People-centric economic recovery amid the recent crisis in Sri Lanka

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The ongoing economic crisis in Sri Lanka is going to severely undermine its SDG attainment.

The likely fiscal consolidation should not come at the cost of wellbeing of people of Sri Lanka.

Sri Lanka can and should ‘build forward better’, but this would require much larger fiscal and financial resources.

ESCAP can offer technical support to help Sri Lanka pursue sustained, inclusive and green development, while addressing public debt sustainability concerns.
Outline of the presentation

- Ongoing economic crisis and its implications for SDG attainment
- People-centric policy focus amid likely fiscal consolidation
- Building forward better in Sri Lanka
- Fiscal policy options and possible ESCAP support to Sri Lanka
Outline of the presentation

Ongoing economic crisis and its implications on SDG attainment

People-centric policy focus amid likely fiscal consolidation

Building forward better in Sri Lanka

Fiscal policy options and possible ESCAP support to Sri Lanka
Sri Lanka is facing a fiscal crisis...

**Fiscal balance (% of GDP)**

- 2015: -13%
- 2016: -11%
- 2017: -10%
- 2018: -9%
- 2019: -8%
- 2020: -7%
- 2021: -6%

**Public debt (% of GDP)**

- 2015: 10%
- 2016: 20%
- 2017: 30%
- 2018: 40%
- 2019: 50%
- 2020: 60%
- 2021: 70%

- Blue: Foreign
- Green: Domestic

**Sovereign credit rating (S&P)**

- SD = selective default, as of April 2022.
- Red dot means negative outlook.

*Source: ESCAP, based on CEIC, Central Bank of Sri Lanka, and www.worldgovernmentbonds.com*
... coupled with a balance-of-payments crisis

Export and import values ($ million)

Tourism receipts (Jan 2019=100)

Workers' remittances ($ million)

Source: ESCAP, based on CEIC and Central Bank of Sri Lanka
In the wake of slowing economic growth, macroeconomic stability deteriorated sharply in the last year or so.

Real GDP growth rate (%)

Source: ESCAP, based on CEIC and Central Bank of Sri Lanka
SDG progress was already limited; it is likely to get worse because of the economic crisis.

Source: https://dashboards.sdgindex.org/profiles/sri-lanka
Example 1: surging prices of essential items will adversely affect poorer people and rural residents more.

Inflation rates in Colombo (%)

Weight in consumer price index basket (%)

Source: ESCAP, based on CEIC and Sri Lanka Census and Statistics.
Example 2: subdued employment in major industries would dampen living conditions of women and informal workers

- Two major employment sources are hard hit by the pandemic and the Russia-Ukraine conflict
  - **Tourism**: border closures, within-country mobility restrictions, higher inflation in tourists’ countries
  - **Garment**: supply chain disruption, weaker demand in developed countries, cotton price rise
- 81% of garment workers in Sri Lanka are women
- 80% of workers employed in the tourism sector are informal workers
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Spending on social protection in Sri Lanka is OK, but coverage can be expanded

Source: ESCAP, based on ILO World Social Protection database.
Poverty-targeted social protection schemes commonly miss half of intended beneficiaries

Exclusion errors (% of intended beneficiaries)

- Indonesia - PKH: 81.8%
- India - OAP: 68.2%
- Bangladesh - OAP: 59.4%
- Sri Lanka - Samurdhi: 57.9%
- Uzbekistan - CA: 57.2%
- Georgia - TSA: 52.7%
- Viet Nam - Poor List: 48.8%
- Philippines - 4Ps: 47.9%

Source: Kidd and Athias (2020).
Providing *universal* social protection benefits would cut poverty and boost private consumption in Sri Lanka

<table>
<thead>
<tr>
<th>Poverty reduction impact of social protection spending (%, based on national poverty line)</th>
<th>Increase in per capita consumption by recipients (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Child</td>
<td>Nationalwide</td>
</tr>
<tr>
<td>Disability</td>
<td>Lowest income decile</td>
</tr>
<tr>
<td>Old age</td>
<td>Highest income decile</td>
</tr>
</tbody>
</table>

Source: ESCAP Social Protection Simulator.
More broadly, public spending on social areas should be maintained to avoid rising income inequality.

Impact of fiscal crisis on Gini income inequality in Asia-Pacific

Impact of social spending (1% of GDP) on Gini income inequality

Source: ESCAP estimates (Survey 2022).
Fiscal consolidation that relies on social spending cuts could notably widen income inequality in Sri Lanka

Impact of fiscal policy change (at 1% of GDP) on Gini income inequality in Sri Lanka

Source: ESCAP estimates (Survey 2022).
Protecting people during crisis: key policy considerations

- **Provide universal coverage**: expand existing schemes and introduce schemes for uncovered contingencies.

- Develop methods to **identify those excluded** from existing schemes.

- **Cover the “missing middle”**: informal workers whose income level is too high to qualify for poverty-targeted non-contributory schemes, but are not eligible to participate in contributory schemes.

- Ensure that **benefits levels are high enough** to make real impact.
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Building forward better: an illustrative policy package

Social services
• Spending increases on
  • Social protection
  • Health care

Digital access
• Spending increases on
  • ICT
  • Education

Green development
• Abolish fuel subsidies
• Introduce a carbon tax
• Spending increases on
  • Energy access and efficiency
  • Climate-resilient infrastructure
  • Biodiversity

Source: ESCAP (Survey 2021).
Sri Lanka’s *additional* investment needs to implement the BFB package amount to about 9% of GDP per year ...

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**Source:** ESCAP estimates (Survey 2019).

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**Bar Chart:**

- **Social services:** 3.1%
- **Digital access:** 2.3%
- **Green development:** 3.8%

*“Ambitious” spending scenario*
... however, based on current trends, financial flows needed seem small – around 17% of investment needs

![Financial Flows Diagram](chart.png)

**Additional investment needs (% of GDP per year)**

- Afghanistan: 20%
- Bangladesh: 20%
- Bhutan: 5%
- India: 25%
- Iran (Islamic Rep.): 10%
- Maldives: 5%
- Nepal: 15%
- Pakistan: 20%
- Sri Lanka: 10%
- Turkey: 15%

**Projected increase in financial flows (% of GDP)**

- 2% growth (actual rate during 2016-19)
- 5% growth (optimistic case)

"Business-as-usual" spending scenario

Source: ESCAP estimates (Survey 2019).

Source: ESCAP estimates (Survey 2021).
Implementing the BFB package brings notable economic gains in Sri Lanka...

Potential output level

Unemployment rate

Household consumption level

Inflation rate

Source: ESCAP estimates (Survey 2021).
... as well as sizeable social and environmental benefits

**Number of poor people**

-0.35
-0.30
-0.25
-0.20
-0.15
-0.10
-0.05
0.00

2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030

**Gini income coefficient**

-0.9 0.0 0.1 0.2 0.3 0.4 0.5 0.6 0.7 0.8 0.9

2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030

**Carbon emissions level**

-20 -15 -10 -5 0

2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030

**Air quality (PM2.5)**

-50 -40 -30 -20 -10 0

2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030

Source: ESCAP estimates (Survey 2021).
Nevertheless, implementing the BFB policy package would have fiscal/debt implications

![Graph: Government debt-to-GDP ratio (percentage point change, relative to the baseline)]

Source: ESCAP estimates (Survey 2021).
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Selected fiscal and public debt challenges in Sri Lanka

**Wide fiscal deficits**
- **Low tax revenue** (8.1% of GDP)
- **Below-potential tax collection** (3.2% of GDP gap, ESCAP estimates)
- **Rigid public spending** (2/3 on wages, pensions and interest payments)

**Large debt servicing and deficit financing burdens**
- **Large upcoming foreign debt service** ($5.6 billion between Apr-Dec 2022)
- **Small, shrinking foreign exchange reserves** ($1.7 billion)
- **Sizeable monetary financing is weakening macroeconomic stability**

**High financing cost**
- **Rapidly deteriorating sovereign credit rating** (from CCC+ to ‘selective default’ in 9 months)
- **Surging government bond yields** (now 24.4% from 12.6% six months ago)
<table>
<thead>
<tr>
<th>Policy options to address fiscal and public debt challenges</th>
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<tbody>
<tr>
<td><strong>Debt relief</strong></td>
</tr>
<tr>
<td>• Bilateral debt service suspension and restructuring</td>
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<tr>
<td>• Debt swaps for development</td>
</tr>
<tr>
<td><strong>Fiscal space</strong></td>
</tr>
<tr>
<td>• Better and effective tax administration</td>
</tr>
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<td>• Progressive income tax</td>
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<tr>
<td>• Taxing carbon emissions and digital economy</td>
</tr>
<tr>
<td>• Rationalized tax privileges</td>
</tr>
<tr>
<td>• Spending efficiency</td>
</tr>
<tr>
<td><strong>Deficit financing</strong></td>
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<tr>
<td>• Green or social sovereign bonds</td>
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<tr>
<td>• Leveraging diaspora savings</td>
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<tr>
<td><strong>Emergency financing</strong></td>
</tr>
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<td>• National reserve funds</td>
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<td>• Catastrophe insurances</td>
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<tr>
<td><strong>Public debt management</strong></td>
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<tr>
<td>• Medium-term debt management framework</td>
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<td>• Contingent liabilities from state-owned enterprises</td>
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### Examples of recent ESCAP work on fiscal policies

<table>
<thead>
<tr>
<th>Policy option</th>
<th>ESCAP analysis and product</th>
</tr>
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<tbody>
<tr>
<td>Improve tax administration</td>
<td>Better tax administration can increase tax revenues; around 2-5% of GDP in several Asia-Pacific economies.</td>
</tr>
<tr>
<td>Enhance public spending efficiency</td>
<td>Asia-Pacific countries can spend 30% less on education and health care and 50% less on infrastructure to achieve the same outcomes.</td>
</tr>
<tr>
<td>Rationalize tax privileges</td>
<td>Rationalizing tax incentives (to try and attract FDI) can save considerable resources.</td>
</tr>
<tr>
<td>Improve public debt management</td>
<td>A policy brief on good public debt management practices in Asia-Pacific</td>
</tr>
<tr>
<td>Explore sovereign bond financing</td>
<td>A study on offshore bonds and diaspora bonds</td>
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Examples of ESCAP work on *SDG-aligned* fiscal policies

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<tr>
<td>Rationalize fuel subsidy &amp; introduce carbon tax</td>
<td>If part of additional fiscal resources are directed towards social protection, both poverty and inequality decline while economic growth rises in the long run.</td>
</tr>
<tr>
<td>Debt swaps for development</td>
<td>A study on debt-for-climate swaps in the Pacific</td>
</tr>
<tr>
<td>Sovereign thematic bonds</td>
<td>A policy brief on feasibility study for sustainability bonds in the Pacific</td>
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</table>
Possible ESCAP supports to Sri Lanka on economic analysis

- A detailed analysis on the potential implications of the economic crisis on SDG achievement
- **Macroeconomic simulations** on the medium-term socioeconomic, environmental and public debt impacts of selected national policy scenarios
- A focused study on **fiscal policy options** to enhance fiscal space and address public debt sustainability concerns
- A **capacity-building project** to enhance the Government’s readiness in adopting selected fiscal policies while remaining focused on debt sustainability concerns
Thank you / Bohoma istuti!

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