

Dissecting Sri Lanka's self-induced crisis

What is the issue?

The leadership's lack of vision and economic sense, combined with vanity, is the root cause for the current mess in Sri Lanka.

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What caused the Sri Lanka's economic crisis?

Long term Economic Mismanagement -

- Over the past decade foreign exchange reserves were dwindling in Sri Lanka.
- Debt-fueled infrastructure spree at such a time has resulted in crushing domestic and overseas debt.
- For example - Barely used Hambantota port, New Mattala Rajapaksa International Airport now being used to store paddy, Colombo Port City reclamation project, all funded by costly Chinese debt estimated around \$11 billion (including private sector loans).

Immediate Causes -

- 2019 Easter terror bombings of churches and luxury hotels in Sri Lanka led to disastrous downfall in tourism which is the biggest source of foreign exchange earnings.
- Thousands of overseas Sri Lankan workers lost jobs during the pandemic induced global economic slowdown.
- This has hit remittances from overseas which is the second biggest source for foreign exchange.
- The pandemic has also hit other foreign exchange earning sectors like apparel and tea exports as global growth and trade faltered.

What were the policy flaws committed while managing the crisis?

Tax reforms -

- The Rajapaksa government sweeping tax reforms after 2019 has drastically altered the structure of both indirect and direct taxes.
- **Value Added Tax** - In most cases VAT was almost halved from 15% to 8%.
- The VAT on services provided by hotels, restaurants and such like who were registered with Sri Lanka's tourism development authority was cut to zero provided they procured 60% of their supplies locally.
- **Income tax** - All income from agriculture, livestock, fisheries, as well as IT services and provision of services overseas was exempted from income tax.
- Also the exemption limit on income tax was raised to LKR 3 million per annum.

- Progressive tax rate were capped at a maximum of 18% for individuals.
- Corporate income tax reduced to 14 per cent for many sectors.

Organic Farming -

- There was a total overnight ban on the use of chemical fertilisers and pesticides.
- This has nearly halved the output of the key rice crop and critical plantation sector.
- All these combined led to a disastrous drop in the government's revenues.
- Lack of revenues has resulted in
- Derailing of its debt-repayment programme.
- The resultant current foreign exchange crisis has led to acute shortages of imported fuel, food products and power.
- Struggle for revenue during Covid pandemic when the government needed funds the most.

Reference

1. <https://www.thehindubusinessline.com/opinion/dissecting-sri-lankas-self-induced-crisis/article65296075.ece>

