



A-level

ECONOMICS

Paper 3 Economic Principles and Issues

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THE ECONOMIC PERFORMANCE OF SRI LANKA

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- **EXTRACT A: The economy of Sri Lanka**
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EXTRACT A: The economy of Sri Lanka

Sri Lanka is one of the main economies in South Asia. Others include Bangladesh, India and Pakistan. South Asia has almost a quarter of the world's population, it is densely populated and experienced rapid economic growth between 2013 and 2019.

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FIGURE 1: Population and population density for selected countries in South Asia

	POPULATION (millions)	POPULATION DENSITY (people per square kilometer)
Bangladesh	164.7	1265
India	1380.0	464
Pakistan	220.9	287
Sri Lanka	21.9	354

Source: World Bank, accessed February 2022

Sri Lanka is a lower-middle-income country with a GDP per head of US\$3,852 in 2019. In the decade up to 2019, its average rate of growth of real GDP was 5.25%. The service sector makes up nearly 60% of the country's economy, the industrial sector makes up over 25% and agriculture accounts for

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just under 10%. Tourism is one of the main industries in Sri Lanka. The pandemic meant that the revenue earned by the industry fell dramatically but is expected to recover. Sri Lanka is the world's fourth largest producer and the third largest exporter of tea. Textiles is another important industry, accounting for over a third of the country's merchandise export revenue.

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Source: News reports, February 2022

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EXTRACT B: Selected economic indicators for Bangladesh, Pakistan and Sri Lanka

Bangladesh, Pakistan and Sri Lanka are all classified as lower-middle-income countries by the World Bank. Nevertheless, during the past decade these countries have experienced different rates of economic growth and are at different stages in their economic development.

FIGURE 2: National income

	GDP (\$ billion), 2020	GDP per capita (\$), 2020	Economic growth (mean annual % change in real GDP 2010–2019)
Bangladesh	323.1	1961.7	6.76%
Pakistan	262.6	1188.8	3.96%
Sri Lanka	80.7	3684.9	5.25%

Source: World Bank and Macrotrends, accessed February 2022

FIGURE 3: Inequality and poverty

	Gini index	Income share of the poorest 40% of the population	International poverty rate(less than \$1.90 a day) % of the population	Lower-middle-income poverty rate (less than \$3.20 a day) % of the population
Bangladesh	32.4	21.0%	14.3%	52.3%
Pakistan	31.6	21.1%	4.4%	35.7%
Sri Lanka	39.3	17.7%	0.9%	11.0%

Source: World Bank, accessed February 2022

NOTE: Figure 3 shows the most recent values (Bangladesh and Sri Lanka – 2016, Pakistan – 2010)

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FIGURE 4: Health and education

	Life expectancy at birth, years	Infant mortality rate, per thousand live births	Mean years of schooling	Adult literacy rate (%)
Bangladesh	72.6	25.1	6.2	73.9%
Pakistan	67.3	57.2	5.2	59.1%
Sri Lanka	77.0	6.4	10.6	91.7%

Source: World Bank and United Nations Development Programme (UNDP), accessed February 2022

FIGURE 5: Other economic indicators

	Human Development Index (HDI)	Labour force participation rate (%)	Capital investment (% of GDP)	CO₂ emissions per capita (tonnes per annum)
Bangladesh	0.632	59.0%	31.6%	0.5
Pakistan	0.557	52.6%	15.6%	1.1
Sri Lanka	0.782	53.9%	27.4%	1.1

Source: World Bank and UNDP, accessed February 2022

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EXTRACT C: The market for tea

According to the Food and Agricultural Organisation (FAO), there are around 400 000 small-scale farmers involved in the production of tea in Sri Lanka. The industry supports over two million people, about one tenth of the country's population.

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Changes in the world market price of tea can have a significant impact on those who depend on growing tea for their livelihood. In real terms, the FAO estimates that tea prices, in 2022, are less than 28% of their 2017 level. Increased production in some major producing countries and the slow growth in the consumption of tea, especially in more developed economies, help to explain this large fall. With increasing incomes, per capita demand for tea is increasing in many developing and emerging economies, including China and India. However, in more mature markets, such as Europe, per capita consumption has declined due to competition from other beverages.

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International tea prices, like those of many other agricultural commodities, are volatile and affected by speculation. Figure 6 below, illustrates the fluctuations in the world market price of tea between June 2012 and June 2021.

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FIGURE 6: Price of tea – June 2012 to June 2021

FIGURE 6 is not reproduced here due to third party copyright restrictions.

The tea plant is highly sensitive to changes in growing conditions. Weather and natural disasters can affect the crop and hence the price of tea. The world market price is also affected by developments in the macroeconomy, including changes in the price of energy and in the value of the currencies of tea-producing countries.

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It is estimated that the price elasticity of supply of tea is 0.25; investing in a tea orchard is a long-term commitment and growers have to be confident that the investment is worthwhile. The demand for tea is also price inelastic, with estimates varying between –0.32 and –0.98. When supply and demand are inelastic, market prices tend to fluctuate significantly. 35

Source: News reports, February 2022

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EXTRACT D: The rising level of Sri Lanka's government debt is a cause for concern

Government spending can help to promote economic development by providing merit and public goods and supporting people on very low incomes. Sri Lankan government spending has financed education and training and has helped to provide essential infrastructure such as roads, bridges, water supply and irrigation systems. Welfare expenditure has included spending on healthcare and nutrition, and safety net programmes to help the most vulnerable.

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However, in 2021, government and government-guaranteed debt was over 115% of GDP and was expected to rise further. Much of the debt is in foreign currency. The Sri Lankan rupee depreciated by 6.8% against the US dollar between January and September 2021 and some fear that Sri Lanka could 'go bankrupt' as the country struggles to repay its overseas debts. Its foreign exchange reserves are at their lowest level for a decade. The pandemic has hit the country's tourist industry which usually contributes more than 10% of GDP and is a vital source of foreign exchange. To protect foreign exchange reserves, the government banned the import of cars and imposed other restrictions on imports.

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Inflation reached 14.2% in January 2022 and appears to be accelerating. As a result, basic

necessities are unaffordable for many, and some are struggling to feed their families. The large budget deficit, financed by the government printing money, has fuelled inflation. Rising oil prices and the fall in the exchange rate have added to inflationary pressures. The depreciating currency has helped the country's exporters, including clothing manufacturers and tea growers, but has made servicing overseas debt more costly.

The International Monetary Fund (IMF) is an organisation that provides loans to countries with balance of payments problems. However, the present government of Sri Lanka is against approaching the IMF for help. It considers that conditions imposed in return for an IMF loan represent unacceptable interference in the country's affairs and are likely to include cuts in government spending. The current recovery in the economy should increase tax revenue and improve the government's finances, but will it be enough?

Source: News reports, February 2022

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