

Business

Economic crisis offers opportunities for meaningful reform

IPS' annual flagship publication: Sri Lanka: State of the Economy 2023:

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Sri Lanka has faced a turbulent economic journey in recent years, with 2022 witnessing an unprecedented crisis marked by a staggering 8.7% GDP contraction. The economy slowly but steadily pulled back from the abyss over the course of 2023. Notably, the Sri Lankan rupee has stabilised and even appreciated by 12%, inflation has dropped to 1.3%, import restrictions are being eased, and interest rates are on the decline.

These positive developments are a result of the implementation of economic stabilisation measures and groundwork for institutional and regulatory reforms to support future growth. These measures have critics concerned about the intense economic pain that falls on those least able to cope with the fallout. As a country that faces years of weak growth, the Institute of Policy Studies of Sri Lanka's (IPS) Sri Lanka: State of the Economy 2023 report, explores the complex policy choices Sri Lanka faces as it navigates the path to economic recovery.

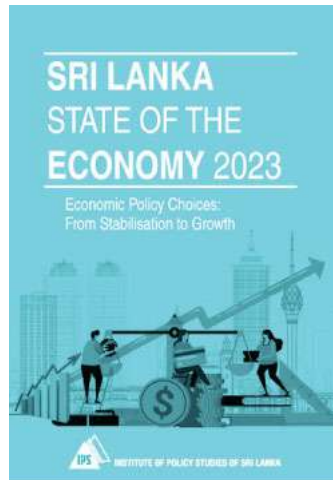
The rocky road to recovery

This year, the economy is expected to contract further, though at a slower pace compared to the previous year. Differing medium term forecasts from the International Monetary Fund (IMF) and the Central Bank of Sri Lanka (CBSL) point to the complexities of accurately predicting the future of an economy that has suffered a sudden and sharp crisis. This year, the IMF predicts a contraction of -3%, while the CBSL holds a more optimistic view at -2%. Both anticipate a return to positive growth in 2024, but uncertainties linger due to social and political opposition to austerity policies, ongoing debt negotiations, and volatile global economic conditions driven by geopolitical tensions.

Following the severe 8.7% GDP contraction in 2022, Sri Lanka embarked on immediate and stringent measures to stabilise its economy. These measures included securing the 17th IMF bailout and implementing substantial increases in value-added taxes (VAT), personal income taxes, energy prices, and a freeze on public sector wages. With shortfalls in anticipated revenue collections, further fiscal tightening measures cannot be ruled out.

Socioeconomic challenges

Faced with growth-inhibiting tough austerity measures, concerns persist regarding the potential exacerbation of inequality and poverty. Sri Lanka witnessed a doubling of national poverty rates to 25% and a tripling of urban poverty to 15% in 2022. Escalating inflation has eroded household savings and real wages, prompting



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many skilled professionals to seek opportunities abroad, potentially resulting in a brain drain and the loss of a generation of young workers.



Sri Lanka's economic challenges are further compounded by disparities in the education and health sectors, which require substantial resources for meaningful reforms. The delicate task of balancing fiscal constraints with the need for improved social protection programs looms large.

Sustainable growth

To achieve sustainable economic growth, Sri Lanka must not only stabilise its economy but also address long-standing structural problems. The country's overemphasis on infrastructure investment with borrowed funds needs to shift towards enhancing global competitiveness in exports. In a world marked by US-China tensions, forging partnerships and aligning industrial and trade policies is vital. Currently, Sri Lanka lags in global value chain (GVC) activity, posing a challenge to economic diversification.

Over-reliance on low-skilled, informal jobs, where more than half of the workforce is engaged in low-skilled jobs, hampers progress towards a competitive and productivity-driven economy. Comprehensive reforms in education, improved access to higher education, and bridging skills gaps in sectors such as Science, Technology, Engineering and Mathematics (STEM) are essential to create well-paying jobs and ensure long-term economic resilience. Addressing corruption, enhancing accountability, and improving public service delivery are also vital to build public trust and support for reforms.

Building consensus for transformation

As Sri Lanka grapples with its economic challenges, presidential elections loom on the horizon in 2024.

Traditional politics may drive opposition to austerity and reforms in pursuit of votes. However, regardless of the election outcome, the country's fragile economic situation will likely necessitate continued adherence to fiscal, monetary, and exchange rate policies outlined in the IMF program. What remains uncertain is the fate of complementary reforms aimed at enhancing economic efficiency and productivity, which might be delayed or abandoned due to political compulsions.

The more contentious reforms may slow down or stall altogether between now and the 2024 elections, to be addressed afterward, depending on electoral outcomes. These possibilities introduce significant uncertainty at a time when economic confidence has already been severely undermined. The solution and best hopes are to build cross-party consensus on areas that do need fixing.

Sri Lanka's journey from economic turmoil to stability is fraught with challenges, but it also offers opportunities for meaningful reform.

While macro-stabilisation measures are laying the foundation, the path to recovery must prioritise quality GDP growth that creates high-quality jobs. Achieving this requires addressing structural issues, strengthening social safety nets, and fostering cross-party consensus. As Sri Lanka navigates its economic challenges, making the right policy choices, coupled with accountable institutions, will be key to transforming its setback into a sustainable success.

These and many other issues are discussed in the IPS' annual flagship publication Sri Lanka: State of the Economy 2023 under the theme 'Economic Policy Choices: From Stabilisation to Growth' which focuses on the policy choices and debates in key areas of reform for a country that is emerging from a deep crisis.

The report was released on Tuesday. – IPS

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