions arising from ethnicity, language, sect, region, gender all disappear and the wrath is so fierce that soldiers, police personnel and law enforcing agencies are hesitant to take coercive measures against the agitating masses not because of the huge numbers, but out of empathy with the agitators as they themselves are facing identical conditions.

The key to avoiding such a gruesome situation is good governance and equitable sharing of the benefits of growth where the majority of the population rather than a narrow elite class derives the benefits. Self-aggrandizement and maximization of personal and familial interests by the elites to the exclusion of others is no longer acceptable to a more informed, urbane and educated youthful population of this day and age. Corruption and nepotism have to be contained and pomp and protocol given up by adopting a simple and austere lifestyle. Basic public services have to be delivered while rule of law has to be observed, with cheap and expeditious justice available to everyone. Accountability of public office-holders needs to be ensured. Merit,

performance and competence rather than loyalty, familial relations or political connections should be the guiding principles for choosing the individuals running the government organizations. Sound economic management should not be sacrificed for the sake of short-term political expediency. These essential elements of good governance and management are the only guarantee for countries to enjoy peace and prosperity and leaders to earn the respect and confidence of the citizens.

In the end, some food for thought for all of us in the development community who have become passive consumers of a plethora of global indices of all kinds that have gripped our minds. Single issue advocacy groups and international agencies with specific mandates – both inter-governmental and NGOs – have found that a quantitative measure such as an index is a persuasive tool as it confers a lot of respectability for their messages. In most cases, a partial positive correlation is asserted between the value of their particular index and general economic betterment.

The Sri Lanka paradox – a vivid example of a star performer on many of these global indices gone sour – raises serious questions about the veracity, authenticity and credibility of these indices which have become a commonplace tool for comparative country analysis and policy actions.

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