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Report – Panel Discussion

“Sri Lanka’s Economic Crisis: Lessons for Pakistan”

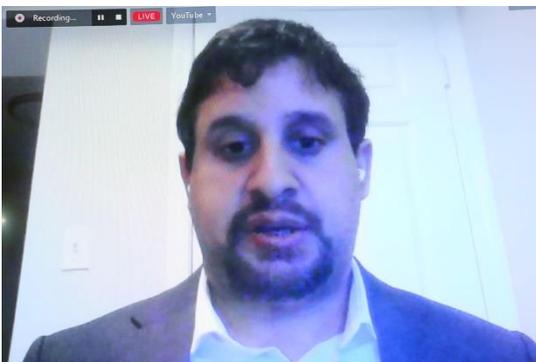
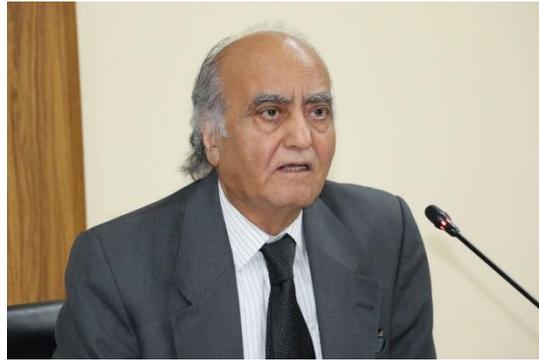
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PICTURES OF THE EVENT



The Centre for Strategic Perspectives (CSP) at the Institute of Strategic Studies Islamabad (ISSI) organised a Panel Discussion titled, “**Sri Lanka’s Economic Crisis and What Pakistan needs to Learn**” on May 17, 2022. The discussants included: Dr. Akhil Bery, Director of South Asia Initiatives, Asia Society Policy Institute, Washington DC; Mr. Sharukh Wani, Economist, International Growth Centre, Blavatnik School of Government, University of Oxford; Ms. Rehana Thowfeeq, Economist, Advocata Institute, Sri Lanka; and Mr. Imran Sardar, Research Analyst, Institute of Regional Studies, Islamabad.

Ambassador Aizaz Ahmed Chaudhary, Director General (ISSI), welcomed all the guest speakers and participants and highlighted the concerns over Island’s economic downfall, asked the speakers to cast some light on the reasons of the crisis, and demanded lessons for Pakistan from them. He commented on the tweet of incumbent PM of Sri Lanka, the PM said in his tweet, “the next couple of months will be the most difficult ones of our lives; I have no desire to hide the truth and to lie to the public. Although, the facts are unpleasant and terrifying, this is the true situation”. Ambassador praised the truthfulness of the leader towards his nation in crisis by telling them the facts about their condition. Later, he also suggested this for leaders of Pakistan to speak the truth to the nation about the looming economic catastrophe.

Dr Akhil Bery, Director of South Asia Initiatives, Asia Society Policy Institute, Washington DC

He highlighted three pivotal mistakes that Sri Lanka did, poor economic planning, Covid-19, and the behaviour of the Political elite of the Island. All these factors are interconnected, he said, Sri Lanka relies heavily on foreign exchange from tourism and from garment exports both of those sources of revenue dried up at the onset of the pandemic. As these two modes of foreign exchange reserves depleted, the country’s leadership could not take decisive decisions. He was of the view that there was another issue of debt service and repayments. Sri Lanka could not qualify for the debt service from the World Bank and failed to engage in the structuring of debt repayments with IMF. Moreover, it also made a strategic blunder by riling over both the giant economic rivals of South Asia, India, and China.

He suggested that China is willing to extend refinancing or extend more loans but was not willing to engage in a restructuring of loans, which Sri Lanka needed the most. He further argued that Sri Lanka should have looked at what Pakistan did, when Prime Minister Imran came into power. How he tried to avoid going to the (IMF) for a long period, went to Turkey, Saudi Arabia, and China seeking loans or kind of a rollover of the debt. However, that help did not come, and ultimately former Prime Minister Imran Khan went to the (IMF) for a program. This did not happen in Sri Lanka, and this was the fundamental misreading of the situation.

Apart from this, he stated that now Sri Lanka has shifted its tilt from the Chinese side to the Indian camp. India is extending bilateral loans and lines of credit to help Sri Lanka navigate the crisis as it is very heavily reliant on this kind of bilateral and strategic aid. India also has been Sri Lanka's champion at the IMF, so that it can have access to more multilateral aid.

Rihanna Towfeek, Economist, Advocata Institute, Sri Lanka

She stated that there are long-term structural problems and serious poor economic decisions. She said that since 1950s, Sri Lanka only faced two fiscal deficits. And GDP growth particularly post-war has been folded quite heavily with government expenditures on infrastructure projects and other development programs. However, most of which was funded through debt, post-war the Island did see exponential growth in the fiscal deficits as well. After 2007, Sri Lanka began relying quite extensively on international sovereign bonds to fund. It funds both these deficits and so with ISB's and ITASCA sovereign bonds, the advantage is that it knows it comes in a lump sum and so it is easy for a government to raise finances whenever it needs.

She said that another major issue is taxation, the tax to GDP ratio has drastically steeped over the decades. In 1990, when Sri Lanka had a per capita income of about 450 dollars, Sri Lanka's tax ratio was about 90%. In 2021, when Sri Lanka has a per capita income of about 3800 dollars, the tax to GDP ratio is 7.7%, it is the lowest post-independence, the current account side, and there were some structural issues that governments failed to address. She further stated that trade policy is highly bureaucratized, and it is very cumbersome to set up an import or an export-oriented business in the country in terms of foreign investments. Post-war Sri Lanka has failed to attract a lot of foreign investment except in large construction projects.

She explained the major events, which led to the economic crisis, were the constitutional crisis, pandemic, no tourism, political instability, subsidies, debt sustainability, and a series of bad decisions. She was of the view that the decisions like printing money excessively led to poverty and inflation along with fixed exchange rates. This encouraged the flow of remittances in the country through black markets that provide better exchange rates than the government. This further discouraged the exporters who normally remit their earnings and decided not to remit and kept the money out that the country required the most. This exchange rate, fixed exchange rate regime that the Central bank followed ended up costing Sri Lanka about 1.5 billion dollars in worker remittances in 2021 alone.

Mr. Shahrukh Wani, Economist, International Growth Centre, Blavatnik School of Government, University of Oxford

He stated that there are three major causes of Pakistan's economic underdevelopment, fiscal deficit; current account deficit and tax to GDP ratio are main tenants of economic downside spiral of Pakistan. He suggested the reason that why Pakistan goes to the International Monetary fund every three years? Because Pakistan does not export enough, so it does not earn enough dollars to pay for its imports. It is not because Pakistan imports a lot; it just does not export enough. Secondly, Pakistan does not tax enough to cover government spending and it becomes much harder to raise dollars.

He mentioned some structural issues in industry, which the country faces. Its firms are not productive, refined, and competitive enough to compete in the international market. Pakistan has lagged in building up labour productivity over the years. It needs to have an investment, education, technology, adaptation, and all of that stuff, in order for our firms to be to go abroad and compete. He said that another hectic challenge to its industrial productivity and quality is of energy and its transmission. This caused it heavily the government must give subsidies over the energy consumption for the industrial production which further drain its resources and these industries are also not producing meaning change in the exports.

He said another major issue is of budget deficit, the previous government have subsidized petroleum products, including poor tax base, Pakistan's tax to GDP ratio is around 10% even less than the average for developing countries. It also leaves up very significant chunks of the

economy including agriculture income and urban land untaxed completely; this also has caused a recurring budget deficit.

He said that the political instability, the high polarization of the society discouraging taking rational decisions and the global stress on the poor economies are also reasons for the economic downfall of Pakistan. He was of the view that the Ukraine-Russia crisis has also contributed to economic uncertainty, which has a very specific impact on food, and global fuel prices. He concluded with suggestions that Pakistan needs political stability for economic stability, focus expand the tax base, and improving the decision-making structure.

Mr. Imran Sardar, Research Analyst, Institute of Regional Studies, Islamabad

He said that there are geo-strategic reasons, which caused the economic crisis in Sri Lanka, balancing policy towards the US, India and China, these issues are related to the power share and power tussle among the major powers of the world. He stated the role of the United States of America, China, and India. Second, the most noticeable reason for economic failure was China's response. He opined those global dynamics are also contributing factor in its crisis, the global tide against Russia and China's response to that crisis after Covid-19, the Ukrainian crisis, and the polarization of them have hit the economies of small countries of South Asia very hard.

He said the then, Prime Minister was reluctant to go to the IMF and wanted some home-grown solutions to the crisis. As Rajapaksa reduced taxes, abolished several taxes, and very importantly did not go ahead with the law that proposed the autonomy of the central bank, which was one of the demands that IMF strongly recommended. However, the balancing approach started collapsing when India started encouraging Rajapaksa to go to the IMF. When the economic assistance from New Delhi started pouring in and that was around three billion dollars. The replacement of Rajapaksa with Ranil Wickremesinghe took place, he is pro west, pro Indian and staunch support of the free market. It became easy for India to install its game plan more effectively.

He suggested that China believed that India's move had the United States' backing and China does not want an open confrontation on the island. As China wants to rise but rise peacefully. He suggested that the current government in Pakistan should not lie to the people of Pakistan about

the economic crisis. In his conclusion, he stated that Pakistan needs to balance its foreign policy approach at a time when there is a crisis of a global nature. Since there is an indirect clash between the West and Russia, countries like Pakistan whose economy is under complex interdependence could face economic troubles. Third and the most important lesson are to have a deep understanding of Chinese behaviour, strategy, and limitation to support South Asian countries during the crisis.

Question and Answer Session

- 1. Do you think literacy has anything to do with economy, can an educated society save its skin from economic meltdown, if yes then how did the Sri Lankan fall into it, despite 97% literacy rate, if not, then why the world is emphasizing on education?**

Mr. Akhil Bery answered the question and said that when a state combines bad policy making decisions along with a wide variety of external shocks, terrorism, Easter bombing attacks, constitutional crisis, diluted tourism, the Covid-19 pandemic, now the Russia Ukraine crisis that has pushed commodity prices up. Therefore, an educated workforce, in his view, would have been unable to deal with this situation in a different way.

- 2. How do you see the international community and particularly the democratic west coming forth to help avoid further economic turmoil in Sri Lanka?**

Rihanna Towfeek answered and said that over the course, of the past year and a half we did not get a lot of support from the west. Sri Lanka got a lot more support from India, which was the biggest source of credit lines and currency swaps and other arrangements. It was actually the Indians, who pushed Sri Lankans to go to the IMF; they had given us two deferments one repayment. She also added to the question regarding educated force. Sri Lanka does have a great literacy rate, people can read a few sentences, it does not mean that everybody is able to intellectually grasp something as big as this economic crisis. There are several issues in its education system, and in her view, economic and financial literacy is not great in Sri Lanka.

3. Do you foresee any decisive political decision that the government will be taking and what options you think are there available?

Mr Wani answered and said that Pakistan needs to address pre-existing structural weaknesses, which leads to the overall crisis. If it does not take, the right decisions at the right time things will get worse, Pakistan need to learn from Lankans' experience.