

THE ROOT CAUSE OF THE SRI LANKAN FOREIGN CURRENCY CRISIS



BY: GAYANTHA DEHIWATTE

Executive Summery

Our country, Sri Lanka, our economy, society and the environment is being trapped by the economic parasites since 1978. They are using free market ideology, if not neoliberalism as their propaganda machine. As at today, most sectors have been captured or in the process of being captured by them, namely finance, health, education, energy, media, agriculture and land to name a few. By now it is clearly visible that the entire state is in their back pocket. As a result, very few individuals are making decisions to make excessive profit for themselves, disregarding the entire country, economy, environment and the society. Rest of the population are gradually being enslaved by this super-rich class.

They work as parasites, getting in to the host animal (economy) and extracting unearned income in various forms such as interest, rent, charges, fees, commission and paralyzing the economy. The rules and regulations are being made thick and fast, helping the rich to siphon out money, wealth, land and other economic centers of the economy. They are looting not only public wealth but also the private wealth of the people. This grand theft has been legalized and even applauded as in achievement.

As a result, the state is on debt bondage to foreign bond holders. Locally, majority of the private sector is on debt bondage to local bond holders. Inequality has risen sharply, number of beggars are sky rocketing, over 60% of the population are indebted and middle class is disappearing by the day.

TABLE OF CONTENTS

Executive Summary	2
1.0 Introduction	4
2.0 History	5
3.0 Income Inequality Trend in Sri Lanka.....	6-8
4.0 Consequences of the Washington Consensus.....	9-10
5.0 Neoliberal Policies and the Foreign Debt Conundrum.....	11
6.0 Recommendations	12 – 13 - 14
7.0 Conclusion	15
8.0 References	16

1.0 Introduction

Not so long-ago, Sri Lanka was praised by the World Bank for its progress in reducing poverty and inequality, and also in sharing prosperity among less well off (financially disadvantaged). World Bank went on to claim that Sri Lanka has almost eliminated extreme poverty in their report which was published in 2021. But the Household Income and Expenditure survey in 2019 which was released recently paint a complete opposite picture, indicating a dramatic increment in poverty headcount. Similarly, it indicates the income and inequality gap continues to get widen to a historical high level. Even though poverty rates seem to be going down between 2006 and 2016, it was short lived. Poverty levels in Sri Lanka have seen a significant increment from 2016. Poverty headcount ratio was 14.3% in 2019 compared to 4.1% in 2016. This is only the tip of the ice berg, before the collapse of the exchange rate. Rupee was approximately 180 per USD at the time, currently rupee is trading below 370 per USD. It is ironic for the World Bank to claim Sri Lankan economy is progressing just before the country declared bankruptcy (in 2021). That itself shows the catastrophic failure of neo classical theorizing.

2.0 History

Until 1978, Sri Lanka was predominantly an agriculture-based economy. During the 1970's industrialization started picking up due to government led investments and bilateral investments. Despite of government investments, the Sri Lankan economy was going through high inflation, product scarcity due to the supply side of shock caused by the oil embargo imposed by the OPEC countries. Sri Lanka was not alone, countries around the world were going through rapid hikes in commodity prices as well due to the oil crisis. In the early 1970's the world could witness a paradigm shift in global monetary history, where United States terminating convertibility of US dollar to gold, bringing the Bretton Woods system to an end unilaterally and effectively making the US dollar a fiat currency. Subsequently, USA raised interest to encourage dollar inflow back to United States to strengthen the value of the fiat dollar.

High interest and high inflation gave an ideal breeding ground to the monetarism philosophy by Milton Friedman, later got popularized as free-market capitalism. Prime Minister Margaret Thatcher of the United Kingdom and President Ronald Reagan of the United States were great ambassadors of the free market ideology in late 1970's and early 1980's.

Institutions such as IMF, World Bank and the World Trade Organization were instrumental in influencing most countries to adapt laissez-faire ideology which later coined as Washington Consensus.

Prior to 1978, Sri Lanka was not indebted to foreign countries due to the strict trade controls, capital controls and policies geared towards a production economy. However, in 1978 the victorious president of United National Party embraced the free market ideology, opening the economy overnight. Sri Lankan rupee was depreciated 100% within 24 hours, opening a new chapter in Sri Lankan history. Liberalization of trade policies caused fast deindustrialization in the economy which was only in the infant stage to begin with. Subsequent liberalization of the financial sector has powered consumerism, asset price inflation and a foreign debt pile more than the size of the economy, an indebted local population and income and wealth inequality.

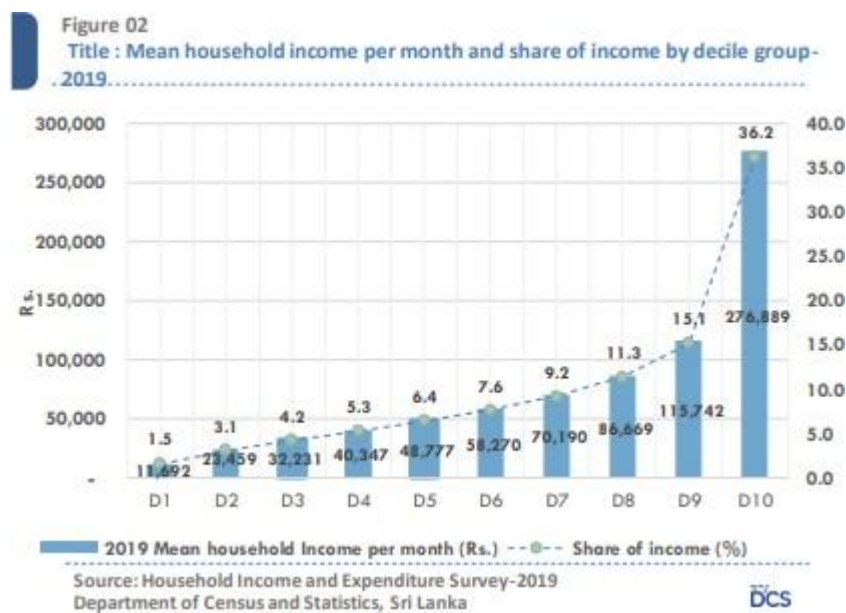
3.0 Income Inequality Trend in Sri Lanka

The Department of Census and Statistics reports income inequality utilizing the following measurements;

1. The Gini index (Gini coefficient)
2. The shares of aggregate household income by quintiles and deciles
3. The quintile dispersion Ratio

The Gini index is the main statistical measure of income inequality ranging from 0.0 to 1.0, where 0 indicates perfect equality and 1 indicates maximum inequality. Gini index measures the amount that any two income values differ, on average relative to mean Income.

The national value of the Gini coefficient of household income is 0.46 in 2019 which shows an increase from 0.45 reported in 2016. In 2019 at the sector level Gini coefficients are 0.49, 0.44 and 0.36 in the Urban, Rural and Estate sectors respectively.



(Department of Census and Statistics, 2019)

Figure 02 shows the share of household income by decile in 2019. A decile is one of ten equal groups ranked by income from lowest to highest so that ten per cent of all households are in each group. The lowest decile received 1.5 per cent of aggregate household income while the households in the top ten per cent that is in the highest decile received 36.2 per cent of aggregate household income.

Table 06 shows the share of household income by quintile and the quintile dispersion ratio of household income based on HIES 2019 and 2016. A quintile is one of five equal groups ranked by the income of households from lowest to highest. In each quintile has 20 per cent of all households.

The quintile dispersion ratio means household income of 5th quintile/ 1st quintile takes the ratio of the top rank 20 per cent to the bottom 20 per cent households in household income distribution. In 2019, The quintile dispersion ratio is 11.2, meaning that households at the top 20 had incomes about eleven times in the incomes of households at the bottom 20 per cent. The ratio increased by 0.6 points from 2016 to 2019.

Table 06: Household income per month by quintile and quintile dispersion ratio

	Household Income quintile					
	1st quintile	2 nd quintile	3 rd quintile	4 th quintile	5 th quintile	Total
2019						
Mean household income per month (Rs.)	17,572	36,290	53,522	78,431	196,289	76,414
Share of income (%)	4.6	9.5	14	20.5	51.4	100
Cumulative share of income (%)	4.6	14.1	28.1	48.6	100	
Cumulative % of Population	20	40	60	80	100	
Quintile Dispersion Ratio = 196,289/17,572 = 11.2						
2016						
Mean household income per month (Rs.)	14,843	30,008	43,713	64,570	158,072	62,237
Share of income (%)	4.8	9.6	14	20.7	50.8	100
Cumulative share of income (%)	4.8	14.4	28.5	49.2	100	
Cumulative % of Population	20	40	60	80	100	
Quintile Dispersion Ratio = 158,072/14,843 = 10.6						

(Department of Census and Statistics, 2019)

Income inequality, Sri Lanka, 1980-2021



(Sri Lanka – WID – World Inequality Database, 2022).

The red line indicates the share of income in the top 1% and the blue line indicates the share of income in the bottom 50%. These two lines are almost mirror images of one another since 1995. The pattern goes on to indicate the long-term trend in income inequality and income extraction from the bottom 50% to the top 1%. The above pattern also gives clear evidence against neoclassical theory of law, diminishing marginal utility. There is no slowing down the collection or extraction of income by the top 1% from the bottom 50%, hence it is clear these theories are built on fake assumptions and have no whatsoever representation of the real world.

4.0 Consequence of Washington Consensus

The introduction of the neo-liberal policies from the late 70's imports have increased dramatically and today we import more than twice the amount collected from exports, workers remittance and tourism. What this means is that it continues to build a trade deficit and we owe foreigners in foreign currency. Mainly, these twin factors have led the rupee to depreciate drastically. At the same time rupee has collapsed from approximately Rs.8/- in 1975 to Rs.370/- in 2022 per us dollar.

Some of the industries of that time have disappeared from Sri Lanka, and we currently see that agriculture is on its knees. People have got used to trading instead as it allows people to make quick money with minimum risk. Trading for over 40 years has put the economy in life support and has resulted in the rupee depreciation and a dramatic rise in cost of living. Two thirds of Sri Lanka's population earn less than Rs. 500/- (\$1.35) a day, denying them of essentials for surviving.

Sri Lanka is a country which goes through a massive essential product scarcity caused by the balance of payment crisis. The general public has to wait in lengthy queues to purchase essential items and in many cases the queues could last few days.

Scarcity of essential items, especially gas and oil has brought the country to its knees. Sadly, it brings back the memories of covid-19 lockdown periods.

Most small businesses are forced to close down their operations. Unemployment is skyrocketing. The passport office cannot meet the demand of people who are trying to flee the country.

Government is barely managing to provide electricity even with several daily power cuts. Government functionality has been paralyzed and limited to operate only few days a week. Most people find it difficult to consume three meals daily and levels of malnourishment in kids are rapidly rising.

When our country is in this dire state, our central bank has increased their interest rates over 30%. It is imposing this heavy burden on people who had to go through severe economic hardship due to Easter attacks and covid-19 lockdowns. These people have barely come out of moratoriums with increased level of indebtedness. Effectively, Sri Lankan people have to pay sky-high interest for the used-up capital and extraordinary high rates for the unpaid interest during the moratorium period.

If imposing extremely high interest rates is the right way to tame inflation in an economy which barely functions with a massive product scarcity, why bother offering moratoriums? This is an illogical mantra taken out from the neoliberal text book and a failed theoretical attempt globally.

The governor of central bank claims that he has raised the interest to save poor people from raising inflation. Would you charge more from the poor to save them from rising costs?

This joker has completely ignored the massive short supply of essential items in the country. When the products are not available for 21 million people to consume, prices are bound to rise. That cannot be and will not be tamed by raising interest rates. That will make the situation worst by paving the way for a complete economic collapse.

Even though government debt grabs all the headlines, private debt is larger and has a greater impact on the economic outcomes. Simply because the government is able to achieve deficit spending and private businesses and households are unable to the same. Massive amounts of earnings goes to debt servicing, leaving the people very little to consume or to invest.

Unfortunately, the current economic crisis struck our country at a time when private debt has grown disproportionately to private income levels. All these coordinated efforts, especially by the central bank, is increase the level of indebtedness of masses of people, pushing them further in to high debt. Private debt is rising at alarming rates, threatening the very existence of businesses and households. It is true that the current central bank strategies favor the bankers by allowing extremely high income at the cost of the general public. In case if you are not aware, during the past covid-19 period, the banking sector made record profits. Simply because they were allowed to charge interest on interest on helpless people faced with enforced lockdowns. I am certain that the central bank will defend their strategies saying that they are raising the interest rates to save the poor depositors. But we all know that the deposits held by poor people are negligible when compared to the massive deposit base of the super-rich. Besides, smaller depositors can be easily protected by giving a deposit guarantee. It is clear, the government policies are the reason for ongoing income and wealth extraction of masses of people making them poor, while making very few people extremely wealthy creating massive income and wealth inequality in the society.

5.0 Neo Liberal Policies and Foreign Debt Conundrum

Foreign Debt is another product of neo liberal economic policies. Regardless of the parties, all governments after 1978 opted to go for loans denominated by foreign currencies for infrastructure projects, funding for imports and funding for previous loan repayments. Under successive governments, massive amounts of foreign loans were taken for unsuccessful projects by our corrupted governments. These projects have yet to yield any revenue for the country and neither has it reduced the people's living cost. These loans pose a massive risk to our economic and our sovereign rights. We can clearly see foreign bond holders already controlling our bankrupt puppet government, dictating terms on our national policy making, enforcing austerity programs restricting government's spending on health, education, infrastructure and much needed subsidiaries for the people. IMF austerity measures are currently being imposed on Sri Lanka namely increasing VAT, increasing interest, increasing fuel, increasing electricity, increasing water and decreasing income tax threshold of wage earners to broaden the tax base. AS per their conditions we will have to privatize our public assets or sell off our state-owned economic monopolies such as public infrastructure and utilities to creditors. Further opening up the economy will only lead to further outflow of dollars in the form of revenue repatriation. These austerity measures are being imposed on people who have been economically suffering since 2019 Easter attack. These measures will further cripple the economy, creating more and more income and wealth inequality.

6.0 Recommendations

1. **Wealth Tax:** Tax reforms, shifting tax burden from consumer, wage income earner to wealthy. Remove or reduce indirect taxes. Tax holiday for wage earners up to a genuinely reasonable level. Increase taxes or limit earnings of financial sector and monopolies. Introduce taxes for technological giants who have oligopolies in the digital economy. Budget cuts may lead the economy into a trap no matter when cuts take place or how judiciously they are made. Government should continue to spend on the economic growth regardless of the tax revenue based on a target rate, meaning a specific unemployment rate and/or growth rate. Sri Lankan sovereign currency has no technical constraints for deficit spending.
2. **Automatic Stabilizer:** The “fiscal trap” must be further moderated or perhaps, eliminated. This includes long term fiscal solutions; the government should seek to use a more comprehensive and rational combination of policy rules and/or automatic stabilizers to help ensure that spending is increased when needed and used in positive ways. This is an approach that Minsky (2008 [1986]) and other Keynesians have supported for many years. These measures would work on the principle of increasing the deficit when capacity utilization, employment growth, economic growth or some similar economic indicator was below par, and vice versa (countercyclical assistance for the state and private sector).
3. **Socialist Policies “Job Guarantee”:** We would support increased programmatic spending aimed at solving key problems, such as, domestic infrastructure and domestic industries, as well as welfare spending in reference to, free health, free education, transfer payments to low-income earners and a job guarantee program. We would hope that a large portion of the new spending would be used in ways that increased employment, not by the invisible hand or perfect markets as prescribed by the neoclassical mythology, but by public sector hiring. The renewed vigor seen in many heterodox economic traditions offers a better hope for effective policies that will steer clear of the fiscal trap and put the economy back on a path to recovery.

4. **Reduce Inequality “Debt Forgiveness”:** We propose government spending to deal with the debt crisis by forgiving debts as was done in ancient times to reset the economy. Our basic premise is that debts that cannot be paid won't be. Widespread foreclosures and evictions would further worsen the distribution of income and wealth, and then further constrain the ability of the economy and the society to sustain. Writing debt down to levels that can be serviced would clear the decks for a real recovery. Income that would be siphoned off in debt service would instead be available for the wellbeing of the society.
5. **Protectionism:** We support protective tariffs to support local industries and to create an independent national economy using a nationalistic trade strategy. Economic history suggests, economic powerhouses such as USA, UK, China, Japan and Germany have built up their economies through protectionism. Protective tariffs cause to reduce imports, hence reducing indebtedness of the economy.
6. **Monitory Sovereignty:** We strictly oppose foreign credits (loans) for domestic spending. Domestic sovereign currency can be infused to the economy using keyboard entries. In this context we would not need foreign capital inflows to extract interest, profits and finally our sovereignty. Sri Lanka should avoid indebting its economy for foreign creditors as return for electronic “computer key board credit”.
7. **Central Planning/ Guidance:** We propose money creation to be nationalized, hence to nationalize the banking system. Money is not a commodity; money is a debt and a creature of the state. Money creation should only be for productive purposes for the wellbeing of the society, economy and the environment. Money creation for importing consumption goods and asset purchases should be strictly prohibited.
8. **Low cost of Living:** We propose to priorities government spending programs on infrastructure development, skill development and healthcare improvement to reduce cost of living in Sri Lanka. Low cost of production will attract natural export opportunities for domestic producers increasing our competitiveness in global markets.

9. **Green Economy:** We propose substantial increment in government spending on renewable energy, environment protection schemes and reforestation. Incentivize private sector via tax and other lucrative concession in order to get them to contributing for a green economy. These measures will help us to overcome the challenges poses by the climate changes.

10. **Financial Assets:** Make available risk-free financial assets such as government bonds, treasury bills and other saving instruments for EPF/ETF funds and pensioners. Special saving vehicles with healthy return for categories who deserves and risk-free investment.

7.0 Conclusion

The rise of neo liberalism has made our country indebted to foreigners. It has destroyed our industry, agriculture and local entrepreneurship. It has made us dependent on foreign imports. Rising foreign debt servicing cost and import cost has made our government enslaved to foreign bondholders.

As a debtor nation, we have started giving away our ports, our sea and many important public assets to creditor nations as a country. By now, our sovereignty is at risk at the hands of these powerful bondholders.

Further, popular neo liberal policy of taxing wage income earners and consumers further reduce the ability to spend for masses people. It has financialized our economy to a stage where entire private sector also in debt bondage to financial institutions. Currently our private sector debt has grown disproportionately to private sector income levels. High proportionate of private sector income goes to debt servicing leaving very little for masses for consumption. All the above factors work hand in hand in order to extract wealth out of masses of people making them poor, while a few are becoming wealthy beyond their wildest dreams creating massive income and wealth inequality.

One does not have to be a genius to work out who benefits at whose expense from these neo liberal policies. While masses are oppressed by these austerity programs in the form of high interest and high turnover taxes, wealth, flows to a few economic parasites who own the oligopolies and financial Institutions.

Our objective is to come up with a set of economic and public policies suitable for a debtor nation like Sri Lanka, to stop ongoing wealth extraction from the working class and to reduce inequality in our society.

8.0 References

- Bank, W. (2021, October 1). Sri Lanka poverty update. Open Knowledge Repository. Retrieved November 12, 2022, from <https://openknowledge.worldbank.org/handle/10986/36456>
- Chowdhury, A., & Jomo, K. S. (2018). Inequality and its discontents. *Development*, 61(1–4), 21–29. <https://link.springer.com/article/10.1057/s41301-018-0179-0>
- Department of Census and Statistics. (2022, November 12). Retrieved November 12, 2022, from <http://www.statistics.gov.lk/IncomeAndExpenditure/StaticInformation>
- Hail, S. (2018). Conclusion—Economics for sustainable prosperity. In *Economics for sustainable prosperity* (pp. 253–270). Palgrave Macmillan, Cham.
- Hudson, M. (1992). *Trade, development, and foreign debt: A history of theories of polarisation and convergence in the international economy* (Vol. 1). Pluto Press (UK).
- Hudson, M. (2015). *Killing the host: How financial parasites and debt destroy the global economy*. Islet.
- Levy Institute Publications. (2022, November 12). Levy Economics Institute of Bard College. Retrieved November 12, 2022, from https://www.levyinstitute.org/pubs/wp_634.pdf
- Publications. (n.d.). Fiscal traps and macro policy after the Eurozone crisis | Levy Economics Institute. Retrieved November 12, 2022, from <https://www.levyinstitute.org/publications/fiscal-traps-and-macro-policy-after-the-eurozone-crisis>
- Piketty, T., & Saez, E. (2014). Inequality in the long run. *Science*, 344(6186), 838–843. <https://www.science.org/doi/full/10.1126/science.1251936>
- Solt, F. (2020). Measuring income inequality across countries and over time: The standardized world income inequality database. *Social Science Quarterly*, 101(3), 1183–1199. <https://onlinelibrary.wiley.com/doi/10.1111/ssqu.12795>
- Sri Lanka - WID - World Inequality Database. WID. (2022, November 12). Retrieved November 12, 2022, from <https://wid.world/country/sri-lanka/>