

## **INSS : Policies to secure economic security for Sri Lanka**



*Talal Rafi*

Sri Lanka's external gross financing needs was a staggering 9.4% of GDP at the time Sri Lanka defaulted in 2022. External gross financing needs is the total repayment due of capital and interest payments in foreign currency (largely in US dollars) for that particular year. In 2022, Sri Lanka's total government revenue was less than 8% of GDP. To put it simply, even if every rupee of money collected by the Sri Lankan government in 2022 was converted to US dollars, it would still not be enough to repay the total capital and interest in foreign debt repayments for 2022 alone. This is not considering the large repayments due for domestic debt. This is the stark and depressing situation of Sri Lanka. The brave soldiers of Sri Lanka have saved this nation with their lives militarily but due to economic mismanagement, Sri Lanka has to make economic policies that are influenced by foreign nations and international multilateral organizations such as the IMF. What Sri Lanka needs is economic security, which is for Sri Lanka to develop its economy the way it chooses while safeguarding its economic interests from potential threats. Below are 5 broad policy directions the government can take to ensure economic security is achieved.

### **Achieve macroeconomic stability**

Macroeconomic stability is very important to have a stable economy for any country. If countries that have been bailed out by the IMF in the past decades are analysed, the number one reason for these countries going bankrupt is not having fiscal discipline. Which means, the expenditure in these countries is larger than their revenues which is largely compensated by borrowing, regressive taxation and monetary financing. Sound monetary policies are also needed to control inflation and ensure a stable currency. As I have [argued](#) in an article for the IMF, that independent central banks ensure lower inflation and prevent the politicization of interest rates. Sri Lanka's Central Bank Act ensures that the core objective of the

Central Bank is price stability which is the right step. It is also essential to create a buffer for any impending crisis that might affect the current account balance by creating a large foreign reserve. Sri Lanka's foreign reserves have passed [\\$6 billion](#), placing Sri Lanka in a much safer economic position than when Sri Lanka defaulted in April 2022, when it had less than [\\$20 million](#) in reserves.

### **Economic Diversification**

Diversification of the Sri Lankan economy is vital to ensure economic security and reduce the impact of a downturn in any particular sector. Sri Lanka is highly vulnerable in this area as its largest exports are apparels and tea. Both apparels purchases and consumption of tea are highly vulnerable to market fluctuations as they would be among the first products to be cut down by consumers when there is an economic downturn. The other 2 foreign revenue earners for Sri Lanka are tourism and worker remittances. Both of these are vulnerable as was the case during the Covid-19 lockdowns and the economic crisis. Around half of Sri Lanka's exports go to the United States and Europe, meaning the Sri Lankan economy is highly vulnerable to the economic outlook of the west. Diversification of exports also needs to reduce the risk. The economy of Sri Lanka also needs to focus on promoting the tradable sectors which are industries which earn foreign exchange. Sri Lanka, sadly, has been growing its non-tradable sectors (sectors which do not earn foreign currency) in the past 2 decades and has been accumulating foreign currency denominated debt. This has been one of the primary reasons for the economic crisis in 2022. Lastly, the small and medium enterprises need to be pushed as they increase employment and diversify risk.

### **Social Protection**

It is very vital to ensure that the poor and vulnerable are protected through social security. This does not mean that large sections of the population should be on welfare payments continuously, but while social security programs are there to protect the poor, they also must be given the opportunity economically uplift themselves. The best way to give every Sri Lankan a good opportunity to succeed is through greater spending on education and health. Today, over 3 billion people around the world live in countries where their government [pays more](#) on interest repayments than on either health or education. Sri Lankans also come under that 3 billion people. If the government can ensure there is guaranteed good healthcare and education for the people, then it is developing a powerful human capital.

Singapore, though a small city state, with no natural resources, is an economic powerhouse. Singapore's greatest asset is its human capital as Singapore focuses on education and innovation to always be a few steps ahead of other countries in the region.

### **Trade and Investment Policies**

Sri Lanka is one of the most protected economies in the world. Sri Lanka as only a nation of 22 million people, cannot produce all the products and services that are needed for consumption by the Sri Lankan people. Even larger nations like India and China are unable to produce all their needs within their borders and even if they do, it will not be at the best quality or the best prices. Sri Lanka needs to focus its limited resources on producing products that it has a comparative advantage on. This will increase Sri Lanka's exports and will also earn the foreign reserves to import the needed goods and pay back the debt. As over half of Sri Lanka's debt is in foreign currency, the only way out of the economic crisis is to increase exports. 70% of global trade is supplying global value chains of large multinational companies. This is how China grew and how nations like Vietnam are growing. It is mostly intra-industry trade where companies find niches in their supply chains and outsource it to countries. Sri Lanka can take advantage of this. But this requires free flow of goods which can be done through increased free trade agreements, trade facilitation and trade liberalization. Sri Lanka also needs foreign direct investment to rebuild the economy. The Sri Lankan government does not have the fiscal space to invest and the saving rates of the Sri Lankan people is also not high enough. Foreign direct investment in sectors which are export oriented and which can create a greater number of jobs is essential to grow the Sri Lankan economy into a stronger economy. In order to attract investments, the Sri Lankan government needs to ensure transparency, reduce red tape and eradicate corruption.

### **Resilience to external shocks**

Sri Lanka needs to build institutional capacity for crisis management and effective governance. Sri Lanka's fiscal position is fragile and any large natural disasters can give an economic blow to the economy. Sri Lanka needs to establish climate-resilient infrastructure and disaster management systems to reduce the impact of natural disasters. Most importantly, Sri Lanka needs to diversify its energy sources. Fuel imports accounted for almost [25%](#) of merchandise imports in 2023 for Sri Lanka which is a large portion of Sri Lanka's much needed foreign currency being used to

import energy. It also means that the Sri Lankan economy is vulnerable to fluctuating global oil and gas prices. Sri Lanka's economic security depends on its energy security. Sri Lanka has hydro, solar and wind energy potential. Sri Lanka's offshore wind energy potential [exceeds](#) its current demands and this can make Sri Lanka energy efficient if the Sri Lankan government can attract the needed investments and technical expertise to utilize Sri Lanka's offshore wind power.

## Conclusion

In conclusion, securing Sri Lanka's economic future demands a multifaceted approach looking at fiscal discipline, economic diversification, robust social protection, liberal trade and investment policies, and resilience against external shocks. By addressing these critical areas, Sri Lanka can navigate its current economic challenges and lay the foundation for sustainable growth. Promoting human capital through education and health, leveraging its comparative advantages in trade, and investing in renewable energy are pivotal steps toward achieving economic security. With transparency, governance reforms, and innovative policy-making, Sri Lanka can reclaim economic sovereignty and ensure prosperity for its people in an increasingly globalized world.

*Talal Rafi is an Economist and he is currently a Consultant at the Asian Development Bank on economic policy. He is a member of the Expert Network of the World Economic Forum and he is a regular columnist for the International Monetary Fund on public finance management. Views expressed are the author's own personal opinions.*