[**Lessons from Lanka**](https://www.dawn.com/news/1686070/lessons-from-lanka)

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The writer completed his doctorate in economics on a Fulbright scholarship.

SRI Lanka figures very largely in the imagination of the people of South Asia. Not only is ‘Ceylon tea’ considered the best tea money can buy, a long line of illustrious cricketers from the island nation have also been admired for their prowess. Sri Lanka also holds the distinction of having the highest literacy rate in the South Asian region at 92.3 per cent.

Unfortunately, Sri Lanka is now in the throes of a vicious economic meltdown. Due to weeks of violent social unrest, the cabinet has resigned leaving the Sri Lankan president and his sibling prime minister in charge. On April 12, 2022, having run out of dollars, Sri Lanka even defaulted on its external debt and sought the IMF’s assistance.

It appears that Pakistan’s new government is also facing similar economic challenges. There remains an urgent need to examine and understand the reasons that led to the Sri Lankan economic catastrophe so that such pitfalls may be avoided by Pakistan’s policymakers.

**Read:** [*Sri Lanka imposes curfew amid protests over price hike*](https://www.dawn.com/news/1683152/sri-lanka-imposes-curfew-amid-protests-over-price-hike)

Sri Lanka was the first country in South Asia to liberalise its economy in the late 1970s through ‘open economy reforms’. But because of the 26-year conflict in Sri Lanka, international investors gradually lost interest.

In 2009, things started looking up mightily after a cataclysmic end to the long war as authoritarian stability imposed by the Rajapaksa brothers saw massive capital flows with the stock market quadrupling in the first 18 months. However, this increasing financialisation did not remove the structural weaknesses like a narrow export base of the Sri Lankan economy even as massive amounts of speculative flows poured in only to take flight at the earliest signs of turbulence.

Pakistan’s policymakers need to examine the reasons that led to the Sri Lankan economic catastrophe.

Apart from these neoliberal economic policies, Sri Lanka was descending into political chaos as some interesting political experiments were underway. By 2019, four Rajapaksa brothers were in control of the office of the president, prime minister, defence minister and finance minister. At the same time, President Gotabaya Rajapaksa had brought back Sri Lanka’s extremely powerful executive presidency to life once more, making the prime minister and parliament mere rubber stamps.

Though it has been recently claimed that interest payments on Chinese infrastructure project [loans](https://www.dawn.com/news/1614230) created steep dollar liabilities and thus are to blame for the recent crisis, Sri Lankan political economist Ahilan Kadirgamar argues it is not so. Kadirgamar points out that in the case of Sri Lanka a majority of the dollar liabilities originate from the debt owed to capital markets. In a sense, Sri Lanka’s increasing neoliberalisation or integration with global financial capital in the absence of a domestic export base had already taken the nation to the brink of the present crisis. And then came Covid-19.

Covid-19 brought about a massive negative shock as dollar earnings from tourism dried up. The Sri Lankan leadership understood that they needed to control their import bill. However, in the ensuing chaos, Sri Lankan policymakers failed to rise to the challenge, often ordering half-baked economic measures to save dollars in a knee-jerk reaction. In one instance, policymakers banned the import of fertiliser to save dollars, but ended up importing rice at a premium since the agricultural yield collapsed. Though it had become abundantly clear that Sri Lanka would have to go to the IMF, the policymakers dragged their feet taking their nation past the point of no return.

Pakistan’s new prime minister confronts the challenge of an economy that is also facing very strong headwinds. Pakistan’s trade deficit [grew 70pc](https://www.dawn.com/news/1683511) year-on-year in the nine months ending in March, indicating that the current account deficit will be the highest in the country’s history. If international oil prices do not come down, Pakistan will keep burning through its foreign exchange reserves. We know where that road takes us.

**Editorial:** [*New PM's challenge*](https://www.dawn.com/news/1684622)

This new government has [indicated](https://www.dawn.com/news/1684769/imf-to-be-approached-for-help-over-balance-of-payments-miftah) reaching out to the IMF. Still, these negotiations will be thorny and require the services of the best experts and negotiators. Negotiations will have to be conducted very skillfully so that Pakistan can revive the presently suspended programme, while also carving out enough fiscal space to provide a modicum of targeted subsidies to the most deserving people — the recipients of the Benazir Income Support Programme. Targeted subsidies will not only provide relief, but also assist in countering social unrest, which in the present political milieu could spiral out of control very quickly.

If international oil prices remain elevated then the government will have to move towards out-of-the-box solutions in order to curtail the ever-widening current account deficit. Fuel rationing can be an option given how European countries are contemplating rationing gas in the wake of the Russia-Ukraine conflict. Many other initiatives like mandatory car and motorcycle pooling as well as disincentivising vehicle use through higher fees can come into play.

Moreover, given how the US Federal Reserve will be increasing policy rate continuously over the next two years, the State Bank of Pakistan will have to significantly increase the policy rate in order to avoid another ‘taper tantrum’ and retain portfolio investment. A higher policy rate will increase the cost of borrowing capital thereby making allies in the industry unhappy, but in the present quest for economic stabilisation, this is one bitter pill that must be swallowed.

Though the Sri Lankan economic catastrophe has the trappings of a classic balance-of-payments crisis, it is, in more ways than one, a failure of their political class in preventing social collapse. Facing an economic crisis, the inability to engage with opponents forced Sri Lanka in the direction of half-baked measures that backfired.

Similarly, tackling Pakistan’s economic challenges is not something that this government will be able to do all by itself. For even if the government is able to stabilise the economy in the short term, the brewing political storm may morph into full-scale social unrest, thereby reversing the gains made by the government. In other words, economic stabilisation in Pakistan will not be sustainable unless supported by a wider political dialogue.

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