[**Lankan meltdown lessons**](https://www.dawn.com/news/1699373/lankan-meltdown-lessons)

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THE spectre of the Sri Lankan situation has come to haunt many a developing nation facing serious economic challenges. After an economic meltdown, the South Asian country is now witnessing the unravelling of its political system. A mass uprising triggered by rising commodity prices has [forced the government out](https://www.dawn.com/news/1699361/sri-lankan-president-gotabaya-rajapaksa-flees-to-maldives-hours-before-he-was-to-step-down). But the crisis is far from over.

As a financially bankrupt country, which doesn’t even have money to import oil and other essential commodities, Sri Lanka is now negotiating with the IMF for a bailout package and seeking financial help from various countries. It needs some $6bn urgently just to keep itself going until the end of the year. The massively indebted country has already defaulted on its external loan repayments making it harder for it to salvage the situation.

What led to Sri Lanka’s economic collapse is obvious. Crippled by the shortage of foreign exchange, the country has not been able to pay for imports of even essential commodities such as fuel. In fact, the crisis had been building up for many years as the country piled up foreign debts to the [tune of $51bn](https://www.dawn.com/news/1684768). A large part of the foreign loans was reportedly spent on huge non-productive infrastructure projects. Meanwhile, flawed economic policies made things worse.

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

While struggling to service the loans, the economic crunch aggravated due to the Covid-19 pandemic. Tourism, which has been the mainstay of the Sri Lankan economy, was the most affected by the prolonged lockdown, greatly diminishing the island’s foreign exchange earnings. Foreign direct investment also dried up because of the rise in incidents of terrorism and economic and political instability. Consequently, its currency collapsed by 80 per cent, making imports much more expensive. Food inflation rose to 57pc.

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The Sri Lankan turmoil is a classic example of an economy caught in an acute debt trap, while failing to boost its revenues. Indeed, political corruption, too, played a role in the country’s financial collapse. Now the IMF is the last hope for the country of 22 million, but aid will not come without stringent conditionalities that may increase the hardship of the people. In fact, a bailout by itself won’t provide a long-term solution, which requires undertaking fundamental structural reform to resuscitate the economy.

There are many developing countries, including Pakistan, which confront a similar predicament. We may not be in Sri Lanka’s shoes yet, but are not very far off as there are some comparable symptoms. With negotiations with the IMF apparently inconclusive, and the much-awaited financial support from friendly countries yet to come, the country is not in a good state.

Without an IMF deal, no international financial assistance will come in. The government may have taken some hard decisions, such as raising fuel prices and increasing taxes, but it seems that not enough has been done to satisfy the IMF which has hardened its position. Time is certainly running out for the government, with the coming debt-servicing obligations.

Foreign exchange reserves are fast depleting. The country needs some urgent help for its external debt-servicing obligations that are projected to be $23bn in 2022-2023. What is most alarming is the component of rising commercial loans.

In the next five years, the country will have to repay, on account of amortisation and the mark-up amount owed by the public sector, a sum of $49.23bn. It is an extremely alarming situation, with no signs of any fundamental change in economic outlook.

We may not be facing an imminent threat of default, but the prospect is certainly staring us in the face. It could become a reality if we don’t take timely action to stem the rot. The situation has gone beyond the usual patchwork job that we have been doing for so many years.

It is not just the external debt but, mainly, the ballooning internal debt that has brought the country close to bankruptcy. The major problem is that we have been living for a very long time beyond our means and have been borrowing money even to run the state. Dependence on foreign aid has further crippled our ability to stand on our own feet.

Unfortunately, no government, military or civilian, has made any effort to solve this perennial problem. With the tax-to-GDP ratio hovering at around less than 9pc, the country will remain trapped in perpetual financial crises. What makes the situation even more untenable is the fact that a major chunk of the budget is going towards debt repayment and defence. There is little information available on the defence-related component of external debts.

**Read:** [*Stunted imagination*](https://www.dawn.com/news/1696446/stunted-imagination)

Heavy domestic borrowing at very high interest rates is at the heart of the macroeconomic crisis faced by the country. That has also been the reason for our becoming a permanent client of the IMF. The stringent conditionalities that come with bailout packages also shackle economic growth.

Meanwhile, population explosion has made it harder to feed the increasing number of people in the country, making us more reliant on the import of food items. All that needs a long-term approach to deal with the economic challenges that cannot be resolved through taking makeshift measures and seeking bailouts from external sources.

It is becoming increasingly apparent that there is a limit to our resort to the ‘begging bowl’ and that even ‘friendly countries’ are reluctant to help. We cannot continue to cash in on our geostrategic importance for long.

Moreover, perpetual political instability, a deteriorating internal situation and the higher cost of doing business have discouraged the flow of direct foreign investment in the country. True, our exports nominally increased last year, but this was not enough to address the increasing current account deficit. Some external factors such as the rise in petroleum and commodity prices may have also contributed to worsening the crisis, but it is mainly our policy flaws that are now coming to haunt us. What happened in Sri Lanka must serve as a timely warning.

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