



Is Pakistan Closer to Sri Lanka? A Comparative Analysis

**Government of Pakistan
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Is Pakistan Closer to Sri Lanka – A Comparative Analysis

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Table of Contents

Introduction.....	1
Economic Structure.....	1
Real Sector	3
Fiscal Position.....	4
Sources of Foreign Exchange Earnings	6
International Trade.....	7
External Public Debt.....	8
IMF Bail-out Packages	9
The Risk of Default.....	9
Conclusion	11
References.....	12

List of Tables

Table 1: Comparison of Basic Macroeconomic Facts & Indicators - 2021	2
Table 2: Major Imports and Exports FY 2021	7
Table 3: DSF position - 2021	10

List of Figures

Figure 1: Sectoral Growth (%).....	4
Figure 2: Fiscal Indicators (% of GDP)	5
Figure 3: Sri Lanka – Trend of Total Government Debt (% of GDP).....	5
Figure 4: Sri Lanka – Composition of Foreign Earnings.....	6
Figure 5: Pakistan – Sources & Trend of Foreign Earnings	7
Figure 6: Sri Lanka - Composition of External Debt.....	8
Figure 7: Pakistan - Composition of External Debt.....	9
Figure 8: Trend of Foreign Exchange Reserves (USD Million).....	10

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Introduction

Sri Lanka defaulted on its debt obligations to its creditors in May 2022 when it failed to repay US\$ 78 million of debt interest even after availing a 30-day grace period (Hoskins, 2022). The foreign exchange earnings of Sri Lanka reveals that the country experienced an overall 29% decrease in foreign exchange earnings in 2021¹ as compared to those in 2019 (CBS, 2022). This decrease occurred as a result of a substantial decline in the tourism (86%), and remittances (18%). The foreign exchange reserves were recorded at US\$ 1.7 billion as of 30th June 2022 which included US\$ 1.5 billion in a swap facility provided by the People's Bank of China (CBS, 2022). Consequently, the credit rating companies declared Sri Lanka as a defaulted country.

On the other side, the economic and political uncertainty in Pakistan is giving an impression globally that Pakistan might be following the footprints of Sri Lanka. However, due to relatively better economic management of the Government, particularly during the pandemic and post-pandemic periods as well as during the prevailing global commodity crisis, Pakistan's economy has shown a great level of resilience. The economic situation seems to be in overall control in Pakistan as the foreign exchange earnings increased by 26% in 2021 as compared to those in 2019. The major increase was witnessed in remittances (35%) and foreign direct investment (10%) (SBP, 2022). Moreover, the total foreign exchange reserves of Pakistan stood at US\$ 15.5 billion as of 30th June, 2022 and yearly debt servicing has remained around 2.5% of GDP during the last year (SBP, 2022). The comparison of the two countries' situation is presented below so as to allay fake impressions:











Economic Structure

Pakistan is a homeland to 224.8 million residents, covering an area of 796,096 km sq which is 12 times greater than that of Sri Lanka (Finance Division, 2022). Similarly, the economic resources of both countries are diverse in quantity and assortment. The basic macroeconomic facts and indicators are given in Table 1. It is evident from Table 1 that the basic indicators of Pakistan are much better than those of Sri Lanka. Though the service sector of both countries is more or

¹ Data for FY 2022 is not readily available.

less the same; however, Pakistan's economy is around 4 times that of Sri Lanka's with a relatively larger agriculture sector. However, due to its larger population, the per capita income of Pakistan is lower than that of Sri Lanka.

Table 1: Comparison of Basic Macroeconomic Facts & Indicators - 2021

PAKISTAN ²		SRI LANKA ³
796,096 km sq.	 <p>LAND AREA</p>	65,610 km sq.
224.8 million	 <p>TOTAL POPULATION</p>	22.2 million
USD 349 billion	 <p>GDP</p>	USD 88 billion
USD 1,676	 <p>PER CAPITA GDP</p>	USD 3,815
23.0%	 <p>AGRICULTURE</p>	8.7%
18.9%	 <p>MANUFACTURING</p>	29.8%
58.1%	 <p>SERVICE SECTOR</p>	55.1%
21.9% (FY 2018-19)	 <p>POVERTY</p>	14.3% (FY 2019)
6.3% (FY 2019-20)	 <p>UNEMPLOYMENT</p>	4.6%

Data Source: Pakistan Economic Survey 2021-22 & Central Bank of Sri Lanka

² Pakistan's data is based on Fiscal Year 2020-21 starting from July, 2020 to Jun, 2021

³ Sri Lanka's data is based on Fiscal Year 2021 starting from January, 2021 to December, 2021

Real Sector

Sri Lanka achieved upper middle-income country status as classified by the World Bank in 2019 after attaining a growth rate of 6% on average during 2007-2016 (CBS, 2019; ADB, 2017). Unfortunately, it failed to sustain this momentum of growth due to an undiversified manufacturing and export base and stagnant rate of export to GDP as already warned by the multilateral partners. In a true sense, the pandemic in 2020 and terrorist attacks in 2019 triggered the crisis which adversely affected the tourism industry, one of the critical sources of foreign earnings and income for the Sri Lankan economy (Economist, 2022). The roots of the crisis were sown two decades back with the end of the civil-war conflict when the country started borrowing from commercial as well as multilateral sources but spent on infrastructure activities instead of tradeable investments. The frightening policy shifts and political decisions dragged the country into a quagmire of financial crisis leading to a shortage of fuel, power cuts, and a dearth of food supplies (Ishak, 2022; Vieira, 2022).

Although, Pakistan is a lower middle-income country but it is structured upon agriculture, industry, and the services sector. The problems mentioned above are seemingly the same for Pakistan. However, the recent economic performance as presented in the Pakistan Economic Survey 2021-22, portrays a positive picture as the economic situation is far better in Pakistan even in a post-covid scenario. In FY 2021-22, all the three sectors i.e. agriculture sector (4.4%), Industry (7.2%), and services (6.2%) have outperformed and kept on moving towards recovery from the pandemic and global inflationary environment. Similarly, the investment to GDP ratio has also increased from 14.6% in 2020-21 to 15.1% in 2021-22 which is the manifestation of a sustainable base of economic activities. The three-year comparison in respect of both countries is presented in Figure 1, whereby FY 2020 is taken as the pandemic year.

In addition to the above, there were some policy mistakes to save the political face of the Sri Lankan ruling party that intensified the economic issues. Given the pandemic, the Government of Sri Lanka introduced tax exemptions in 2019 which reduced the government revenue by USD 1.4 billion. On the other hand, the decline in foreign earnings through reduced tourism created foreign currency shortages which led to the ban on imports of expensive chemical fertilizers and the promotion of organic farming using locally produced fertilizers in April, 2020. Consequently, the Government faced shortage of domestic and foreign resources which discouraged investment

and production of commodity-producing sectors, causing a decline in growth of all sectors in FY2020 (as presented below):

Figure 1: Sectoral Growth (%)



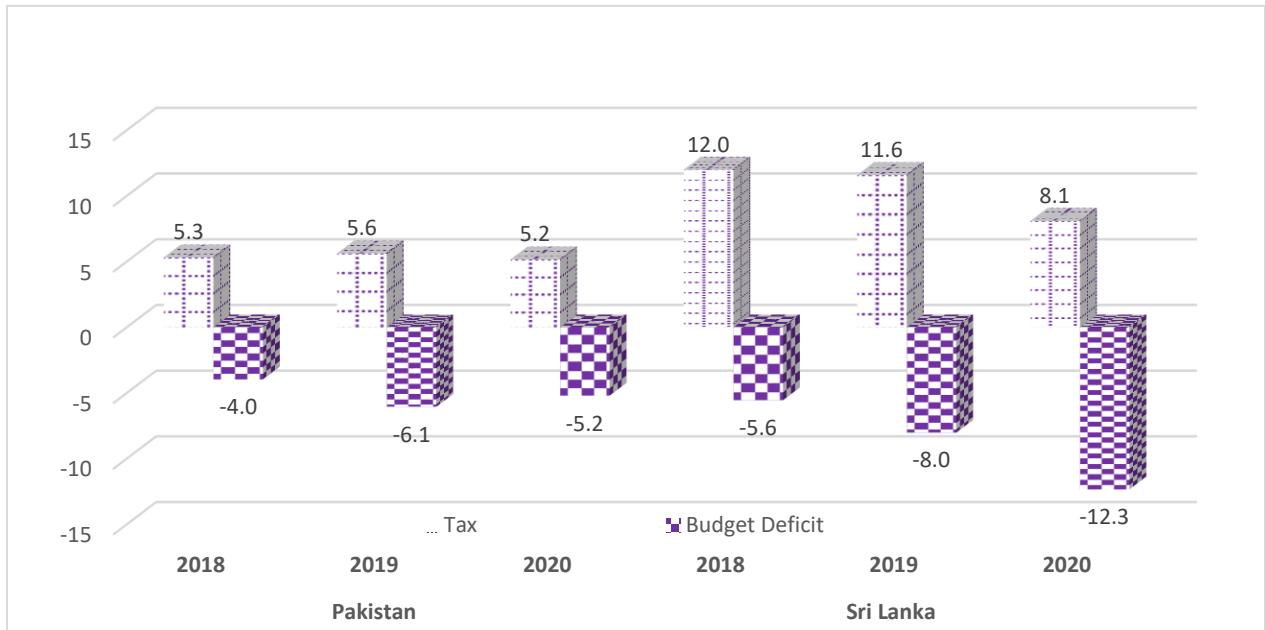
Data Source: Economic Survey of Pakistan 2021-22, Central Bank of Sri Lanka

In contrast, Pakistan tried to contain the impact of the pandemic by launching many livelihood incentives as well as generating economic activities. The most significant initiative was the provision of a stimulus package of Rs.1.2 trillion that includes direct financial assistance of Rs. 200 billion for the vulnerable, electricity bill payments, deferment of rents and installments at all banks level, and lowering the policy rate to 8 percent, etc.

Fiscal Position

The fiscal policy of a country plays a crucial role in macroeconomic stabilization. The recent global challenges such as the pandemic, and the ongoing Ukraine-Russia war added to the domestic challenges. The economies of Pakistan and Sri Lanka are battling with such emerging global and domestic issues which immediately affect the fiscal space available with the Government. However, while comparing the factual fiscal position of both countries, it is obvious that Pakistan's tax collection and the budget deficit (as % of GDP) are far better than those of Sri Lanka (see Figure 2). Moreover, in the case of Sri Lanka, the impact of the tax-cuts policy is evident in 2020 which reduced the tax to GDP ratio from 11.6% in 2019 to 8.1% in 2020 and widened the budget deficit.

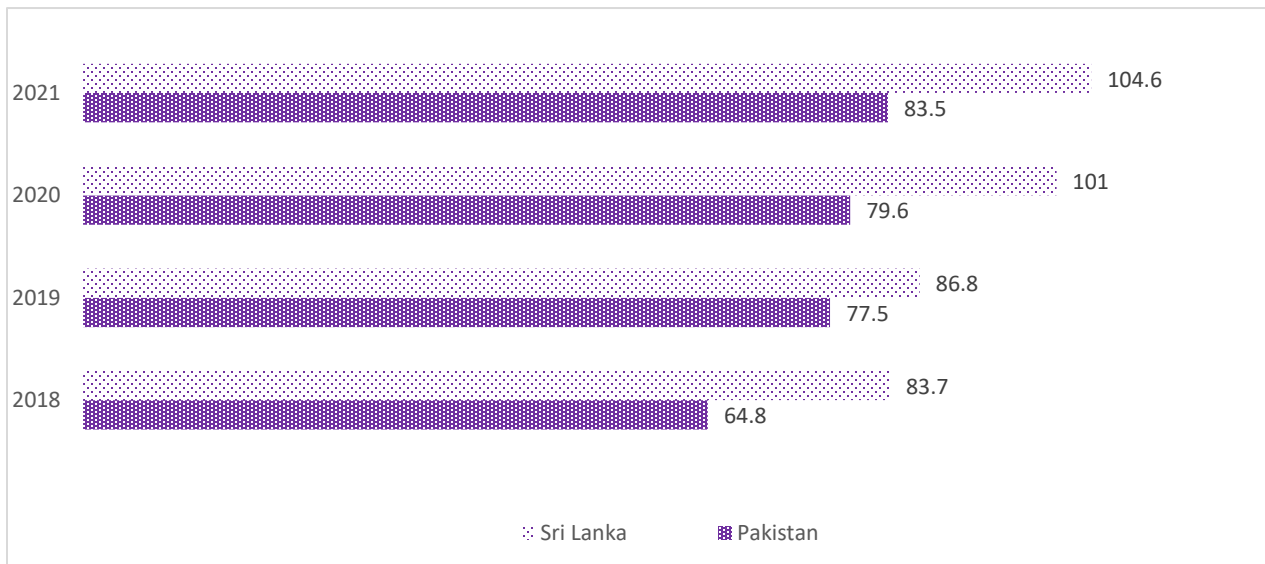
Figure 2: Fiscal Indicators (% of GDP)



Data Source: Economic Survey of Pakistan 2021-22, Central Bank of Sri Lanka

Similarly, the total government debt to GDP of Sri Lanka has witnessed a jump from 86.8% (2019) to 105% (2021) within two years indicating the severity of fiscal challenges that the country faced. Though Pakistan has also kept on borrowing, its macroeconomic imbalances have been in control being a relatively large country with a better-performing real sector.

Figure 3: Sri Lanka – Trend of Total Government Debt (% of GDP)



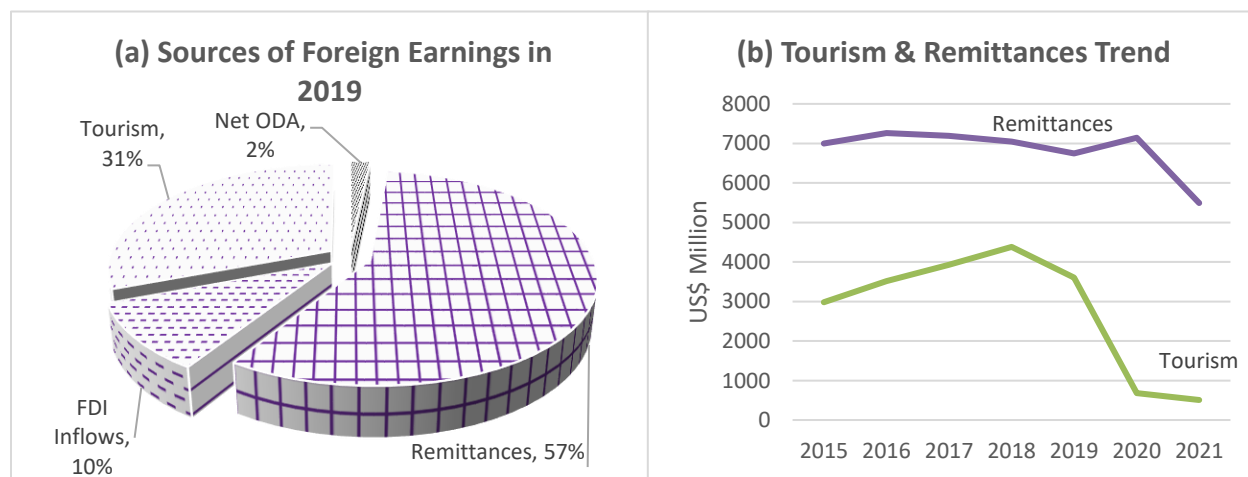
Data Source: Ministry of Finance, Pakistan and Central Bank of Sri Lanka

Sources of Foreign Exchange Earnings

Remittances and tourism are the two largest sources of foreign exchange earning for the Sri Lankan economy after exports. The reliance of the Sri Lankan economy on tourism has made the country vulnerable in the external and real sectors by squeezing the aggregate demand. After excluding exports, the remittances and tourists' income constitute a significant role in providing foreign earnings contributing 57% and 31% to total external inflows in 2019 (see Figure 4a). However, due to terrorist attacks in 2019 and a global pandemic in 2020, foreign exchange earnings from tourism have substantially declined which had a severe impact on Sri Lanka's balance of payments. Likewise, the remittances received through official channels which cover 80% of the annual trade deficit of Sri Lanka have also dropped significantly due to exchange rate pegging with the Middle Eastern exchange houses (see Figure 4b). It is observed that the country experienced an overall 29% decrease in the foreign earnings in 2021 when compared with those of 2019 with an 86% decline in tourism earnings and an 18% decline in the remittances in 2021 (CBS, 2022). Consequently, the shortage of foreign earnings has aggravated the external sector and debt-servicing problems.

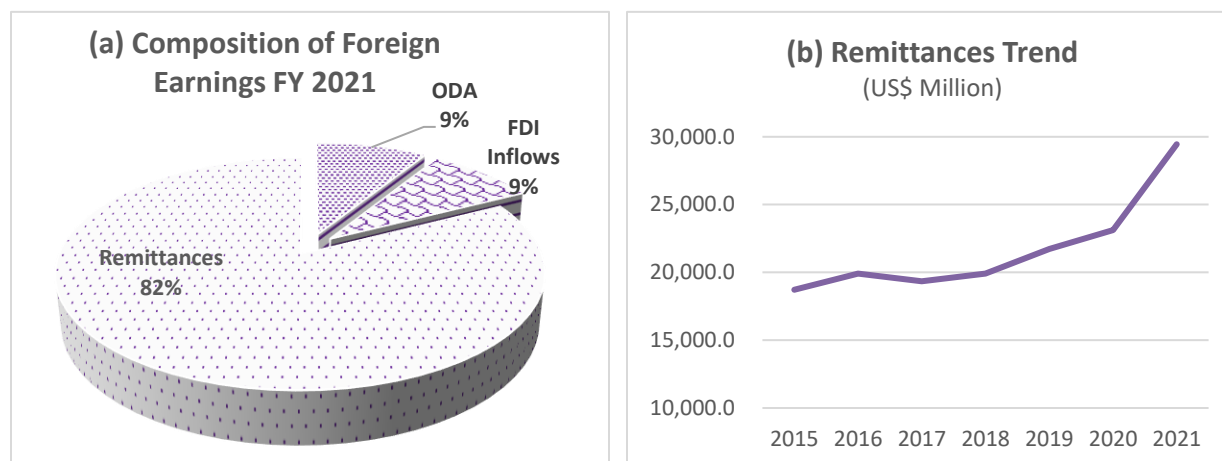
On the other side, by excluding exports, remittances provide 82% of the foreign earnings to Pakistan (see Figure 5a). The country received one of the highest remittances inflows during Covid-19 period defying all predictions (World Bank, 2021). Furthermore, a 26% increase in 2021's foreign earnings was observed as compared to those in 2019 with a 35% increase in remittances and a 10% increase in FDI in 2021 (SBP, 2022).

Figure 4: Sri Lanka – Composition of Foreign Earnings



Data Source: Central Bank of Sri Lanka and WDI, World Bank Statistics

Figure 5: Pakistan – Sources & Trend of Foreign Earnings



Data Source: State Bank of Pakistan

International Trade

At a glance, the international trade profile of Sri Lanka resembles that of Pakistan as the trade deficit of both countries is at worrisome levels. Similarly, the direction of imports of both countries highlights the crucial need and consumption of fuel (see Table 2). Since, there is no alternative to cutting down fuel imports, at least in the short-run, it is prudent for Pakistan to abolish subsidies on fuel to save the country from default. Pakistan recently opted for this policy and ended the fuel subsidy to reduce the fiscal burden.

Table 2: Major Imports and Exports FY 2021

Major Imports (US\$ Billion)		Major Exports (US\$ Billion)	
Pakistan	Sri Lanka	Pakistan	Sri Lanka
<u>Total: US\$ 62.7 B</u>	<u>Total: US\$ 20.63 B</u>	<u>Total: US\$ 31.58 B</u>	<u>Total: 12.5 B</u>
Mineral Fuels: \$16.5B (26% of total imports)	Fuel: \$3.7B (18% of total imports)	Cotton/Textiles: \$14.2B (45%)	Tea: \$1.32B (11%)
Food: \$6.32B (10%)	Food: \$2.27B (11.2%)	Chemicals & Pharmaceuticals.: \$1.09B	Textile & garments: \$5.4B (43%)
Machinery: \$7.8B	Textiles & articles: \$3.06B		Rubber: \$1.05B
Textiles: \$4.8B	Chemicals: \$1.04B		
	Total Non-oil: \$16.89B (81% of total imports)		

Data Source: State Bank of Pakistan & Central Bank of Sri Lanka

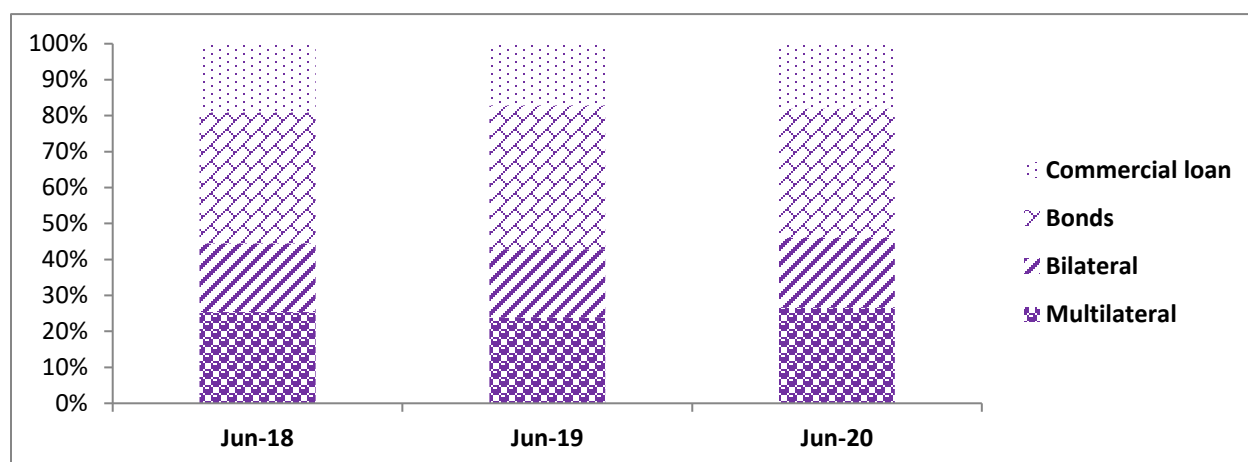
External Public Debt

A careful examination of the composition of external public debt reveals that Sri Lanka has been borrowing money more from expensive sources such as foreign commercial banks and international bonds and less from bilateral and multilateral donors. It is widely admitted that during the time of financial crisis, governments adopt financial rescue programs which widen the deficit gap which is later met through stringent austerity measures to keep the deficits at sustainable levels (Partington, 2022; Karunungan & Pollard, 2022).

The Government of Sri Lanka continued to borrow from external sources for the last two decades without generating sufficient revenues at home. Since the civil war ended in 2009, the country started excessive borrowing through market-based instruments and commercial loans which are expensive forms of borrowings with five to ten years long maturity. Recently, the borrowing through sovereign bonds and commercial banks by Sri Lanka reached approximately 55 percent of the total external debt. The debt servicing also rose making it difficult for the Government to repay its loan (see Figure 6).

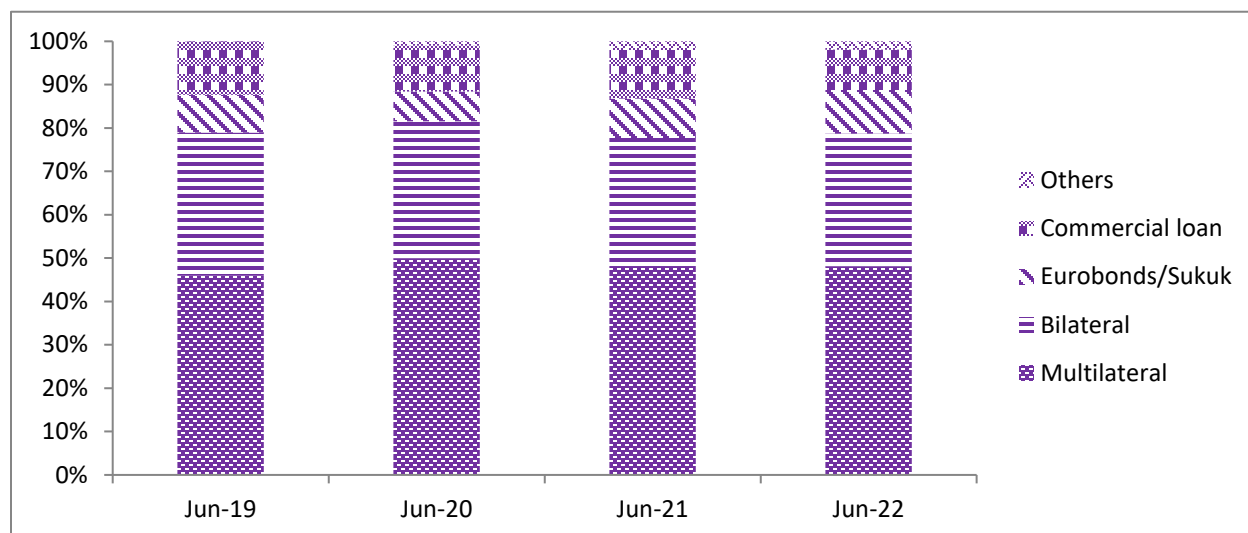
In the case of Pakistan, two-thirds of total external public debt is concessional, obtained from multilateral and bilateral sources, having an average maturity of 25 years. As of FY22, approximately, 10% of total external public debt has been acquired through Eurobonds/Sukuk and 9% through Commercial banks. The average maturity of international bonds is 20 years whereas Commercial banks' instruments' maturity is 1 to 3 years.

Figure 6: Sri Lanka - Composition of External Debt



Data Source: Central Bank of Sri Lanka

Figure 7: Pakistan - Composition of External Debt



Data Source: Economic Survey of Pakistan, 2021-22

IMF Bail-out Packages

IMF was cognizant of the fact that many developing countries would require debt servicing relief or debt restructuring as well as financial support during the pandemic. Sri Lanka should have approached the IMF, before the economic crisis was emerged. However, the extreme nationalism and anti-IMF sentiments restrained the Sri Lankan political leaders from doing so. Consequently, the recent IMF-Sri Lanka talks also ended without finalizing a deal (Buddhavarapu, 2022). On the other hand, Pakistan talks with the IMF to reinstate the stabilization program of 2019. This time Pakistan has taken policy initiatives which reflect the political will to implement the economic reforms agenda.

The Risk of Default

The Central Debt of the Government of Sri Lanka reached 104.6% of GDP in 2021 which stood at 78.5% in 2015. According to the Debt Sustainability Framework (DSF), if the gross external debt shows a significant or sustained breach of a threshold of 50% of GDP and the country is already facing difficulties in servicing its debt, then the country is said to be under debt distress. In the case of Sri Lanka, the total external debt reached 60% of GDP in the third quarter of 2016 which kept on increasing further until 66% of GDP in 2019 but again reached 60% of GDP in 2021 (CBS, 2022). Similarly, the ratio of external debt to exports was 278% of GDP which also breached the threshold level of 240% (as in Table 03). The DSF position of both countries is as under:

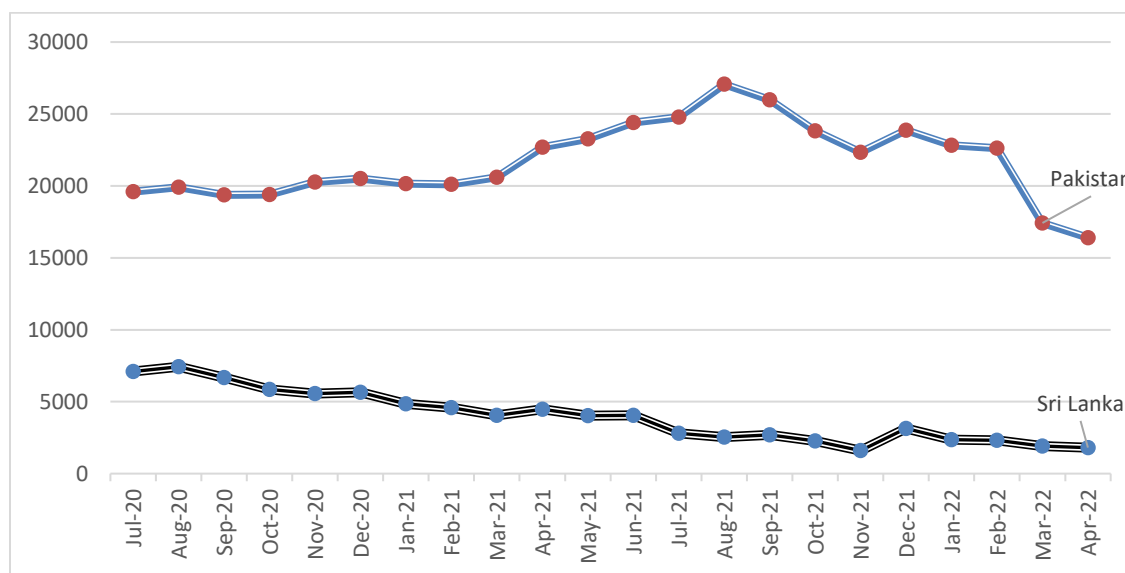
Table 3: DSF position - 2021

Country	Total External Debt Stock (US\$ bn)	Debt-to-GDP ratio (%)	External debt stocks to exports (%)	Debt service to exports (%)	Debt vulnerability (as of IMF)
DSF Threshold		50	240	21	
Pakistan	108,530	83.5 (High Risk)	280 (High Risk)	33 (High Risk)	Strong
Sri Lanka	50,724	104.6 (V. High Risk)	278 (High Risk)	39 (High Risk)	Strong

Source: IMF DSF Framework, Ministry of Finance, Pakistan and Central Bank of Sri Lanka

The DSF statistics in respect of Pakistan are relatively better than that of Sri Lanka. In May 2022, Sri Lanka failed to repay its debt payments due to a shortage of foreign exchange. The foreign exchange reserves declined substantially from USD 7.1 billion in July 2020 to USD 1.8 billion in April 2022. In contrast, Pakistan’s level of foreign exchange reserves initially showed an increasing trend, from USD 20 billion in July 2020 to USD 27.1 billion in August 2021, and then started to decline and reached the level of USD 16.4 billion in April 2022.

Figure 8: Trend of Foreign Exchange Reserves (USD Million)



Data Source: State Bank of Pakistan and Central Bank of Sri Lanka

Pakistan’s risk of default is low mainly due to the following reasons. First, Pakistan is already in the IMF program and has recently reached a Staff level agreement to avail USD 1.18 billion. Second, major multilateral and bilateral development partners have shown commitments to provide USD 8.7 billion during the current financial year. It is also expected that Pakistan will

be able to generate USD 14.1 billion from other sources such as issuance of Bonds/Sukuk, foreign commercial borrowings, Naya Pakistan certificates, etc. Thus, the total expected inflows for the FY 2022-23 are USD 22.8 billion. Third, remittances from the Pakistani diaspora have always provided a sustainable cushion to meet external currency demands and which have shown an increasing trend. Fourth, Pakistan has good economic relations with China, UAE, and Saudi Arabia. History has shown that in crisis situation, these countries have provided significant support. Finally, the Government is cognizant of the default risk and initiated appropriate measures like taxing the wealthy, reducing subsidies, and re-adjusting the fuel, electricity, and gas prices to reduce the burden on the exchequer.

In addition, Japan, Greece, Italy, and Singapore are some of the countries with the highest debt to GDP ratios but they have sustainable economic indicators. In this regard, the IMF describes the usability of debt ratios as *“Debt ratios should be considered in conjunction with key economic and financial variables, in particular expected growth and interest rates, which determine their trend in medium-term scenarios”* (IMF, 2003). Foregoing in view, the macroeconomic indicators in respect of Pakistan’s economy as described above are relatively better than that of Sri Lanka.

Conclusion

In conclusion, it can be stated that Sri Lanka's heavy reliance on the tourism industry and then the tourism sector’s collapse, devastated the foreign earnings of the economy. Political expediency compelled politicians to take unwise economic and policy decisions whose cost is now being paid by the entire nation. To show smooth running of government affairs, they continued to borrow from the market at high-interest rates which ultimately made it default on its debts. In the case of Pakistan, the borrowing from multilateral and bilateral sources (i.e. concessionary loans) keeps its debt servicing relatively lower than that of Sri Lanka. Furthermore, Pakistan’s strategy to handle the pandemic crisis, better level of foreign exchange earnings and reforming the economy under the IMF program will most likely prevent it from going into default. Moreover, Pakistan’s strong economic relations with China, UAE, and Saudi Arabia have always provided a cushion during hard times which is a strength for Pakistan. However, the global as well as regional dynamics have significantly been changed, it is high time to change our thinking and policy making approaches from assistance seeking to self-sustained economy for a better future.

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