

SRI LANKA ECONOMIC CRISIS – THE SYMPTOMS, CAUSES, AND POSSIBLE CURES

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Abstract *Sri Lanka is going through a major economic crisis. There is an ongoing shortage of fuel, food, electricity, and medicines. Prices have been going through the roof. There is a scarcity of things and the life of the common man has become extremely difficult. This paper looks at the main symptoms that have plagued the island nation. Further, it analyses the chief causes of these symptoms, including how the country has fallen into the Chinese debt-trap. The sources of these data are secondary, from material published in different journals, magazines, and online sources. Some of the important reasons found were over-reliance on tourism and foreign remittances from expatriates for the country's income and foreign exchange, in addition to over-dependence on fuel import and use of this fuel for its energy needs. The paper further considers the possible solutions, long- and short-term, for the nation to come out of this crisis, and how to implement them. These include export of value-added products, more foreign trade agreements, JVs with foreign companies, increased focus on MSMEs, and greater reliance on alternate energy sources.*

Keywords *Sri Lanka, Economic Crisis, Balance of Trade*

INTRODUCTION

Sri Lanka is in serious financial trouble. In fact, it has been for some years, but the problems have worsened recently. What was potential has now become a full-fledged catastrophe. According to the Economic Times (2022), the country became nearly bankrupt and suspended repaying its foreign debt of USD51 billion. Measures are being taken to improve the situation. The International Monetary Fund (IMF) has agreed to a USD2.9 billion package to bail out the island nation consequent to its restructuring its debt. However, there is obviously a long way to go for the situation to improve to an agreeable extent. So what were the symptoms of the crisis?

THE BLUEPRINT OF THE CRISIS

The island nation of Sri Lanka is mainly dependent on imports for its essential commodities. An acute scarcity of foreign currency reserves left the country powerless to pay for crucial imports, including staple food, medicines, and fuel on a continuous basis. According to the Financial Express (2022), the current account deficit of Sri Lanka was a whopping USD3.2 billion in 2021. The country's foreign reserves decreased to USD1.93 billion by the end of March 2022. This in turn has resulted in a scarcity of essentials and

the price of commodities going through the roof. The soaring inflation left countless people without even proper food and daily necessities. It had also reached a level where the government was providing fuel only for emergency services like ambulances. Lack of fuel to run the power plants had also led to crippling power cuts extending up to 13 hours.

The upshot of this was a nation that went bankrupt with no access to the financial markets other than through multilateral bailout packages and foreign development aid, and consequently, the citizens taking to the streets to protest the government policies, which later escalated into riots to remove the incumbent president.

OBJECTIVES OF THE PAPER

The objectives of this paper are:

- To understand the reason behind the crisis, and the cause of the symptoms.
- To find possible solutions to resolve this crisis by dealing with the causes for the same.

RESEARCH METHODOLOGY

Based on secondary data collected from various sources, the reasons for the crisis were studied in detail. Further, for each

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cause possible solutions were found. These included short-term as well as long-term solutions. Some were application-oriented and others were more change in attitudes.

THE GENESIS OF THE CRISIS

According to Sahoo et al. (2022), the crisis in Sri Lanka was the net result of inherited problems, as well as economic mismanagement by consecutive governments, a by-product of the long drawn-out civil war, the repercussions of the Easter bombings of 2019, the global recession of 2008, and the COVID-19 pandemic. Besides these, the disasters were further magnified by the upsets in the global supply chains with the start of the Ukrainian war.

To begin with, the global recession of 2008 reduced foreign remittances, thereby draining the economy of its forex reserves. This prompted the government to raise loans from the IMF. However, as a counter measure they did not do enough to increase aggregate economic demand and output.

Further, the government initiated some erroneous policy decisions. To stick to their election manifesto, the Rajapaksa-led government slashed value-added taxes towards the end of 2019 by almost half. Corporate taxes were brought down by 4 per cent and indirect taxes were abolished, reducing the GDP by as much as 2 per cent. Unfortunately, these were enacted just a few weeks before the COVID-19 pandemic hit. And the deepening crisis due to the pandemic demolished the Sri Lankan economy.

In another wrong move, the government banned fertiliser imports in the middle of 2021 to prevent foreign exchange outflow. To show the decision in a good light, the government also declared Sri Lanka as a 100 per cent organic farming country. Since such a change was not possible in the short term, it led to a substantial decline in agricultural production. This led to inflation and shortages of necessary produce. Exports of commodities like coffee, tea, and spices were also badly affected. Though the government removed the ban on the import of fertilisers for cultivating exportable commodities, by then the harm had already been done. The inflation is still very high, making the lives of the people, especially the low-income groups, extremely tough.

As per the Times of India (2022), Sri Lanka has accumulated substantial foreign loans that it obtained for infrastructure development projects, and is hence severely burdened by China's debt-trap diplomacy, which is one of the main contributing factors to the country's economic woes. Sahoo et al. (2022) state that, furthermore, the significant reliance on commercial loans contracted at exorbitant rates and soft loans from Chinese commercial financial institutions to

support these development projects have been unproductive and added to the strain on the exchequer.

The continuing economic crisis can also be ascribed to a drastic decline in the country's highly profitable tourism industry. According to Bhowmick (2022), the island nation of Sri Lanka is mainly dependent on tourism, which makes up almost 12 per cent of the nation's GDP. Tourism is also the third behind foreign remittances from its citizens and the apparel industry for its foreign exchange revenue.

The reduction in revenue from tourism and remittances has translated into an unparalleled rise in Sri Lanka's foreign debt. Credit rating agencies have downgraded Sri Lanka's economy and discouraged it from participating in global capital markets due to the bankruptcy condition, in which the country's forex reserves are insufficient to pay for imports or debt servicing (World Bank, 2022).

As the problems increased, Sri Lanka devalued its currency hoping to draw in more investments and boost remittances (Gautam, 2022). Sri Lanka's exports would have benefited from higher inflation and currency depreciation, but as a consumption-led growth economy, it had few finished goods to export. Furthermore, imports of necessities like food, petrol, and so on, have become significantly more expensive due to the sharp decline in the value of the Sri Lankan rupee.

Finally, to make matters worse, funds from the government exchequer were used for unsuccessful initiatives. As a result, the Asian Development Bank now refers to Sri Lanka's economy as having "dual deficits", meaning that there is both a budget deficit and a current account deficit (Weerakoon et al., 2022).

As can be seen, the persisting crisis in Sri Lanka is the net result of a number of interrelated elements, including careless economic policies, disruptions in the global market, and problems with domestic security. The nation is mired in a vicious cycle of debt, and to receive aid from the IMF, it must meet specific requirements. These conditions have prevented the government from making required investments, which has slowed the economy and made it necessary to frequently request the help of the IMF, leading to a never-ending debt spiral. However, this action increased inflation and weakened the Sri Lankan rupee.

RESOLUTION OF THE CRISIS

Now that the symptoms and causes of the Sri Lankan crisis is clear, what are the solutions in front of the Sri Lankan government to resolve it? Some of the causes of the crisis itself suggest the solutions. Others are not as clear-cut and may require indirect or long-term interventions.

Short- to Medium-Term Solutions

Economic Actions

To pay its debts and recover from this crisis stronger, Sri Lanka needs extensive economic reforms for long-term sustainable prosperity. One of the reasons for reduction in remittances could also be the lack of trust of the expatriates in the current financial set-up. To maintain macroeconomic stability and public trust in the local currency, a steady monetary policy is essential. An independent Central Bank is crucial, as even the IMF has clearly indicated, in resolving the current economic crisis that Sri Lanka is experiencing (Central Banking, 2022). Fiscal consolidation can only be seriously considered by the treasury if the central bank is independent and has the power to forbid money from being printed against the wishes of the government. It could be possible for Central Bank committees to make long-term policy decisions on interest rates and reserve requirements, without interference from politics, only by adding more well-respected professionals who will not be swayed by political alignments and giving them a fixed deadline.

Twin Deficit Hypothesis Reforms

The twin-deficit hypothesis, also known as the twin-deficit phenomenon, is a finding in macroeconomics that, in theory, there is a significant causal relationship between a country's current account balance and its government budget balance (Cavallo, 2005). The difference between total government spending and total tax revenues is known as the budget deficit, while the difference between total trade revenues and costs and net transfers to the nation is known as the current account deficit.

The maintenance of sustainable budget deficits has been cited as one of the essential conditions for an economy's success. One of the primary macroeconomic ills is concurrently believed to be large current account deficits, which threaten macroeconomic stability in general and external stability in particular.

Sri Lanka must improve its ability to earn foreign exchange to achieve debt sustainability and go past recovery. To reduce the country's anti-export and anti-FDI prejudices, further measures are needed, in addition to the medium-term budgetary restructuring that is necessary. A crisis is a once-in-a-lifetime opportunity to put the necessary reforms into place, one that ideally should not be missed.

Sri Lanka's economic performance has been influenced more by spending performance (internal finance) than by trade performance (external finance). The twin-deficit hypothesis predicts that these countries will eventually have uncontrollable deficits in both their trade and government

spending, as opposed to those with an external finance concentration, which often enjoy improvements in both.

Privatisation of SOEs

Reform is also necessary to rein in public spending. State-owned Enterprises (SOEs) drastically deplete the state's coffers (Rodrigo, 2022). The fiscal deficit has increased as a result. The reason why state-owned enterprise management is poor is because the ruling parties use SOEs for short-term political gains and lose sight of the long-term sustainable strategy. Since the chairperson and board of directors of SOEs are chosen by the relevant government ministries, they typically have political party allegiances.

After a thorough study is performed to assess the advantages and risks involved, many SOEs should be privatised. In extremely competitive industries like hotels, supermarkets, and airlines, where it is unnecessary for a state institution to have commercial interests, privatising SOEs makes perfect sense. As Thailand did during its economic crisis in 1997, some Sri Lankan SOEs should at least be reorganised and corporatised so they can be privatised in the future if necessary.

Reducing Shortages

Sri Lanka has a very high import tariff rate, protecting the local industry with a focus on import substitution. The GDP of Sri Lanka, a small country, is USD80 billion. When many products are produced solely in Sri Lanka for the domestic market, economies of scale are reduced, which results in products that are of lower quality and/or higher price. A strategy to turn the country into an economy that is export-driven needs to be implemented as soon as the economy stabilises, since lowering tariff rates in the short term is not an option because of the Forex problem. Lifting quantitative restrictions would be suggested, even if tariff rates remain high, to solve the issue of shortages in the nation.

Proper Tax Collection

For revenue-based fiscal consolidation, another condition which is crucial for economic sustainability is tax reforms. The government could establish a process to collect taxes more efficiently, as well as expand the tax base rather than just raising tax rates for increasing tax revenue (Budget Speech, 2016).

Long-Term Solutions

There is no one individual solution for the financial crisis. It has to be a combination of many things, some short-term

to take care of the immediate situation, some long-term to ensure that Sri Lanka is not in this situation ever again.

Change in Mind-Set

There should be a change in mind-set among the people. They cannot expect the government to do everything. There is a limit to what the government can do. However, there has to be a brand ambassador in the government to persuade the common man to do what they are supposed to do. One of the prime examples is the Prime Minister of India, Narendra Modi. He has consciously tried to change the mind-set of the people (Business Standard, 2019). He speaks, he comes out with slogans, he launches projects, he provides the funding, but ultimately the common man has to implement them.

Value-Added Products

Instead of selling natural raw materials, they have to be converted into finished value-added products so that there is more of a margin. Instead of selling monosite and ilmenite, which are present in the sands of the country's beaches, they can be converted into finished products like paints and sold at much higher prices. With the availability of spices, spices and masalas are areas that the country can concentrate on. They need to bring out spices that cater to different tastes across the world.

Cash Crops

Get people to do agriculture and farming of cash crops. And even crops can be converted into finished products before selling them. For example, spices can be converted into masalas, or rubber to tyres and chappals. Crops can be cultivated specifically with an eye to producing such things as furniture, besides fruit-bearing or medically useful ones.

Renewable Energy – Wind and Solar Power

Popular renewable energy sources include solar and wind energy. Supporters contend that these two viable alternatives offer a complete break from fossil fuels and rely on power derived from natural sources. Exciting developments have also been made in wind power. Wind power is one of the most affordable energy solutions available.

Both forms of energy do have drawbacks. The implementation of solar energy is still hampered by grid integration issues and market obstacles. Cost issues are also brought on by hardware and non-hardware costs.

Meanwhile, distant areas away from cities where electricity is needed are frequently the greatest places for wind generation. So the solution is for it to be connected to the main grid. It

has its own drawbacks, but it is a renewable resource and will reduce the reliance on imports in Sri Lanka. There is also a lot of potential in solar and wind energy plants. Imports of fuel will be reduced, reducing the unfavourable balance of trade in the country. It can be set up by the government or private parties, and the cost of setting up can be reduced by three-fourth if the raw materials for the plants are produced in Sri Lanka itself. Another alternative for the capital of these plants are tie-up/collaborations with nearby countries like India, or maybe even Australian companies.

Cutting Use of Petroleum in Vehicles

Some of the methods of cutting down petroleum use in vehicles is by using hydrogen or ethanol. While hydrogen vehicles need a completely different engine, ethanol which is available from sugarcane and other plants can be mixed with the costlier fuels like petrol and diesel without compromising the engine performance. Electric vehicles are another option. The filling stations could be run by solar power, or innovation in design and manufacture can help make the vehicles itself solar powered.

Motivate Everyone to Open Bank Accounts

This will cut down on corruption. Welfare measures like subsidy from the government can be transferred directly to the beneficiary. Paying wages/salaries into these accounts can also help women in many cases where their husbands are alcoholic and wastrels. These next couple of points are part of what the Indian Prime Minister (Narendra Modi) calls JAM.

Give Everyone a Unique ID

This will help in reducing corruption; and linking these to people's bank accounts will improve the unequal distribution of resources among the rich and poor, where government subsidies and rations can help the weaker sections of society. This can also lessen black market transactions in the underworld.

Cut Down on Populist Subsidies

With direct remittances of subsidies, the amounts can be brought down as they reach the hands of the beneficiaries without any leakages in between. Besides, it is better to train people and give them employment than giving them temporary satisfaction through citizen-pleasing schemes.

Infrastructure Development

Infrastructure development projects taken up by the government have two-fold benefits. They help improve the living conditions, as well as trade and commerce. Besides,

they also provide jobs to the lowest level of the society. These can be done in the PPP model to reduce the finance burden of the government.

Digitalisation

Most transactions, especially financial, can be digitised, which will also provide a reduction in corruption. Government payments like taxes can also be made online, especially once almost everyone has a bank account. Citizen identity cards can be linked to bank accounts. With the advent of mobile banking, all financial transactions can not only be made easier, but transparent and accountable.

Make Government Records Online

All possible government records should be made available online, for example, real estate details. This will decrease corruption and also improve the statistical database of the different ministries.

Tie-Ups with Indian Companies

There can be tie-ups with two-wheeler/three-wheeler or automobile manufacturers from India. Other tie-ups can be with Ayurveda and allopathy companies to produce medicines as well as establish hospitals. These will also increase business-linked tourism. Besides, there will be the need for setting up ancillary units which can be done as MSMEs.

Monetisation of Gold

Just like Indians, Sri Lankans do like their gold. It is used for jewellery, but equally importantly, as investments. During the present crisis, a lot of gold was sold as a last resort as the common man was unable to invest in shares, bank interest rates had hit rock bottom, and the currency was depreciating. Monetisation of gold is a scheme that the Sri Lankan government could introduce to mobilise the idle gold lying with people, to reduce the country's reliance on the import of gold, as well as to kick-start the economy. Investment in gold ETFs could be encouraged, since the ordinary citizen trusts gold as an investment option. As far as the government is concerned, investing in gold ETFs is better than the gold lying idle.

Bringing about Favourable Balance of Trade

There are a number of things that could be done to improve the balance of trade position. Here are some of them.

Export of Unique Products

To create a favourable balance of trade and foreign exchange resource, and to bring about better foreign relations, there need to be increased exports of value-added Sri Lankan products. Besides tea, the country can export coconut products like Virgin Coconut Oil; and food products like idli or other famous and popular Sri Lankan food, including canned ones. Natural fragrances and flavours can be prepared using Sri Lanka's vast herbal, flower, and spice resources, and the same can be exported for manufacturing perfumes or selling it as it is. Beauty products using these natural herbs and Ayurvedic formulae can also be exported.

Export of Products Manufactured through JVs

The products manufactured with JVs, like the two- and four-wheelers mentioned earlier, can be exported. The country can provide special schemes for setting up export-oriented JVs. JVs with Indian businesses will boost Sri Lanka's access to the Indian market and increase its appeal to export-focused foreign investors. The closeness and air connection will also give potential Indian investors extra benefits.

Free Trade Agreements (FTA)

Sri Lanka should join international supply chains and adopt the current industrial trends around the world. Finding specialised value additions it can implement in the supply chains of multinational corporations is an effective approach for Sri Lanka to improve its exports. This has been one of the strategies used by emerging nations like Vietnam. Sri Lanka requires trade liberalisation, Foreign Direct Investment (FDI) that is export-focused, more Free Trade Agreements (FTAs), and better trade facilitation, to integrate with global supply chains. Sri Lanka only has three FTAs, with China, India, and Pakistan, compared to Vietnam's 26, even though it opened its economy considerably later.

FTA agreements, as mentioned in the 2016 budget speech (MOFA, 2016), could be implemented with the country exploring possibilities of entering into FTAs with countries such as Australia, the United States, South Korea, Singapore, Japan, and South Africa.

Improving Ease of Doing Business

Sri Lanka lies in the 99th spot in the ease of doing business rankings with the World Bank (CBSL, 2020) and it was ranked 164th in the world in 2020 on enforcing contracts, both of which have to be improved.

Improving Performance

There are a number of measures that are needed to improve the performance of the government and the country as a whole.

Government as a Corporate

The government has to run like a corporate with proper targets and standards, monitoring the work, performance analysis, and course corrections. There should be periodic meetings and presentations to analyse the growth and development of each department and ministry in the government. These meetings and discussions should be to find deviations, if any, and find the cause and solutions to correct it. This should motivate and guide the employees.

Privatisation of Airlines

This is a measure that is already under discussion (Daily Mirror, 2022). The Sri Lankan Airlines is a white elephant with a huge loss which is increasing every year. Its privatisation would do a lot of good in terms of service as well as reducing the debt burden of the state. Maybe FDI can also be thought of in this context, as the present efforts at privatisation are not having the desired effect.

Developing Service Industry

As countries go from underdeveloped to a developed economy, the focus shifts from agriculture to industry to service. In spite of being a developing economy, Sri Lanka was very reliant on the service sector for its income. However, it was concentrated on one aspect – tourism and its related facilities like hotels, restaurants, and activities like adventure and sports. However, if this could be further augmented by something like IT and ITES, with the necessary support and infrastructure provided by the government, Sri Lanka could go the Indian way. These are also not much affected by pandemics like the COVID-19.

More Emphasis on MSMEs

A country's equitable development is possible only with the start of more MSMEs. It is also one way for Sri Lanka to ensure that the national income is more than the national expenditure, as well as to strike a favourable balance of trade. Setting up MSMEs to promote common people to start businesses with little resources, capital, and human resources, and increase production and profit, slowly, and start exporting these products is the way to go.

Like we saw when we discussed value-added products, these companies can manufacture Ayurvedic soaps, shampoos, conditioners, lotions, and oils. They could also come up with herbal products like Moringa leaf powder, which is very popular as a health alternative in many western countries.

Start-Up Culture

The government can encourage a start-up culture, with ideathons, business plan contests, and other competitions among college students. They could have incubation centres in all professional institutions. MSMEs should have access to micro-finance from different sources, which should be made easily available.

Land Privatisation

In Sri Lanka, the government owns around 82 per cent of the land (Fernando, 2020), which severely restricts how much of it can be used by the private sector. There are two negatives to renting out government property: the tenant will not be able to use it as collateral and might not be able to make long-term investments in it. Land fragmentation, which makes it harder to find large tracts of land for essential development projects, is another serious issue. A suitable method of land appraisal is also necessary to attract investors.

The government could look at land privatisation, where there could be a cap on how much land a person can hold. They could be charged a rate which is beneficial to the government.

Improving Tourism Structure

The tourism structure could work at two levels. One, a board to work on the policies and promotion, as well as working on a global level; and two, a council to take care of the implementation, especially at the local level. This could also be the involvement in infrastructure, like government tours, motels, and restaurants, besides taking care of the destinations.

Inclusive and Category-Specific Tourism

Tourism has to be inclusive so that the locals could benefit, and which the Sri Lankan government is already trying to implement. However, more focus has to be placed on this. Besides, tourism could be made category-based, like cultural tourism, beach tourism, nature tourism, and so on. Destination weddings is another opportunity that can be investigated.

Tourism Collaborations

There could be tourist collaborations like a Buddhism or Ramayana Trail from India, which starts from India and ends in Sri Lanka, or a Trade Winds Trail that starts from Portugal and ends in Sri Lanka.

Marketing the Country

More marketing has to be done via social media, not only at the tourist level but also on other things like development works, infrastructure building, and so on. Travel vlogs, food vlogs, and lots of other YouTube videos create a great impact.

Social Welfare

The government should govern, and one part of it is ensuring the welfare of its citizens. Here are some of the things the government can do to improve the conditions of the citizens.

Farmer Cards

Create farmer cards to give crop insurance, marketing services, and direct monetary assistance to the farmers. This can also help them in buying subsidised materials for farming.

Agriculture Collectives

Farmers to be given provision to start special agricultural cooperative companies which can get special schemes from the government. These companies could start factories for value addition of products as well as collection and storage of seasonal products.

Insurance

The government to provide insurance to all bank account holders – registered with the IT department – at minimal cost. The government can also provide medicines through online platforms using a PP model at highly reduced costs.

Self-Help Groups

More emphasis on self-help groups like the Mahila Mandals. These groups could manufacture products like pickles, run canteens, take care of garbage collection, and so on. The government banks should provide them with micro-finance at low interest rates.

Common Age Pension

Pension for the disabled and the elderly people have to be made common, without any additional parameters. For example, a particular amount can be given to all after the age of 60, irrespective of any other considerations. Any additional amount should be contributory in nature.

Sustainable Development

For sustainable development, Sri Lanka should also look at the 'reduce, reuse, and recycle' route. As much as possible, go for repair rather than use and throw products. Wherever possible, pool resources and share costly assets.

Human Resource Development

For the economy to become more competitive, human resource development reforms are required. Sri Lanka is particularly unattractive to investors because of its high retrenchment costs. The government has to introduce more reforms aimed at women employees. In addition, women have to be empowered through proper education and training. This brings us to the point – give people more employable skills.

Skilling People

To increase labour productivity, the labour force should be expanded through education and training, with a focus on developing future abilities like analytical thinking and creativity. State-of-the-art techniques and technology have to be taught, with hands-on-training.

CONCLUSION

As a starting point, the Sri Lankan government has taken measures to restructure and reduce the debt burden. Besides, it has asked the IMF as well as its neighbouring powerhouses for financial aid. The IMF has agreed to a USD2.9 billion bail-out package consequent to the restructuring of Sri Lanka's financial credits. Hence, the government is in talks with China, who is the main lender with almost 15% of its credit, for restructuring their loans. The other major lenders in the case of Sri Lanka are the Asian Development Bank and Japan.

Meanwhile, Sri Lanka has also asked China and India for aid, notably the latter for petroleum and necessities. However, these are short-term measures and the country has to stop its

over-reliance on tourism and foreign remittances. It has to start manufacturing the necessities. This could be done by entering into JVs with big manufacturers of neighbouring nations. It has to also stop its reliance on importing fuel and look at alternative energy sources, especially for power generation. More than all this, the government has to privatise many of the sectors and do their job of governing the land, and let the common citizens carry on with their work and business without too much interference.

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