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How Can Sri Lankan Economy Get Away from the Debt Issue

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A B S T R A C T

Sri Lanka was a colony of Portuguese, Dutch and British. Sri Lanka got independence in 1948 from British. During that time Sri Lanka was ranked as one of the good economies in Asia. , in 2021 situation is worst when considering the Sri Lankan economy, Sri Lanka has taken huge loans and the main reason for that is low tax revenue and less foreign direct investment. The country has been relying heavily on foreign loans with the expectation of developing the country for the last 40 years. During the early 1990 the majority of Sri Lanka's foreign debts consisted of concessionary loans. Most of these loans were provided by the development agencies such as World Bank, Asian development bank and Japan International Cooperation Agency. These Loans are very important to Sri Lanka because they have a long payback period, very low interest rate (1% or less than 1%) and considerable grace period which mean even after the due date payment can be made without a penalty. Then, Sri Lanka was promoted from poor country to lower middle income earning country in1997.Then its ability to gain concessionary loans from multilateral agencies and bilateral donors were declined. Therefore, Sri Lanka had to look for alternative foreign financing sources through International Capital Market. The main reason why Sri Lanka get into debt issue is country heavily dependent on only commercial borrowings without improving the structural weaknesses of the economy. Economy can not be developed through only commercial loans there should be strategy use those money in an effective way that country enjoy benefit in long term. Eg: profitable projects. Some important methods to remember is that the foreign debt issue can be resolved by addressing the structural weaknesses of the economy. Therefore, country has to find the solution by increasing the export while managing the imports. Further, Sri Lanka should not go for any further commercial loans (ISBs) since country has to pay these loans till 2030.Sri Lanka should reduce imports while improving production in many sectors.

Keywords: Sri Lankan economy, Loans, International capital market, Foreign debt, imports, Sectors

Introduction

Sri Lanka was a colony of Portuguese, Dutch and British. Sri Lanka got independence in 1948 from British. During that time Sri Lanka was ranked as one of the good economies in Asia (Jigging, 1976). Sri Lanka per capita income and the other economic indicators proved that Sri Lanka was well ahead not only among South Asian countries but also among countries like Korea and Thailand.(Athukorala*et a*l ,2017). Sri Lankan people received the universal suffrage since 1931.Further during this time Sri Lanka had a stable political system (Athukorala et al,2017).Former Singapore prime minister Lee Kuan Yew was the hero to develop the Singapore economy. He introduced Sri Lanka as "The best in Asia" and he wanted to make Singapore like Sri Lanka (Lee 2000: 461-2). The good evidence to Prove that Sri Lanka had a stable Political system is in 1948 Sri Lanka first prime minister D.S Senanayake said " Sri Lanka wants neither grants nor loans from US or any other country (Wijesinghe,1976).

In 1960 Sri Lanka per capita income has fallen compared to other Asian countries (Athukorala & Rajapathirana, 2000). In 1977 after the economic liberalization reforms were initiated, it was observed that there was a rapid growth in Sri Lankan economy. However, this growth is last only for a short time period due to some factors such as political unrest, terrorist events (LTTE) and external shocks (Athukorala*et al*, 2017). However, this affected negatively on successful domestic industries operated in Sri Lanka. As a result of this protectionist policies were affected negatively (Rajapathirana, 1998). Further, Sri Lanka could not achieve some benefits after the open economy policy due to the ethnic conflict in early 1980(Athukorala*et al* , 2017).

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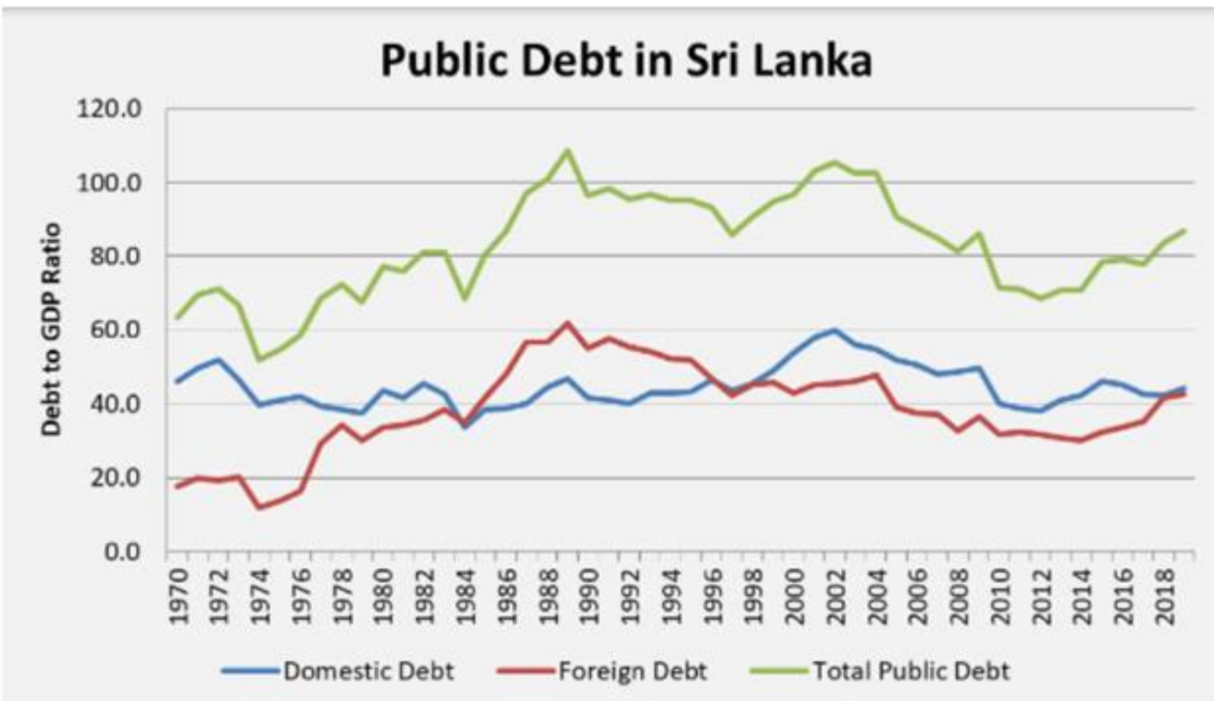
The second liberalization package was introduced in1990 followed by notable privatization and deregularly reforms. Sri Lanka had to increase the import tariff to meet the budget for the war which Sri Lankan government had to face. So Sri Lanka could not enjoy benefits during that time(Rajapathirana, 2004). So tariffs were adjusted in ad hoc manner without a proper plan (Pursell, 2011).

Public debts in Sri Lanka

However, in 2021 situation is worst when considering the Sri Lankan economy. Sri Lanka has taken huge loans and the main reason for that is low tax revenue and less foreign direct investment. The country has been relying heavily on foreign loans with the expectation of developing the country for the last 40 years. In 1989 Sri Lanka's foreign debt represented nearly 62% of its GDP. However, Sri Lanka's foreign debt to GDP ratio has declined drastically compared to the figures in early 1990.



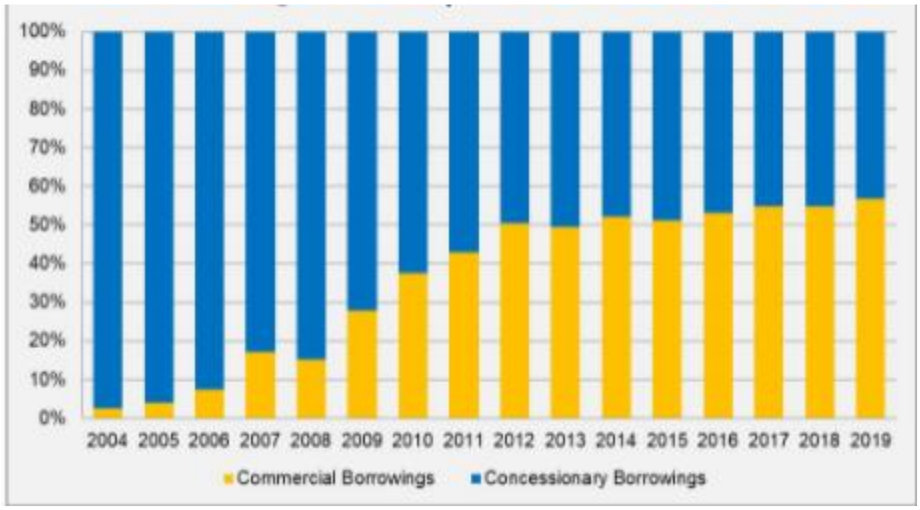
Source: Central Bank, Sri Lanka

During the early 1990 the majority of Sri Lanka's foreign debts consisted of concessionary loans. Most of these loans were provided by the development agencies such as World Bank, Asian development bank and Japan International Cooperation Agency. These Loans are very important to Sri Lanka because they have a long payback period, very low interest rate (1% or less than 1%) and considerable grace period which mean even after the due date payment can be made without a penalty. These loan conditions were very favourable to low income earning country like Sri Lanka. Most important favourable condition comes under this concessionary loan is repayment period since it is very important to country like Sri Lanka. These loans repayment period is normally 25-40 years (Moramudali, 2021) with very low interest which country like Sri Lanka can manage. Therefore, foreign debt was not a burden, risk or threat to foreign exchange reserves and the B.O.P of Sri Lanka.

However, Today's situation is different. Sri Lanka was promoted from poor country to lower middle income earning country in1997.Then its ability to gain concessionary loans from multilateral agencies and bilateral donors were declined. Therefore, Sri Lanka had to look for alternative foreign financing sources. In the year 2007, Sri Lanka issued its first International Sovereign Bond (ISB) worth of $500 million and started raised finance through International Capital Market.

Sri Lanka was mainly dependent on ISBs to raise the finance and Sri Lanka's foreign debt composition changed completely. In 2004, commercial loans amounted to only 2.5% of Sri Lanka's foreign debt but by the end of 2019. 56% the country's foreign loans were through commercial borrowings and most of which are ISBs (Moramudali, 2021). However, in 2019 Sri lanka was upgraded to Upper middle income earning country by the world bank since Sri Lanka's per capita income was $4060.Unfortunately, in 2020 Sri Lanka again downgraded again to lower middle income earning country since per capita income reduced to $4020(Daily FT,3rd July 2020).

Foreign Debt Composition in Sri Lanka



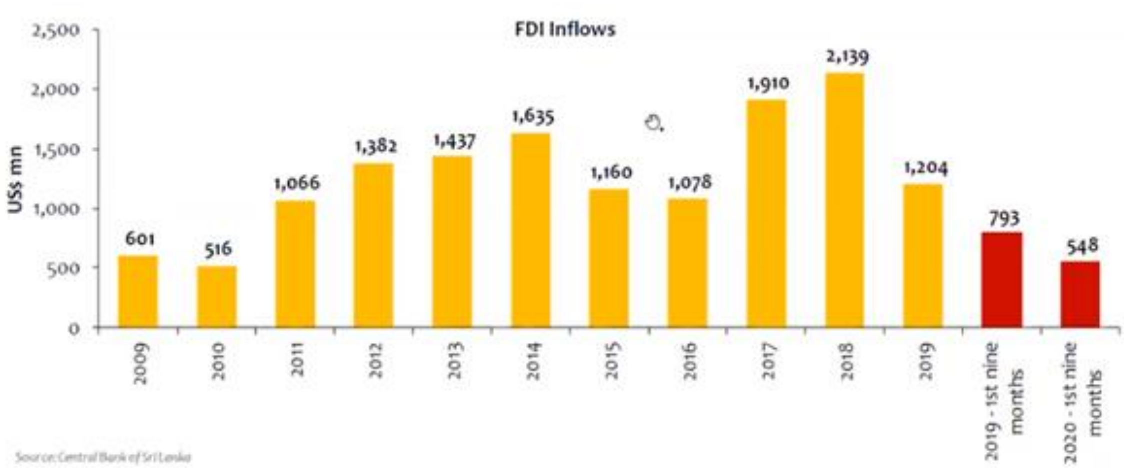
Source: Central Bank Sri Lanka

These Commercial loans have short payback period with annual interest above 6% to be paid twice a year with the principal payment. Therefore total loan amount should be settled at the bond maturity date. So government has a difficulty to pay the total amount rather than annual repayment. When ISB matures Sri Lanka has to pay lump- sum as the foreign debt repayment which resulting huge foreign cash outflow from the country. These loans affect negatively the foreign reserves of the country and the B.O.P. Therefore it is understood that this debt dynamics have shifted the country's economy to a very risky situation.

How did Sri Lanka get into debt issue?

- The main reason why Sri Lanka get into debt issue is country heavily dependent on only commercial borrowings without improving the structural weaknesses of the economy. Economy can not be developed through only commercial loans there should be strategy use those money in an effective way that country enjoy benefit in long term.Eg: profitable projects.
- Major structural weaknesses found in Sri Lankan economy were low GDP, Low level of Foreign Direct Investment, declining tax revenue, failure to improve the exports in different sectors.

FDI inflow

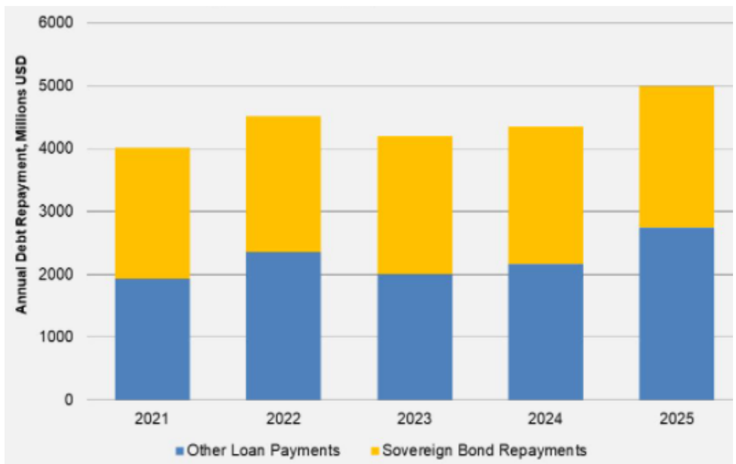


Source: Central bank ,Sri Lanka

- GDP has been falling from 33% in the year 2000 to 13% in 2019. Sri Lanka has to focus more on this to have more export earnings. So export earnings have become stagnant.

- In addition, FDI inflows remain low. Sri Lanka was unable to achieve the FDI targets. This means that foreign currency inflow did not show a considerable improvement while foreign currency outflow increased due to ISBs maturity and other loan repayments. This negatively affected the foreign exchange reserves. This caused Sri Lanka's foreign reserves to run dry. In addition to a debt issue this can be considered as a serious macroeconomic issue which is needed to find the answer since this is affected the BOP adversely.

Foreign debt repayment of Sri Lanka

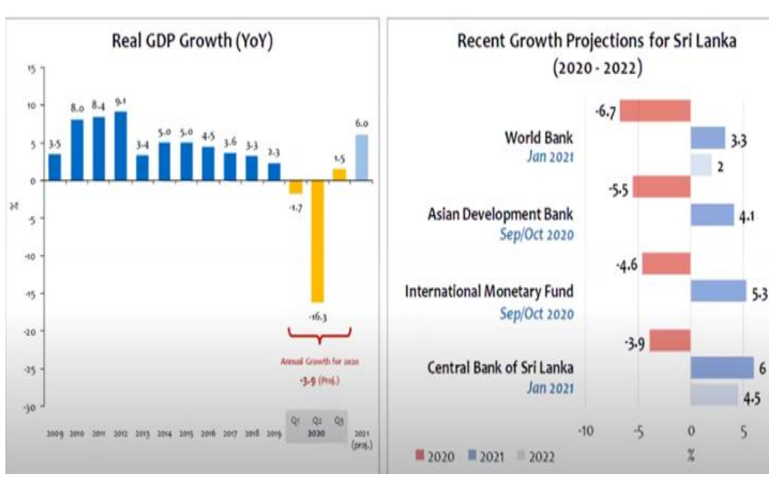


Source: Department of external resources, Sri Lanka

Covid 19 pandemic affected negatively Sri Lanka's economy from 2020.Sri Lanka uses some temporary solutions which does not fix the problem. These temporary solutions are:

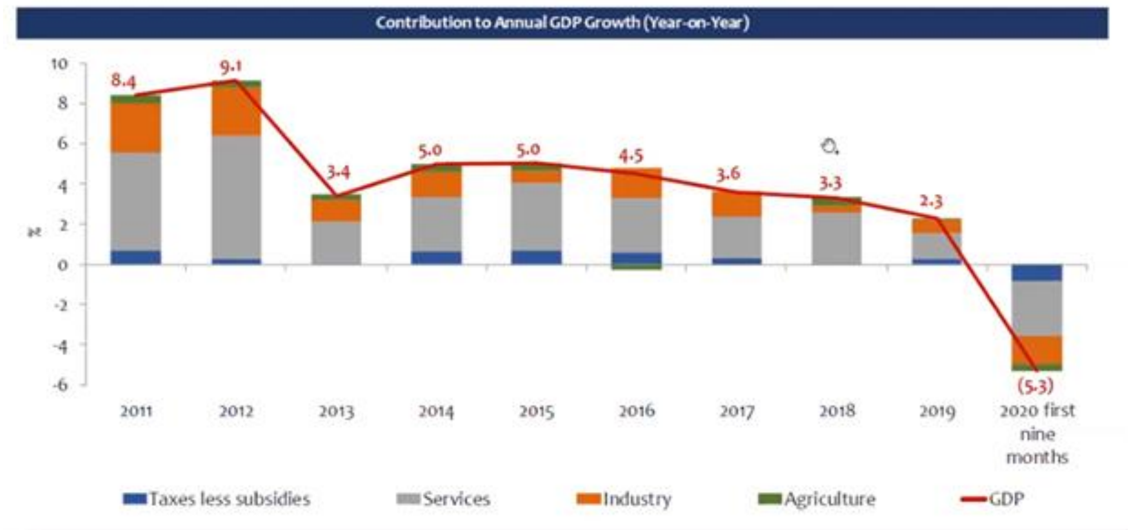
- Issue more ISBs and roll over other foreign loans which are costly to the country. In long term this will cause more issues to the country's economy.
- Seek assistance from IMF and request to bailout packages to increase the foreign currency reserves to avoid BOP crisis.
- Get financial assistant from china largely through foreign currency term financing facilities (FCTFF).Sri Lanka obtain $500 million as FCTFF from in April 2020 while country having $1 billion FCTFF from China obtained in 2018.
- Use currency SWAP facility from India and Bangladesh. Currency swap is a transaction in which two parties exchange equivalent amount of money and will repayable amounts at a specific date.

Covid 19 pandemic and economic growth



Source: Central bank, Sri Lanka

GDP During the corona pandemic



Source: Central bank, Sri Lanka

Sri Lanka's economy in 2021

Sri Lanka is not getting the support of IMF for the loan facility. Sri Lanka is unable to raise finance through international capital market since country has to settle previous International sovereign bonds.

Nearly 20% of the Sri Lanka's export income is generated through the tourism industry. However, due to covid pandemic tourism industry was affected in enormous way. This affects the foreign reserves since 80% of the income was lost to the country.

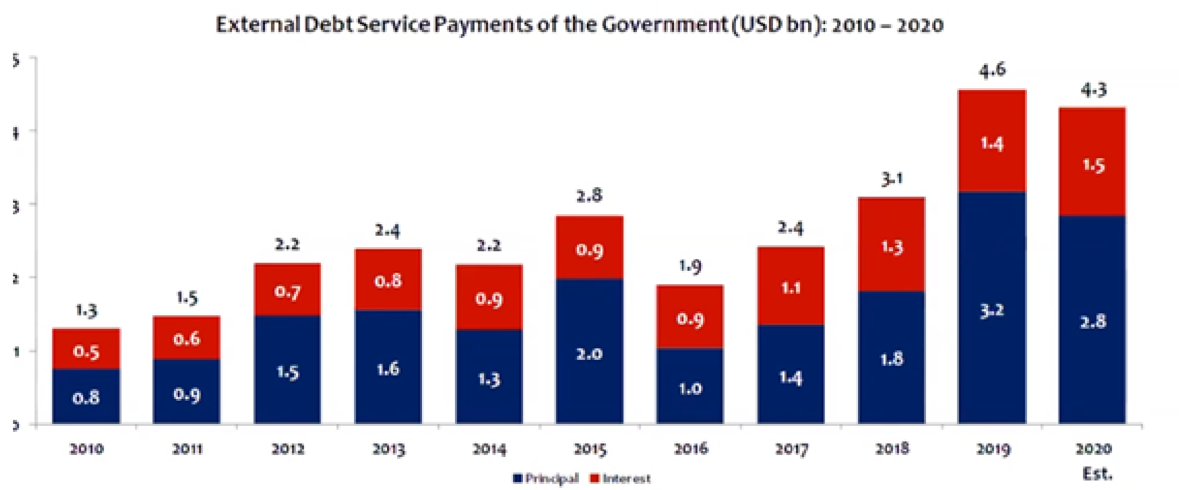
Earnings from tourism

Source: Central bank ,Sri Lanka

Government implemented a strategy is to manage the foreign debts through import restrictions. Government has restricted to import some goods including motor vehicles and many other products. Reduction of imports including vehicles cause to reduce the foreign currency outflow which gives a breathing room to manage the foreign debt repayment.

Sri Lanka tries to manage the foreign reserves issue through currency swaps. Sri Lanka has obtained currency swap of $ 400 million from Reserve bank of India in 2020 and repaid it in February 2021.Currency swap is used to increase the foreign reserves in the country. However, Sri Lanka has to pay that money with the interest in Sri Lankan rupees. In 2021 obtained another currency swap from China worth $ 1.5 billion. In addition, Sri Lanka has taken another currency swap even from Bangladesh worth $250 million dollars.

Government is seeking solution from china to resolve this foreign exchange crisis. However, Sri Lanka has to be very careful when they take many loans from china. Sri Lanka has to think whether they are really helping us or not. Sri Lanka's debt rating was downgraded by Standard and Poor, Moody and Fitch. They are the three major rate agencies. Debt that Sri Lanka has to pay is $ 4.5 billion in every year.



Source: Central bank, Sri Lanka

Further, country has lost a big foreign exchange to the country since very high percentage of Sri Lankans lost their jobs compared to 2020.

Recommendations to restructure the economy of Sri Lanka

- It is important to remember that the foreign debt issue can be resolved by addressing the structural weaknesses of the economy. Therefore, country has to find the solution by increasing the export while managing the imports.
- Sri Lanka should not go for any further commercial loans (ISBs) since country has to pay these loans till 2030.
- Sri Lanka should reduce imports while improving production in many sectors. These imports should be reduced gradually while improving production in the country gradually. Researcher recommends that below method helps to reduce the imports gradually.

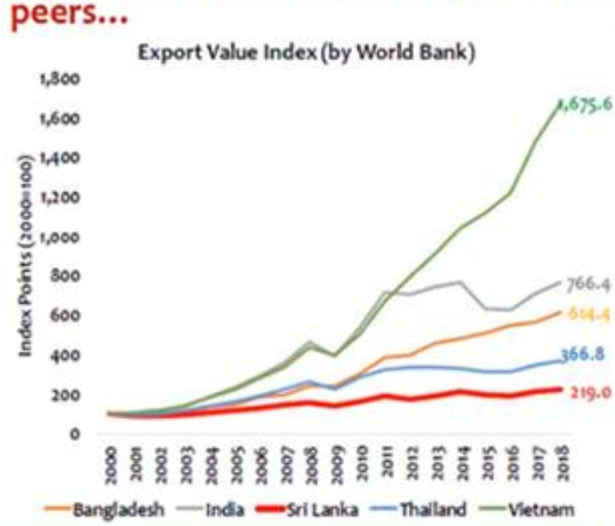
Time Period	Reduction of imports
1-2 years	25% reduction
3-4 years	50% reduction
5-6 years	75% reduction
7-8 years	100% reduction

It is important that Sri Lanka has to increase the production of the selected good to meet the reduction amount.

Source: Central bank, Sri Lanka

The below graph shows exports of Sri Lanka compared to some regional countries like Bangladesh, India,Thailand and Vietnam.It is identified when compared with other regional countries, export growth of Sri Lanka was low and worst thing is only Sri Lanka's export growth (CAGR=6.7%) was lower than the country's average GDP and import growth. During the year 2000 to 2018, Vietnam exports increased more than 16 times, India 7times,Bangladesh 6 times while Sri Lankan exports increased only by 2 times.

Sri Lankan exports have lagged behind when compared with regional peers...

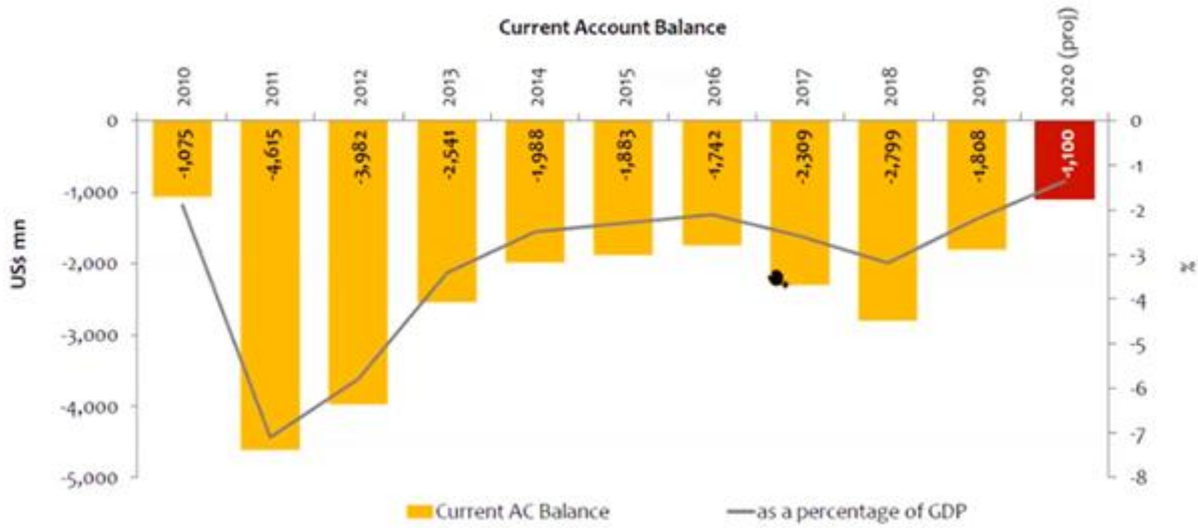


Comparison of GDP, Exports and Imports (US$ bn)

Country Name	Series Name	1985	2005	2015	2019	CAGR 1985-2019 %
Bangladesh	GDP	22.3	69.4	195.1	302.6	8.0
	Exports	1.0	9.3	32.4	39.3	11.4
	Imports	2.5	13.9	42.0	59.1	9.7
India	GDP	232.5	820.4	2,103.6	2,868.9	7.7
	Exports	9.1	99.6	268.0	324.3	11.1
	Imports	15.9	142.9	394.1	486.1	10.6
Thailand	GDP	38.9	189.3	401.3	543.5	8.1
	Exports	7.1	110.9	214.3	246.3	11.0
	Imports	9.2	118.2	202.7	236.3	10.0
Vietnam	GDP	14.1	57.6	193.2	261.9	9.0
	Exports	0.7	32.4	162.1	264.3	19.1
	Imports	1.9	36.8	165.6	253.9	15.6
Sri Lanka	GDP	6.0	24.4	80.6	84.0	8.1
	Exports	1.3	6.3	10.5	11.9	6.7
	Imports	1.8	8.8	18.9	19.9	7.3

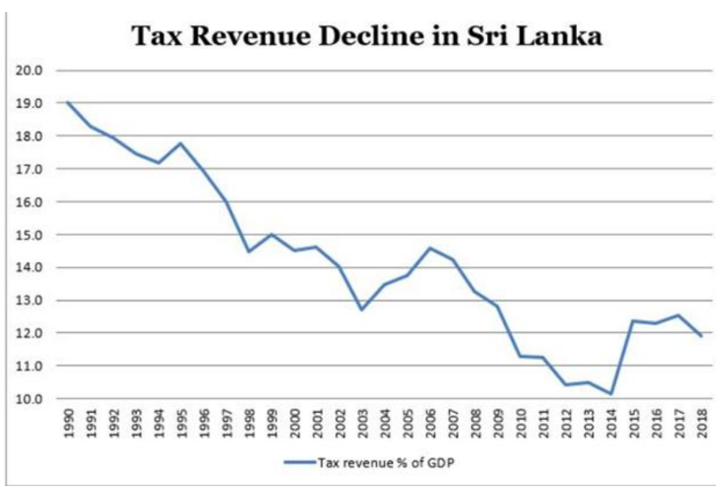
CAGR – Compound Annual Growth Rate Source: World Bank

Source: World Bank



Source: Central bank, Sri Lanka

- A researcher point out that current tax system is ok. However, government has to implement a proper system to monitor whether everyone pays the related tax. By introducing proper computerized system this can be managed effectively since many countries do this effectively since that is one of the main incomes of a government.



Source: Sri Lanka department of treasury & World bank

- Unnecessary expenses on government officials such as huge salary (FromRs. 7 lakhs -22 lakhs) and should monitor thoroughly unnecessary wastages. A good example is Pakistan president reduced lot of unnecessary expenses through a proper administration.

- Government has introduced organic fertilizer instead of chemical fertilizer. Researcher points out that it is a good decision because it affects the people's health positively. However, government should start to produce organic fertilizer to meet the country's need and should provide knowledge to farmers on effective use of organic fertilizer.

- It is important to introduce the subject "entrepreneurship" to the ordinary level, advanced level and university level. It is important to encourage students to select these subjects which can result many entrepreneurs to the country. These text books should be written with the subject knowledge to motivate students to be entrepreneurs in the future.

Recommendations from Singapore economic model to Sri Lanka

- In Singapore economic development model mainly concern about the open economy framework, Strong government involvement in labour and land & industrial development policy. These three concerns helped Singapore to transit from third world status to first world status less than four decades(Lee, 2000).Sri Lanka also can concern the above three factors to develop Sri Lankan economy.

- Establish a fund to promote entrepreneurship. In 1998 Singapore allocated more than US $ 1 billion funds to invest in venture capital funds and to promote entrepreneurship. This created more entrepreneurs in the country who can contribute to the economy (Winston, 2006).

- Established foreign talent policy for technical professionals, skilled workers. This helped Skilled Singaporeans to work in other countries in a high position. This helped the country gain more foreign exchange to the country and it contributes the economic growth favorably. Sri Lanka even can use method to develop the economy.

- Singapore allocated funds for universities to do researches. These researchers will help to do new innovations and country can use it in profitable manner which can contribute to the economy. Even in Sri Lanka can make these new findings from the researchers to profitable projects.

- Technopreneurship programs should be introduced to skilled people with new innovations and help them to manufacture and export their products. This is very good method to increase the entrepreneurs in technology field. These firms can contribute the Sri Lanka's GDP in favourable way (Winston, 2006).

- Singapore developed venture capital industry and assisted domestic industries to become world class companies. Government helps firms with capital and resulted very positive results in Singapore. This can be good method for Sri Lanka to encourage entrepreneurs to start many businesses in the country.

Conclusion

Sri Lanka had a good economy after the independence in 1948.Even foreign leaders like Lee Kwan yew considered that Sri Lanka was a better country with good economy.However,, after Sri Lanka was upgrade to middle income earning country for low income earning country Sri Lanka could not get much concessionary loans.Therefore, country has to take ISB loans with high interest with less payback period.Sri Lanka has to pay these loans till 2030.These loans are very costly as well as risky to the country.Further, Sri Lanka has to invest this loans for profitable project otherwise whole country is in a very risky situation. When Sri Lanka takes more loans like that,Sri Lanka has to repay within a short period and if the project invested was not succeeded then the country has to repay it . So foreign reserves will out flow from the country. This is a very dangerous situation.

Sri Lankan has to consider to do more production in different sectors which is needed to increase the GDP and exports which contributes the current account in a favourable manner.In addition, Sri Lanka is taking more currency swap increase the foreign reserves.Sri Lanka has to consider many sectors to start production while reducing imports gradually.It is must to give a proper training on organic fertilizer restore their farming. Agricultural sector should be develop into a stage that country can export them earn foreign exchange.Further, Sri Lanka has to implement proper tax monitoring system and proper administration to recover it.If Sri Lanka wants to get away from debt issue, it is important to keep full stop mark to unnecessary expenses, wastage and corruption.The concept "entrepreneurship" is very important to the country to make strong the economy. The government can introduce venture capital industry to support domestic industries and new entrepreneurs with creative ideas.Technopreneurship has to play major role in Sri Lankan economy to increase the GDP and economic growth.The debt issue that Sri Lanka faced can be eliminated if the country takes the necessary decisions by considering facts introduced by the researcher.

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