Vol-06 Issue 06, June -2022 ISSN: 2456-9348
Impact Factor: 5.004

iJETRM
International Journal of Engineering Technology Research & Management

CRISIS AMIDST THE COVID-19 PANDEMIC: FACTORS THAT ATTRIBUTED TO THE BANKRUPTCY OF SRI LANKA

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Abstract:
Sri Lanka is now facing its worst economic crisis since independence in 1948, with critical shortages of food, fuel, and other essentials. The country also decided to suspend the payments on their foreign loans. On April 12, 2022, the government temporarily halted payments to international creditors, marking a historic milestone in the economic and financial crisis damaging the island nation of 22 million people. For the first time, Sri Lanka defaulted. Its economic miseries have brought on a political crisis, with the government facing a protest and a vote of no-confidence motion in Parliament.

Keywords:
Sri Lanka, Foreign Loans, Economic Crisis, Financial Crisis, Political Crisis.

INTRODUCTION

Economic issues influence our daily lives. This includes issues such as tax, inflation, interest rates, wealth, inequality, emerging markets, energy, and the environment. A broad subject, economics provides answers to a range of health, social and political issues that impact households and wider communities. On the other hand, the inability of a country to fulfill its debts will more likely results in default or bankruptcy. There are a variety of reasons why a country defaults on its debt, including a simple reversal of global money, flows and insufficient revenues. In the case of Sri Lanka, Economic Mismanagement, Foreign Exchange Reserves, and the Covid-19 Pandemic are the main reasons why the country was forced to enter bankruptcy. Sri Lanka's foreign currency reserves have run dry, and it can no longer afford to pay for imports of staple foods and fuel. The government blames the Covid-19 Pandemic, which affected Sri Lanka's tourist trade, one of its biggest foreign currency earners. It also says tourists have been frightened off by a series of deadly bomb attacks on churches in 2019. However, many experts say government mismanagement is to blame.

STATEMENT OF THE PROBLEM

Protests have been taking place on the island nation of 22 million people since the end of March of 2022 between pro-government supporters and those calling for an immediate change in authority. The country has $25bn (£19.2bn) of foreign debt, which is due over the next five years - however, it has unilaterally suspended all payments. Inflation hit a record high of 11.1% in November 2021 and escalating prices have left those who were previously well off struggling to feed their families, while basic goods are now unaffordable for many. After Rajapaksa, the previous Prime Minister declared Sri Lanka to be in an economic emergency, the military was given the power to ensure essential items, including rice and sugar, were sold at set government prices, but it has done little to ease people's distress.

> ***The foreign currency crisis has limited imports and caused severe shortages of essential goods like fuel, cooking gas, medicine, and food. People must line up for hours to buy what they can and many return home with little, if any, of what they were seeking.***

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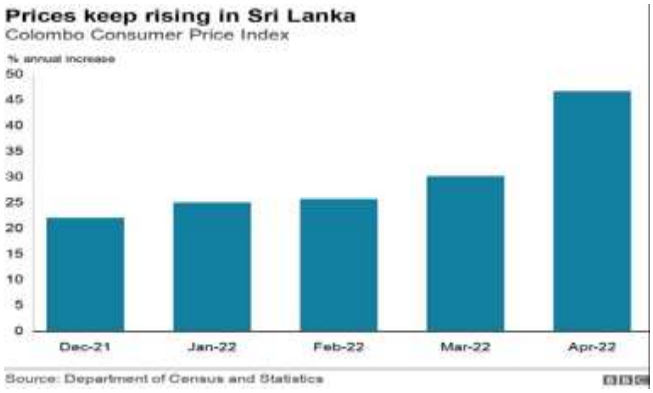

Fig. 1: Sri Lanka Consumer Price Index

Source: ***https://tradingeconomics.com/sri-lanka/consumer-price-index-cpi***

One of the most pressing problems for Sri Lanka is its huge foreign debt burden, in particular to China. It owes China more than $5bn in debt and last year took an additional $1bn loan from Beijing to help with its severe financial crisis, which is being paid in installments. In the next 12 months, in the government and private sectors, Sri Lanka will be required to repay an estimated $7.3bn in domestic and foreign loans, including a $500m international sovereign bond repayment in January. However, as of November, available foreign currency reserves were just $1.6bn. In an attempt to temporarily ease the problems and to avoid the difficult and most likely unpopular policies, the government has resorted to temporary relief measures, such as credit lines to import foods, medicines, and fuel from its neighboring ally India, as well as currency swaps from India, China and Bangladesh and loans to purchase petroleum from Oman. However, these loans provide only short-term relief and must be paid back quickly at high-interest rates, adding to Sri Lanka's debt load.

CAUSES OF THE PROBLEM

There are multiple reasons that attributed to the bankruptcy of Sri Lanka. Aside from the fact that the country has been in financial crisis prior to the election of the new government, here are other reasons that attributed to the fast decline of the country:

A. Economic Mismanagement

Ahead of the November 2019 election, Sri Lankan presidential challenger Gotabaya Rajapaksa proposed reckless deep tax cuts from 15% to 8% and scrap other levies. After being elected, he passed the tax cut immediately in his first cabinet meeting. It only took 30 months for Sri Lanka to run out of cash to pay for essential goods like food and fuel, leading to long petrol lines and daily 13-hour power cuts.

Finance Minister Ali Sabry has said these tax cuts lost the government more than $1.4bn (£1.13bn) a year in revenue. When Sri Lanka's foreign currency shortages became a serious problem in early 2021, the government tried to limit the outflow by banning imports of chemical fertilizer, telling farmers to use locally sourced organic fertilizers instead. This led to widespread crop failure. Sri Lanka had to supplement its food stocks from abroad, which made its foreign currency shortage and food security even worse.

B. Covid-19 Pandemic

The Covid-19 pandemic is one of the main reasons for the country's debilitating economic situation. The pandemic has caused several tourism-related businesses to shut down, leading to a massive loss in revenue. The government also failed to order covid-19 vaccines in a timely manner resulting in buying them later at higher prices. Unemployment increased in the country as COVID-19 has eaten into the tourism industry, leaving thousands and

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thousands without a job. Fears of further meltdown, the government printed money, boosting supply by 42% between December 2019 and August 2021—which aided what would become Asia's fastest inflation.

C. Foreign Exchange Reserves

The foreign currency crisis has limited imports and caused severe shortages of essential goods like fuel, cooking gas, medicine, and food. People must line up for hours to buy what they can and many return home with little, if any, of what they were seeking.

Foreign Exchange Reserves in Sri Lanka decreased to $2311 million in February from $2362 million in January of 2022.

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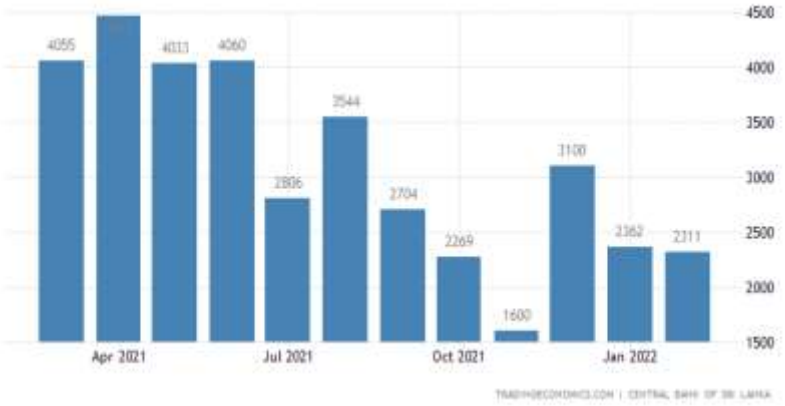

With foreign currency in short supply due to less tourism and other revenues, official reserves were tapped to pay for importing essentials including fuel, gas, coal, and medicines beginning in August 2021. The bulk of Sri Lanka's remaining reserves, including a $1.5 billion equivalent swap from China, are not usable for settling dollar-denominated payments, according to Ali Sabry, Minister of Finance of Sri Lanka.

COURSES OF ACTION

The initial response of the government to resolve its economic downfall is to raise the value-added tax from 8% to 12% and also the corporate income tax. Prime Minister Ranil Wickremesinghe, who took office this month and plans to present an interim budget within weeks, said that the measures were necessary as the current state of government finances was unsustainable. An increase in value-added tax (VAT) to 12 percent from 8 percent with immediate effect is among the key tax increases, which is expected to boost government revenues by 65 billion Sri Lankan rupees ($180.56m). Other measures, including increasing corporate income tax to 30 percent from 24 percent from October 2021, will earn an additional 52 billion rupees and will definitely help the economic growth of the country.

CONCLUSION

Most conflicts arise from problems of governance. A government must always be effective and efficient. Every decision-making process and its institutions must be able to produce decisions that meet every community needs. Community resources must also be utilized optimally by the government. All institutions involved in good governance have full responsibility to the public for the sake of improving the quality of society. The main reason why Sri Lanka fell on the brink of bankruptcy was due to the poor governance and scheme of President Gotabaya Rajapaksa. Amidst the warning of then finance minister, Mangala Samaraweera, Rajapaksa still passed the reduction of the value-added tax which resorted in food and fuel shortages and daily 13-hour power cuts. Instead of learning to govern with more

humility, Rajapaksa rushed to restore the family's brand of populist authoritarianism—which we now know to have backfired.

RECOMMENDATION

In order to pay off its debt to creditors, the Sri Lanka government should look into restructuring its foreign debt. Negotiating with the countries they owe and creating new debt management plans with each one rather than selling off government assets.

The initial response of the government to retract the tax cuts it made is a good decision. In this way, the government is positioning itself to recover in a slow and steady-state. The additional revenue it generates could be spent to boost the country's exports on trades and goods.

Other measures like creating business-friendly tax and policy regimes, digitizing all government services, and eliminating red tapes will open the country for foreign investments. In addition, in lieu of the ease in Covid restrictions, the government should also improve its tourism and support for foreign workers which will aid in increasing its depleted foreign reserves.

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