

Sri Lanka: Govt-IMF Reach Agreement But Basic Question Remains



03-28-2024 ~ *Sri Lanka's economic crisis has worsened due to IMF deals, causing social unrest, unemployment, poverty, and food insecurity, and posing significant challenges for its people.*

The International Monetary Fund (IMF) announced on March 21, 2024, that it has reached a staff-level agreement with Sri Lanka regarding the next phase of financial assistance, granting access to \$337 million from the previously approved \$3 billion bailout allocated in 2023 for the financially strained nation. A staff-level agreement represents an initial consensus achieved between the personnel of the IMF and the governing authorities of a member nation concerning economic policies and reforms.

Over two weeks starting from March 7, a team from the IMF, led by senior mission chief Peter Breuer and deputy mission chief Katsiaryna Svirydzenka, conducted the second review of the bailout program in Colombo. The initial bailout, totaling \$2.9 billion and spanning four years, was approved in March 2023. Two tranches of \$330 million each were disbursed in March and December 2023.

Upon approval by IMF management and subsequent completion by the IMF executive board, Sri Lanka will now gain access to [SDR](#) 254 million (approximately \$337 million) in financial assistance.

Sri Lanka had declared its first-ever sovereign default since gaining independence from Britain in 1948 in April 2022.

The Sri Lankan Uprising of 2022

The 2022 protests in Sri Lanka, popularly referred to as Aragalaya (The Struggle), began in March of that year as a response to the government's policies. Criticisms

were aimed at the government's handling of the country's economy, which had plunged into a severe crisis. The crisis, which sparked widespread unrest, was fueled by a combination of factors, including rampant inflation, frequent power cuts, and shortages of essential goods like fuel and domestic gas.

Massive protests culminated in a governmental collapse in Sri Lanka on July 13, 2022. A significant number of demonstrators had marched toward President Gotabaya Rajapaksa's residence asking for his resignation. Rajapaksa left the country for the Maldives, leaving Ranil Wickremesinghe to assume the role of acting president due to his position as prime minister. By evening, Prime Minister Wickremesinghe too had resigned, paving the way for the establishment of an all-party government.

Wickremesinghe, who had previously held the position of Prime Minister on six occasions and was serving as acting President, was elected as the eighth executive President of Sri Lanka following a parliamentary vote on [July 20, 2022](#).

Crisis in the Sri Lankan Economy

Sri Lanka finds itself embroiled in a severe economic crisis, exacerbating the already pressing issue of food insecurity within the nation. The United Nations Children's Fund (UNICEF) reports that [6.2 million](#) individuals, constituting 28 percent of the population, are somewhat food insecure, with an additional 66,000 facing severe food insecurity.

The crisis, fueled by soaring inflation and prolonged political turmoil, has reshaped the landscape of governance in Sri Lanka, disproportionately affecting its impoverished communities. Once spending 32 percent of their income on food in 2019, in 2022, the same figure was a staggering [75 percent](#). The brunt of this crisis is borne most acutely by informal sector workers, with 86 percent of households reducing food intake, and some even skipping meals.

The food security challenge in Sri Lanka has been compounded by a significant decline in food production, impacting the [26.41 percent](#) of the population dependent on agriculture. The [United Nations Office of the Coordination of Humanitarian Affairs's \(OCHA\) Needs Assessment Report](#) highlighted a serious decline in domestic agricultural output stemming from an unsuccessful transition to organic farming. In April 2021, the former government had imposed a ban on [importing chemical fertilizers](#), which, even after being lifted in November, led to a

40 to 50 percent reduction in agricultural outputs for both [Maha and Yala monsoon seasons](#).

[Two in three](#) households adjusted their children's eating habits during the crisis: over half of all children (54 percent) had to eat cheaper or lower quality food; over one-third (35 percent) had to reduce the quantity their children were eating; and about one in ten children (12 percent) had to reduce the frequency of their children's food intake.

In 2022, the youth unemployment rate in Sri Lanka reached a staggering [24 percent](#), reflecting a concerning trend in the labor force ages 15 to 24. [Poverty levels](#) have been on the rise since 2019, increasing from 11.3 percent to 12.7 percent in 2020, which equates to over 300,000 new individuals falling below the poverty line during that period. This trend continued into 2021, with poverty rates doubling between 2021 and 2022, soaring from 13.1 percent to 25.0 percent. This sharp increase has pushed an additional 2.5 million people into poverty in 2022 alone. Households have been profoundly affected by this economic turmoil, facing multiple challenges such as a 46 percent increase in prices, a contraction in service and industry jobs (forcing workers into lower-paying agricultural roles), a decline in remittances, and negative impacts on agricultural incomes due to the ban on chemical fertilizers implemented in 2021.

Austerity Measures and the IMF

IMF packages in Sri Lanka have negatively impacted the people. Austerity measures and structural reforms have led to cuts in public spending, increased unemployment, and reduced access to essential services. Privatization and deregulation have resulted in higher costs of necessities, exacerbating poverty and inequality. While these packages offer short-term financial aid, their long-term effects deepen social hardships for the most vulnerable communities in Sri Lanka.

With the imposition of various bailout packages, the Sri Lankan government has also implemented a series of austerity measures, increasing the challenges faced by its citizens amidst the country's severe economic crisis. These measures entail significant reductions in government expenditures across different sectors, including critical areas such as social protection measures, and essential public services like healthcare and education, further undermining the well-being of the population. Notably, each ministry's annual budget has been [slashed by 5](#)

[percent](#).

In addition to these detrimental cuts, Sri Lanka's tax system has come under scrutiny for its regressive nature, characterized by a disproportionate reliance on indirect taxes such as the value-added tax (VAT), which accounts for [80 percent of tax revenue](#). This disproportionately affects lower-income individuals, who end up paying a larger share of their income in taxes compared to their higher-income counterparts.

Furthermore, the government's decision to privatize state-owned enterprises as part of its austerity measures has had negative consequences for both employees and consumers, leading to job losses and reduced access to essential services. Similarly, recent economic policy initiatives promoting labor "[flexibility](#)" have resulted in the erosion of workers' rights and welfare, exacerbating income disparities and labor exploitation.

Changes in pension regulations, such as the gradual reduction of pension gratuities for retirees, have further increased the financial insecurity faced by vulnerable segments of the population, particularly retirees relying on fixed incomes for their livelihoods.

The Central Bank of Sri Lanka's adoption of a significantly tighter monetary policy stance, characterized by successive increases in policy interest rates has had adverse effects on borrowing costs of both industries and citizens and economic activity in terms of production and consumer expenditure.

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