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Should Sri Lanka Inject Money to Combat their Current Economic Crisis?

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ABSTRACT

This paper aims to examine, whether Sri Lanka should inject money into their economy to fight their current economic crisis. They are currently suffering from a financial crisis where they are struggling to provide basic necessities such as daily energy consumption, food, fuel, and medicine. Due to their high dependency on foreign exports, they have gone under a huge debt of $51bn along with a hyperinflation of 54.6%. The paper intends on investigating Sri Lanka's next steps on overcoming this crisis by studying similar incidents in the past; the 2008 Zimbabwean economic crisis and the 2020 COVID-pandemic. During the Zimbabwean economic crisis, they aimed on resolving the rising prices by printing more money to support the people. This led to hyperinflation of goods, so much so that people needed wheel barrows full of cash to buy a loaf of bread, rendering the Zimbabwean Dollar worthless. Conversely, to avoid recession during the COVID pandemic, they printed more money to encourage spending as people began to limit their purchases. Thus, injection of money into an economy needs to be done according to the situation of the crisis.

Keywords: Inflation, recession, prices, demand, currency.

Subject: Economics

INTRODUCTION

Struggling in a major economic crisis, Sri Lanka is in a debt of $51bn and is yet to pay interest payments to foreign markets. Following the 2008 civil war, they focused on providing its domestic market with goods and services instead of boosting their foreign trade. Being dependent on foreign markets, they import supplies worth $3 billion more than their exports, leading to shortage of foreign currency. It was reported that Sri Lanka had $7.9 billion in their foreign currency reserves, which by the end of 2019, got reduced to $250 million. The government also decided to introduce tax cuts, which greatly decreased the government cash reserves. Currently, they have a hyperinflation of more than 50% (currently at 54.6%). The effects of this is detrimental on the economy as failing to pay debts will damage their reputation for future loans. Due to a halt of foreign imports, there is low stock of chemical fertilizers, using local organic fertilizers as a response has led to widespread crop failure, therefore having to import foreign food stocks which is further decreasing their foreign currency reserves. They struggle to provide basic necessities such as daily energy consumption, food, fuel, and medicine (Perera, 2022). Although it is widely believed that printing money can lead to inflation, times are changing and so are the impacts of monetary decisions.

RESULTS & DISCUSSION

As more money is added into an economy, the demand curve shifts for goods and services, this increase in demand results to rising prices as the economic output is still constant. Therefore, more money circulated would lower currency value. On the other hand, increase in supply would mean low demand, decreasing the price of goods and leading to deflation (WonderWhy, 2013). Healthy and steady inflation can boost economic growth as more consumers and businesses are spending on goods and services, as famous american economist, Milton Friedman said, 'Inflation is always and everywhere a monetary phenomenon'. The Fed usually target 2% annual inflation rates, central banks modify their policies by changing interest rates to meet this 2%. High inflation although decreases the value of present money in the future, a former chief economist at IMF, Olivier Blanchard states that, 'when the inflation rate is very high, it is very difficult to make any calculation for savings' (Schulze, 2020). Looking at the 2008 Zimbabwean economic crisis, where in response to economic failure, more money was being printed through government expenditure and led to a hyperinflation (6.5 sextillion%). This meant that prices of goods and services were doubled daily, which was being resolved by printing more money (the 4th updated ZWL was printed at $hundred trillion,

equivalent to $100) (Ranade, 2021). Recorded as the second worst inflation, wheelbarrows of cash were used to buy a loaf of bread and people were being arrested as raising inflation became illegal (WonderWhy, 2013).

Central banks inject money to fight global recessions, such as that overcome during the COVID-pandemic, where the federal reserve balance sheet had increased from $4 trillion to around $7 trillion (⅓ of the American economy). This however raised concerns for inflation, as Milton Friedman famously said, ‘Too much money chasing too few goods causes prices to rise’; in fact, supply shocks had increased prices for few goods for some months, although inflation stayed relatively low due to unemployment and stymied consumer spending. People were saving instead of spending their cash in fear of worsened economy, as high unemployment rates and weaker consumer demand continued, it would lead to low inflation. It was predicted that as unemployment remained high, wages would be low, hence in order to boost the economy, policy makers planned to print trillions of cash into the financial system. Cash infusion through the $1200 stimulus checks would not have resulted in inflation as the public needed it for daily payments and lost income, rather than spending of leisure purchases, these checks were consequently life preservers hindering from further economic depression (Schulze, 2020).

Inflation however cannot just be apparent through physical consumer expenditures (a measure of inflation such as grocery market and oil stations), they may still be present for other assets such as the stock market, the housing market, or credit spreads. There are other factors which also effect inflation, such as commodity prices. Production halts (such as oil shortage), can cause oil prices to rise, which lead to increase in gas prices. Expectations by the actors in an economy- households, businesses, consumers, workers, and investors - can also affect inflation. It is further believed that globalization, technology, and an aging population would be the future determinants of consumer prices. Public debt can also cause inflation, trillions of dollars spent during the economic stimulus had increased government debt, although this deficit spending to fund public investment could be easily paid as it is in fixed dollar amounts (Schulze, 2020).

CONCLUSION

Evaluating the above information, there are several factors to consider when deciding whether Sri Lanka should print money to fight their debts. On the one hand, inflation can be a major risk affecting their economy, while on the other hand, injecting money can often boost the economy from approaching a depression. Therefore, deciding this issue completely depends on the situation, and time of occurrence. Sri Lanka is already suffering from hyper-inflation, at 54.6%, although this is due to supply shortages due to stymied foreign imports, injecting consumer earning however would only increase inflation and decrease their currency value further. Sri Lanka nonetheless could seek new ways to boost their foreign currency reserves in order to purchase foreign imports, and should also focus on educating their population to specialize in exports and overall decrease their dependency on net imports.

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