

## 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>

