



# Southern China International MUN

*Official Background Guide*

*Group of Twenty: On measures to mitigate the economic crisis in Sri Lanka*

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## **1. Description of the Issue**

### **1.1 History of the Issue**

Ever since Sri Lanka graduated to a middle-income country, they have been trying to figure out an efficient way to further improve their economy. However, many internal factors that the country faces restrict them from doing so <sup>1</sup>. Despite difficulties, fluctuations, and an underlying economic crisis, Sri Lanka's economy was still slowly growing until 2019, where the combination of the COVID pandemic, poor **monetary policies**, and large **fiscal deficits** among other issues, the worst Sri Lanka economic crisis began <sup>2</sup>.

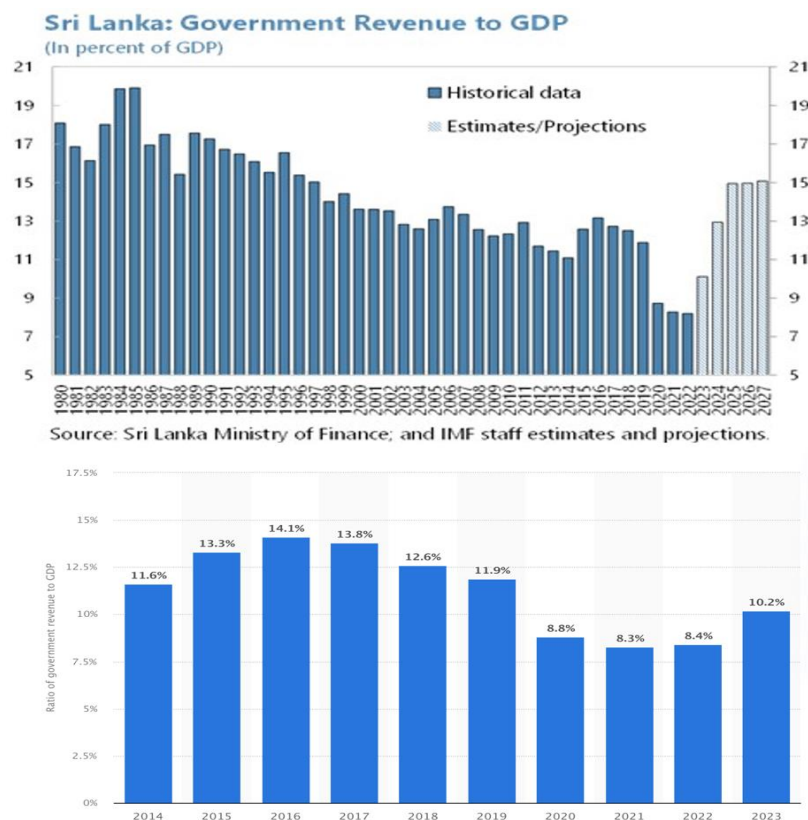
Sri Lanka has an economy that is heavily reliant on exports and tourism <sup>4</sup>. However, due to the COVID pandemic that began in 2019, there was a substantial decrease in the number of tourists in Sri Lanka<sup>2</sup>. This led to a decrease in one of the main sources of income for the country.

Additionally, from a law imposed on the allowed agricultural products in April 2021 <sup>5</sup>, there was a significant decrease in agricultural exports because of the ban on agrochemicals like fertilizers <sup>5</sup>.

Additionally, for a long time, Sri Lanka has never been able to fully pay out the foreign **debt** they faced. Problems like consistent fiscal deficits and **balance of payments (BoP)** have been around for quite some time <sup>3</sup>. Predictably, fiscal profligacy, compounded by the COVID-19 pandemic, set off a predictable chain of outcomes—higher budget deficits, higher public debt, higher foreign debt, credit downgrades, higher cost of external borrowing, loss of international market access for foreign borrowings, loss of foreign currency (FX) reserves, a BoP crisis, currency depreciation, rising inflation, and external debt default <sup>3</sup>. Eventually, by the end of 2021, the outstanding foreign debt stood at nearly 51 billion dollars <sup>7</sup> and the country was forced to declare **sovereign default** in 2022 <sup>6</sup>, showing the extent of the economic crisis.

## 1.2 Recent Developments

Sri Lanka approached the International Monetary Fund (IMF) in 2022 in hopes of containing the crisis<sup>8</sup> and they were given a \$3 billion loan. This loan was to keep the country's lifeline while they resolved "deep-seated" issues<sup>9</sup> within the country. The IMF carried out a government diagnosis that investigates Sri Lanka's strengths and weaknesses where the civil society should play a prominent role<sup>9</sup>.



The graph on the top is from the IMF showing the Government revenue to GDP ratio of Sri Lanka based on their past and also their estimated projection from the funds given in 2022<sup>8</sup>. The graph on the bottom shows the recorded amount of Government Revenue to GDP ratio. In 2023, similar to the IMF's estimation, there was a growth of<sup>10</sup>.

However, due to the goal of the program ultimately being trying to increase government revenues and the utilization of tax, issues in civil society may start to appear. Initially, revenue-based fiscal consolidation may lead to increased taxes or reduced public services, impacting citizens' daily lives<sup>11</sup>. Additionally, austerity measures and economic reforms may disproportionately affect lower-income groups, potentially exacerbating inequality.

In September of 2024 though, according to the central bank of Sri Lanka, inflation percentage

reached a -0.5 value for that month. Despite there being a deflation and small stabilization, long-term issues still exist such as poverty, labor force decrease, food insecurity, and debt restructuring<sup>13</sup> which could be underlying factors to the economic crisis.

## **Key Terms**

**Fiscal Deficits** – The shortfall between a government's total revenue and total expenditure in a given financial year.

**Monetary Policies** – A set of actions implemented by a nation's central bank to control the money supply and promote economic growth.

**Sovereign Default** – A government's failure or refusal to repay its debt obligations in full when due. *This can involve both domestic and foreign debt.*

**Debt** – A financial obligation where one party (the borrower) owes money to another party (the lender), typically involving the repayment of the principal amount along with interest over a specified period.

**Balance of Payment (BoP)** – A comprehensive record of all economic transactions between residents of a country and the rest of the world over a specific period, typically a year or quarter.

## **2. Emphasis of the Discourse**

### **2.1 Right-Wing Approach**

Even though there are separations between right-wing and left-wing approaches, it is important to keep in mind that most countries take into account both liberal and conservative opinions, and both opinions are used to make decisions. There is no right or wrong but just the beliefs of the two different parties.

Conservatives tend to prioritize fiscal discipline, free market, and limited government intervention. Their approach is all rooted in the principles of capitalism and individual freedom. Their aim is to foster economic growth while maintaining the efficiency of the market. Conservatives would be likely to put emphasis on reducing government expenditure and achieving a balanced budget<sup>15</sup>.

Traditionalist policymakers in Sri Lanka would focus on preserving stability, promoting cultural identity, achieving economic self-sufficiency, and supporting established institutions while advocating for prudent fiscal management<sup>18</sup> and gradual reforms. Their approach aims to create a

resilient economy that respects historical precedents while addressing contemporary challenges. They seek to advocate policies that prevent drastic changes and preserve stability as it is essential for national cohesion <sup>16</sup>. As conservatives want to prevent drastic changes, globalization like widespread foreign investment would be approached cautiously to further protect local industries rather than upholding foreign competition.

A conservative economic approach in Sri Lanka offers key benefits: fiscal responsibility reduces debt and restores stability <sup>18</sup>, free markets attract investment and drive growth, traditional institutions enhance social cohesion, and gradual reforms ensure smoother economic transitions with minimal disruption. However, there would be less government expenditure available, there may be a larger negative impact on vulnerable populations, and the country may become over-reliant on market forces <sup>19</sup>.

## **2.2 Left-Wing Approach**

Liberalist approaches, on the other hand, prioritize social equity, government intervention, and the welfare of the working class. Rooted in principles of social justice, their aim is to enhance living standards for all while addressing systemic inequalities. They emphasize increasing the minimum wage, strengthening labor unions, and implementing progressive taxation to redistribute wealth. They advocate for expanded government roles to ensure social welfare and provide essential services, aiming for a more inclusive economy that benefits the broader population rather than just the affluent <sup>20</sup>.

The benefit of a left-wing approach includes social development due to increased opportunity within the economy and an increase in export potential, estimated at \$10 billion annually. Which could create over 140,000 new jobs <sup>21</sup>, and this could possibly help the economy. However, due to most of these being theoretical, in reality, a left-wing approach could lead to economic instability, job losses, and social inequality because the benefits of economic reforms have often been concentrated among the wealthiest segments of society, exacerbating social inequality <sup>22</sup>.

## **2.3 Stance of Intergovernmental Organizations**

Intergovernmental organizations closely linked with the economic crisis include the International Monetary Fund (IMF), the World Bank, and the United Nations (UN).

The IMF views and emphasizes the importance of strategies that support long-term economic

growth and stability for Sri Lanka <sup>15</sup>. The World Bank focuses on a combination of human equality and ensuring economic stability while implementing small reforms to support the economy. The UN focuses on sustainable development goals (SDGs) and humanitarian assistance as the economic crisis has brought a large gap between the upper class and the lower class of civil society. As stated before, there are still long-term issues that still exist such as poverty, labor force decrease, food insecurity, and debt restructuring <sup>13</sup> which are aimed to be mitigated through the SDGs. Sri Lanka, alongside countries like China, India, Japan, United States are most likely interested in these intergovernmental organizations. Apart from Sri Lanka, these countries are huge supporters and gave huge assistance to Sri Lanka during the economic crisis <sup>23</sup>.

## 2.4 Stance of Developed Countries

The economic crisis of Sri Lanka may bring insights into the causation of the crisis. Developed countries generally view Sri Lanka's economic crisis as a significant concern, reflecting broader issues of governance, debt management, and geopolitical influence in South Asia. Their perspectives often emphasize the need for sustainable economic reforms, debt restructuring, and adherence to democratic principles. Hence, developed countries like the **United States, Japan, and Australia** have shown similar stances where they are for humanitarian assistance and hope to promote economic growth <sup>24</sup>. However, they do have different focuses and approaches where the US focuses on the geopolitical aspect of the crisis, Japan focuses on economic assistance and supporting reforms, and Australia primarily focuses on security and asylum seeker issues <sup>25</sup>.

In general, most of the developed countries have similar stances with each other but their focuses and approaches may be different.

## 2.5 Stance of Developing Countries

A noteworthy country to be discussed, China <sup>14</sup>, initially held a negative stance towards Sri Lanka. They were reluctant to provide aid and assistance at first. China eventually chose to assist Sri Lanka, as stated by the Chinese embassy “Xi Jinping stressed that China firmly supports Sri Lanka in safeguarding its sovereignty, independence and national dignity, exploring a modernization path suited to its national conditions, and will continue to provide assistance within its capacity for Sri Lanka's economic and social development <sup>27</sup>.” However, there are debates on whether Sri Lanka is falling into a “debt-trap” created by the Chinese government <sup>26</sup>.

Developing countries generally view Sri Lanka's economic crisis as a cautionary tale and an

opportunity to reassess their own economic vulnerabilities. Their stances are shaped by shared challenges, such as high debt burdens, reliance on external financing, and susceptibility to global economic shocks. Developing countries like **India and Bangladesh** have shown similar stances where they both provided support and aid to Sri Lanka. However, with similarities to developed countries, motives and approaches are different.

### **3. Possible Solutions**

#### **3.1 In Favor of Developed Countries**

Developed countries play a major role in contributing to possible solutions to alleviate the economic crisis in Sri Lanka. A big reason is that most of the developed countries hold crucial positions in the world economy and have a huge impact on it. That said, they have the ability to control the flow of trades, debts, the flow of economy, and investments. Most of the solutions would be likely supported by developed countries as long as it is ethical and logical fundamentally.

Therefore one of the possible solutions that are in favor of developed countries could be debt restructuring where because **Sri Lanka defaulted due to a huge number of debts**, developed countries can advocate for comprehensive debt restructuring through multilateral agreements, ensuring fair treatment of all creditors. Some of these restructurings include reducing debt burdens and extending repayment periods to allow Sri Lanka to focus on economic recovery while ensuring the payment of debt <sup>28</sup>.

#### **3.2 In Favor of Developing Countries**

Many developing countries view this economic crisis as a great learning experience and a great opportunity to build mutual bonds and foster regional cooperation with one another. Developing countries would most likely support solutions where the roots and reasoning behind the solutions contain a focus on helping Sri Lanka but not benefiting anyone. These solutions would and might only prioritize the alleviation of the issue.

Thus, one possible solution would be the focus on regional cooperation and solidarity.

Developing countries can foster regional cooperation through organizations like SAARC (South Asian Association for Regional Cooperation) to provide mutual support during crises. This could include sharing resources, expertise, and best practices <sup>29</sup>. That means there could be an

agreement where developing countries are required to help each other during times like an economic crisis. In this case, once developing countries assist Sri Lanka, then Sri Lanka will be obliged to assist back whenever the developing countries need help. India has already demonstrated this by providing over \$4 billion in aid to Sri Lanka through credit lines for essential imports like food and fuel <sup>30</sup>.

#### **4. Keep in Mind the Following**

This Background Assistive Report does not include the full history of Sri Lanka's background leading up to the economic crisis. It is wise and recommended that delegates research and understand the history and origins of Sri Lanka and its economic crisis. Additionally, each country has their own motives, stances, and reasoning in choosing to aid or not aid Sri Lanka. Therefore, while researching, it is best to keep these (*but not limited to*) the following questions in mind:

- 1. What were the root causes and what are the main policy implications arising from Sri Lanka's economic crisis?*
- 2. Has/Is your country faced/facing a similar economic crisis at the moment that could relate you similarly to Sri Lanka?*
- 3. If your country lends and borrows money to Sri Lanka, do they need to be paid in a short span of time or a long span of time? How high are the interests?*
- 4. What are the exact motives and reasoning behind your country choosing to provide aid to Sri Lanka?*
- 5. If you are a developing country, will the process of mitigating the issue create an insight that could help your country if a similar crisis does appear?*
- 6. To what extent does your role and position in supranational organizations affect your understanding and stances in providing aid to Sri Lanka?*
- 7. Can your country help Sri Lanka ease their economic crisis and also simultaneously alleviate other issues within Sri Lanka?*

#### **5. Evaluation**

Sri Lanka has been dealing with this economic crisis for the 5<sup>th</sup> year now and this economic crisis can be described like an iceberg. The crisis is like the surface of an iceberg, whereas the many underlying problems within the country are substantially bigger and eventually bite Sri Lanka in surprise act as the hidden iceberg below the sea level. For example, although Sri Lanka's GDP is

starting to stabilize and perhaps increase, *what about the unemployment rates? What about the lack of labor force that could possibly cause a decrease in the economy of Sri Lanka long-term wise?* Thus, although the topic's main focus is on mitigating the economic crisis in Sri Lanka, it would be best to understand and explore solutions that could also solve the issues caused by the economic crisis. All in all, always keep in mind that nations are interdependent; solutions for one country may not be the exact best for others, making it important to relate the reasoning and stances between each country. As you move forward, focus on meaningful collaborative solutions and possibly find thoughtful discussions between countries that can address both the visible and hidden challenges of Sri Lanka's economic crisis. Good luck, delegates!

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