

# Is Nepal on the Verge of Economic Crisis? A Comparative Study of Sri Lanka and Nepal

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**Received Date** 4 September 2022

**Accepted Date** 22 September 2022

**Published Date** 27 September 2022

## ABSTRACT

This paper attempts to analyze the economic condition of Sri Lanka and compare it with that of Nepal especially based on external sector indicators. The main objective of this study is to identify the level of risk that economic crisis looming in Nepal by examining and comparing indicators using secondary data collected from various publications of the government of Nepal and Sri Lanka, central banks of both countries, World Bank, IMF and others across six years starting from 2016 to 2021. This Study follows the comparative and descriptive research design and analysis has gone through the same. The data and calculated indicators suggest that Sri Lankan economy had gone through bad phases after year 2019 and that led to acute crisis. The external sector indicators of Nepal show that Nepal was also facing some sort of issues after COVID-19 pandemic followed by Russia-Ukraine war in 2020 and 2021 however, there are encouraging signs of recovery in recent times. The study came with the conclusion that the economic crisis caused by drained of foreign exchange reserve has given a wakeup call to small growing economies and Nepal is not an exception. However, as a result of the precautionary policies and measures that Nepal has taken so far, the external sector's indicators not showing worrying syndrome for severe economic crisis. To avoid the crisis in medium and long term Nepal should take initiatives for policy and structural reforms to enhance its productive capacity to induce export, tourism and other industries.

## KEYWORDS

Economic Crisis, External Sector, Foreign Exchange, Nepal, Sri Lanka

## INTRODUCTION

The development experience of Asian region has thrown up the example of countries using trade and the international capital market as engine of growth and transformation of themselves from 'hopeless basket case' into rapidly growing vibrant economies. In contrast this Rags-to Riches stories of economic success, the region has thrown up the examples of countries, which among other things followed less appropriate trade and foreign exchange policies and could not exploit full potential of their resource endowment, both physical and human (Srinivasa,1994).

The high degree of economic interdependence among today's economies reflects the historical evidence of world's political and economic order. Recognizing that world economic interdependence is complex and its effects uneven, the economic community has taken step towards international cooperation. Conferences devoted to global economic issues have explored avenues through which cooperation could be fostered between industrial and developing nations. The effort of developing nations to reap larger gain from international trade and to participate more fully in international institutions have been hastened by the impact of global recession, industrial inflation, and burden of high-priced energy. Over the past 50 years, the world's market economies have become increasingly interdependent. Exports and imports as a share of national output have risen for most industrial

nations, while foreign investment and international lending have expanded. This closer linkage of economies can be mutually advantageous for trading nations. It permits producers in each nation to take advantage of the specialization and efficiencies of large scale production. A Nation can consume wider variety of products at a cost less than that which could be achieved in absence of trade. On the other side of coin, demand have grown for protection against imports, the protectionist pressure have been strongest during the period of rising unemployment caused by economic recession (Carbaugh, 2018).

Economic interdependence has become a complex issue in recent times, often resulting in strong and uneven impacts among nations and among sectors within a nation. Businesses, labours, investors and consumers all feel the repercussions of changing economic conditions and trade policies in other nations. The globalized economy demands for to cope up with the myriad issues and problems, specially caused by issues like natural disaster, pandemic and regional tensions.

The rising south Asian island nation faced with unique and severe economic crisis after independence. The crisis has been marked byrun-away inflation and acute fuel and energy shortages. Economic growth has been hampered byhigh external debt and debt trap, dwindling foreign currency reserves caused by fall of remittances and tourism sector, currency depreciation, and a series of lockdowns. Aside from the effect of the COVID-19 pandemic, the crisis was caused by mismanaged government finances, agricultural crisis by shifting into organic farming and sick-timed tax reductions. Several bilateral and multilateral partners offered assistance to resolve the issue. The country itself may seek financial aid from the International Monetary Fund (IMF) to properly address the economic crisis arising due to external sector imbalances.

The economic crisis in Sri Lanka is a reminder to other countries to constantly introspect their economic policies at regular intervals. It provides a lesson to every nation regarding the adverse consequences that can arise due to ill-timed and irrational policy decisions (Sharma et al., 2022).

There would be limited international and diaspora funding as even the strong economies have undergone downturn as aftereffects of the pandemic and the flow of remittance too would slow down given the furloughs of Nepali jobholders in global workplaces. It is indicative of a painful slow starter for economic upturn. Stillthere are no indications that political leadership will be able to revert to integrity, responsiveness, and accountability that could promise more productive outcome with limited resource (Sayah & Chhami, 2020).

There is growing speculation that the Nepali economy is on the verge of disintegration like in Sri Lanka with foreign exchange reserve have shrunk and inflation has soared with rising fuel prices. For the first time since the 2000s foreign exchange reserve have dropped to around 9 billion US Dollars which is barely enough to fund goods and services import of six months, down from 11 months. At the same time, inflation hit all time high 8.56% with the disappointingly high rate of unemployment (Shakya, 2022).

There are significant numbers of study is being carried out by several researchers with regards to the economic crisis, its causes and impact in Sri Lanka, however not much work done on the area of its signals and learning lessons to similar economies especially in South Asia. The Key objective of this paper, therefore, is to put together the major elements causing economic crisis specially focusing external sector and identifying the level of risk that economic crisis looming in Nepal examining and comparing indicators with one another.

## METHODOLOGY

This study adopted comparative and descriptive research design to study economic crisis of Sri Lanka and assess the position of Nepal in similar indicators. Several quantitative and qualitative techniques such as correlation coefficient, ratios, tables and figures have been used to analyze data collected from secondary sources such as various reports and other publications of Finance Ministry of Sri Lanka and Nepal, central banks of both countries along with data and reports of World Bank and IMF. In order to fulfill objectives of the study six years data from 2016 to 2021 for all indicators and data up to mid July 2022 for some of the indicators have taken into consideration.

## RESULTS

The Crisis in Sri Lanka arises as a result of depletion of foreign exchange reserve which causes the south Asian Island Nation had been earmarked for sovereign default, as the remaining foreign exchange reserves would not be sufficient to pay the country's foreign debt obligations and finance import of goods and services. As the economy hard hit by Covid-19 Pandemic followed by Russian evasion to Ukraine which worsened the economic condition more. The Similar impact can be seen in Nepali economy; however the condition of Nepal is not as miserable as that of Sri Lanka.

**Table 1: GDP of Nepal and Sri Lanka In billion USD**

Sri Lanka GDP - Historical Data			Nepal GDP - Historical Data	
Year	GDP (Billions \$)	Growth	GDP (Billions \$)	Growth
2021	84.52	3.66%	36.29	4.25%
2020	80.97	-3.62%	33.43	-2.37%
2019	83.9	2.33%	34.19	6.66%
2018	87.96	3.27%	33.11	7.62%
2017	87.43	3.58%	28.97	8.98%
2016	82.4	4.49%	24.52	0.43%

(Source: World Bank)

The results in Table 1 show that Growth of GDP in Sri Lanka is not as promising as that of Nepal. In Last 5 Years GDP (in USD term) of Sri Lanka just grew by mere 2.57% as compared to whopping 48% growth of Nepal. Both countries faced negative growth of GDP in year 2020. Sri Lanka had been experiencing less than 4% growth over the years on the other hand Nepal's GDP growth is more than 5% in most of the years under study.

## Correlation with foreign exchange reserve

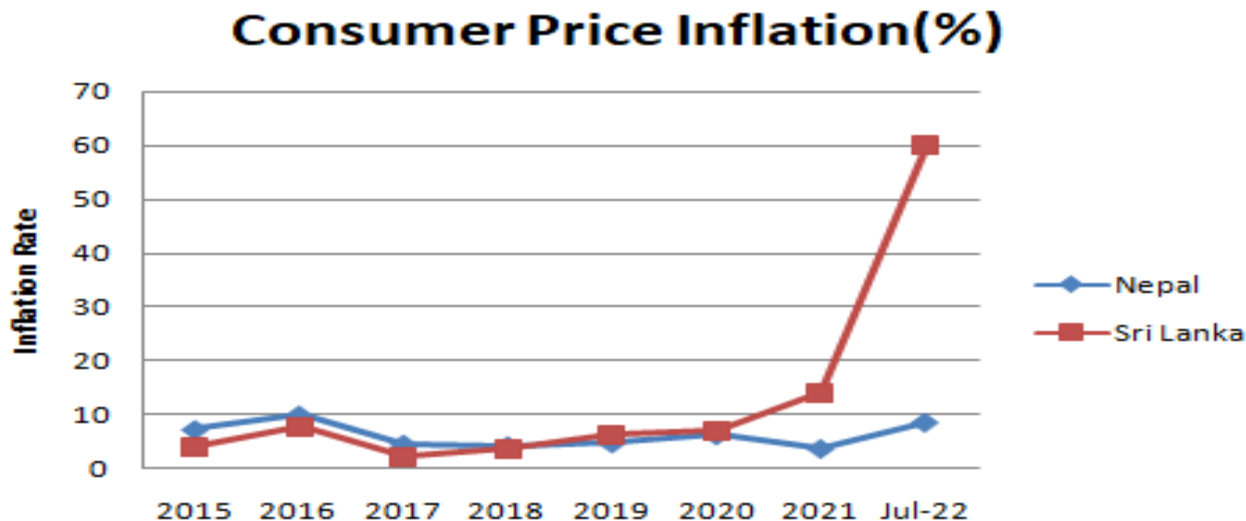
**Table 2: Correlation with foreign exchange reserve**

Indicators	Nepal	Sri Lanka
Inflation	-0.28	-0.82
Import	0.21	0.19
Export	-0.64	-0.16
Correnncy Strength	-0.77	0.58
Remittance	-0.20	0.77
Tourism	0.85	0.83

(Source: Empirical calculations)

Table 2 illustrates the existence of linear relationship of several external sector indicators with foreign exchange reserve, based on the relationship the indicators calculated and analyzed.

## Consumer Price Inflation



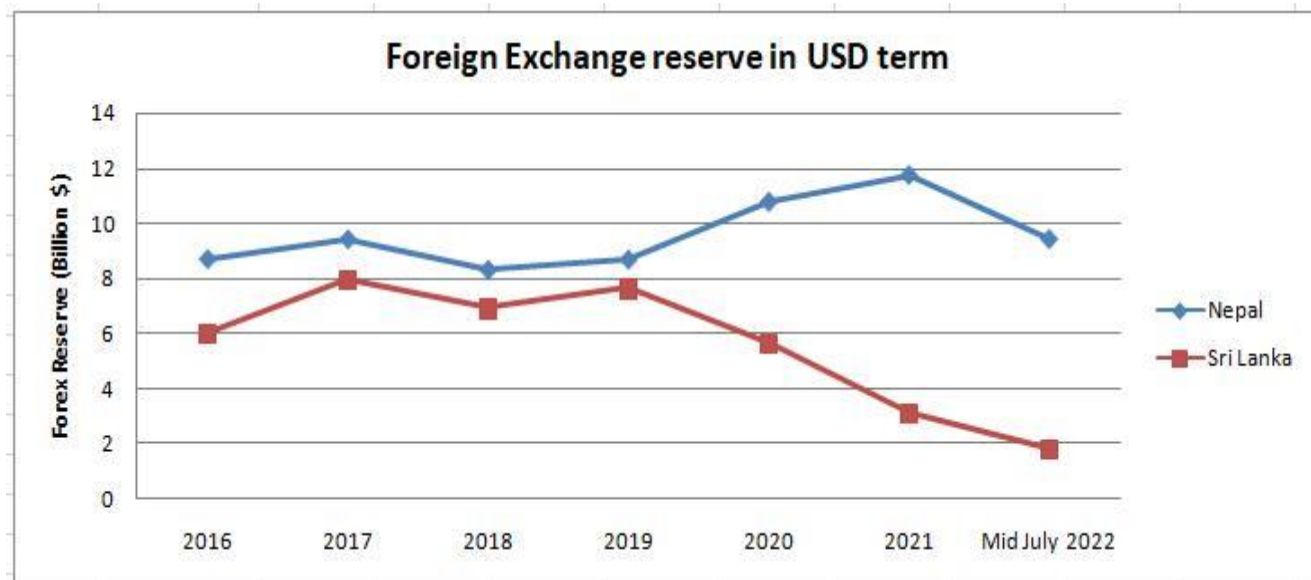
**Figure 1: Consumer Price Inflation**

(Source: Reports of Central Bank of Sri Lanka and Nepal Rastra Bank)

As per Figure 1 the price level is not fluctuating much in both economies from year 2015 through 2020. After 2020 Sri Lankan People are facing very high price rise in basic goods and petroleum products in mid July 2022 it has reached above 60% on Year-On-Year Term. Till 2018 Nepal had experienced higher Inflation, and then The Price Level is below that of Sri Lanka. After Year 2021 Nepali is also experiencing continued rise in price level above government's target up to 8.54% in mid July 2022, which is worrying sing but too low as compared to Sri Lanka.

## Foreign Exchange Reserve (USD Term)

The Developing economies whose budget is generally deficit budget, and raise source from abroad in loans and grants and trade consists much of import, need sustainable level of foreign exchange reserve to payout foreign dues and obligations.



**Figure 2: Foreign Exchange Reserve (USD Term)**  
 (Source: Reports of Central Bank of Sri Lanka and Nepal Rastra Bank)

Figure 2 demonstrates that Nepal had been maintaining more than 8 billion US dollars through to 2019 and increased to USD 10.79 billion and USD 11.75 billion in 2020 and 2021 respectively. However, the reserve started to decline rapidly due to increased import and reached USD 9.45 billion in Mid July 2022. Sri Lanka had been maintaining foreign exchange reserve less than that of Nepal but consistently above 6 billion USD till 2019. Thereafter it goes down 5.66 Billion, 3.1 billion and 1.82 billion in 2020, 2021 and mid July 2022 causing country even failing to meet its foreign debt obligations.

### Foreign Trade (In USD terms)

**Table 3: Foreign Trade (In USD terms)**

Year	Nepal			Sri Lanka		
	Import	Export	Import to Export Ratio	Import	Export	Import to Export Ratio
2016	8.32	2.01	4.14	19.18	10.31	1.86
2017	10.67	2.26	4.72	20.98	11.36	1.85
2018	13.45	2.59	5.19	22.23	11.89	1.87
2019	14.18	2.66	5.33	19.94	11.94	1.67
2020	11.41	2.28	5.00	16.06	10.05	1.60
2021	14.01	1.89	7.41	20.64	12.50	1.65

(Source: Central Bank of Sri Lanka and Nepal Rastra Bank)

The both countries have almost identical tendencies with regards to trade importing high value goods and services and exporting low value especially primary goods and services, which results in huge deficits in trade balances. According to Table 3 in Nepal, there is continued growth in import USD 8.32 billion in 2016 reaching to USD 14.01 billion in 2021, only year which showed falling import is year 2020 with 11.41 billion of Import. On the other hand export of the landlocked South Asian nation is not a huge exporter just below USD 3 billion in its trading bill in export accounts throughout study period 2016 to 2021.

Sri Lanka’s foreign trade also consists import almost double that of exports. In 2016, 2017 and 2018 the country’s import was 19.18, 20.98 and 22.23 billion USD and exports account showed 10.31, 11.36 and 11.89 billion USD. Than the island nation has reduced the import in 2019 and 2020 and rose slightly higher in 2021 as increased prices of petroleum and other goods and serviced globally due to Covid-19 and Russian evasion of Ukraine. The export declined in 2020 and is in rising trend thereafter.

### Relative Currency Strength

A strong Currency induces import and depreciated currency influences country’s exports. A stronger domestic currency can have an adverse effect on exports and on the trade balance. Higher inflation can also impact exports by having a direct impact on input costs such as materials and labor. These higher costs can have a substantial impact on the competitiveness of exports in the international trade environment (Investopedia). However consistent exchange rates are tonic for growing small economies.

**Table 4: Relative Currency Strength**

Currency Strength (In relation to 1 USD)								
Country	2016	2017	2018	2019	2020	2021	Mid July 2022	July
Nepal (NPR)	106.73	102.77	109.34	109.36	120.37	119.4	127.5	
Sri Lanka (SLR)	145.6	152.46	162.54	178.78	185.52	198.88	358.12	

(Source: Central Bank of Sri Lanka and Nepal Rastra Bank)

The Table 4 signifies that Nepali currency NRP 106.73 was equivalent to 1 USD in 2016, appreciated in 2017 and slightly depreciated in next two years and little bit higher in 2020 when 1 USD can be bought by NPR 120.37 which appreciated to NPR 119.4 in 2021 and reached NPR 127.5 equivalent to 1 USD. Sri Lanka had been experiencing continued decline in its currency value in relation to USD. A US Dollar in Sri Lanka could be bought by Sri Lankan Rupee 145.6 in 2016 and 198.88 in 2021 and government depreciated its currency to 358.12 for 1 USD during mid July 2022.

### Tourism

Tourism is the one of the major sources of foreign exchange and both the countries consider tourism to be one of the medium to be prosperous and balancing factor in international payments.

**Table 5: Tourism**

Year	Nepal		Sri Lanka	
	No of Tourist Arrivals in Nepal	Growth Rate of Tourism in Nepal (%)	No of Tourist Arrivals in Sri Lanka	Growth Rate of Tourism in Sri Lanka (%)
2016	753002	40	2050832	14
2017	940218	24.86	2116407	3.20
2018	1173072	24.77	2333796	10.27
2019	1197191	2.06	1913702	-18.00
2020	230085	-80.78	504704	-73.63
2021	150962	-34.39	194495	-61.46
2022	237660	57.43	458670	135.83

(Source: Publications and reports of government of Sri Lanka and Nepal)

Table 5 speaks the volume of truth about the tourism activities in both South Asian nations during the study period. The tourism industry is growing constantly till 2018, in both countries. In 2019, 2020 and 2021 Tourist arrival deep down by 18%, 73.63% and 61.46% in corresponding years respectively in Sri Lanka after Easter bombings followed by worldwide COVID-19 Pandemic. However, tourism in beautiful island country showing sign of recovery as numbers of foreign tourists’ arrival reached to 458670 till mid July 2022. On the other side the Himalayan nation Nepal had been facing recession in its tourism industry in 2020 and 2021 when only 230058 and 150962 tourists got Nepali hospitality as a result of lockdowns, travel restrictions and advisories issued by almost all countries. However, signal of gradual growth can be witnessed as per report of Ministry of Culture, Civil Aviation and Tourism of Nepal.

**Remittance**

Workers’ remittances have been a key pillar of Sri Lanka’s foreign currency earnings providing a substantial cushion against the widening trade deficit and thereby enhancing the external sector resilience of the country. Being a major source of foreign exchange earnings, workers’ remittances have covered around 80 per cent of the annual trade deficit, on average, over the past two decades. Workers’ remittances are non-debt creating foreign exchange inflows to the country and unlike many merchandise export categories, there is no import content involved in this source of foreign exchange earnings (Central Bank of Sri Lanka). The case is more or less same with Nepal.

**Table 6: Remittance Inflow in USD term**

Year	Remittance Inflow of Nepal (Billion USD)	Remittance Inflow of Sri Lanka (USD Billions)
2016	6.61	7.24
2017	6.93	7.16
2018	8.29	7.02
2019	8.25	6.72
2020	7.39	7.10
2021	7.51	5.49
July 2022	4.2	1.89

(Source: Publications and reports of central banks and governments of Sri Lanka and Nepal)

Table 6 is the evident that Sri Lanka had been witnessing decline in remittance inflow in 2017, 2018 and 2019 then slight increase in 2020 declined by huge margin in 2021 and no promising scenario as only 1.89 billion USD till mid-July of 2022. In the context of Nepal remittance inflow had been increasing apart from the year 2020. Increasing remittance inflow was seen in 2021 as foreign workers sent remittance amounting USD 7.51 billion which was 7.39 a year before.

**DISCUSSION**

Sri Lanka has been facing an acute economic disruption due to depletion in foreign exchange reserves which in turn has resulted in failure to meet foreign debt obligations and payment of imports of essential items like fuel, food, medicines among others. Sri Lankan government has done very little to overcome the issues and is hopeful that with the policy measures initiated so far and with the improvement in the COVID-19 situation, it would help in overcoming the crisis soon. The situation on the ground as well as the analyses of government’s policy measures, global geopolitical-economic developments including the fallout of Russia–Ukraine war, nonetheless suggest that Sri Lankans are not going to feel the economic relief any time sooner. Opposition and public criticism against government’s handling of the crisis is intensifying in Sri Lanka. (Sultana & Gulbin, 2022). The condition of other South Asian nations is more or less similar. Nepal, Bangladesh, Bhutan are also warned of similar crisis unless they take issues seriously on time. The economic crisis in Sri Lanka is a reminder to other countries to constantly introspect their economic policies at regular intervals. It provides a lesson to every nation regarding the adverse

consequences that can arise due to ill-timed and irrational policy decisions (Sharma et. al 2022). Amid Growing speculations that the Nepali economy will be disintegrated like in Sri Lanka as country's Foreign exchange have shrunk inflation has soared with rising fuel and other imports prices, an economic crisis is inevitable if Nepal ignores its early symptoms (Shakya, 2022). However, Rijal (2022) concludes that Nepal and Sri Lanka are geographically different with unique socio, political and economic characteristics, it is critical to understand any kind of economic crisis would have similar and more devastation impact. The recent political and economic crisis in Sri Lanka has prompted to compare Nepal's economic environment to Sri Lanka, but Nature and extent of problems in respective economies are distinct (Sharma, 2022). Bansal (2022) finds no reason to fall Nepali economy as country have foreign exchange available with forecasts of increasing remittances and exports, India's relation, timely address by government and no dynasty politics like Sri Lanka. This study focused several indicators of external sector of an economy and attempted to analyze the situation with respect to Sri Lanka. Looking after those indicators and comparing against own past and with Sri Lanka there is not much to worry and no symptoms currently suggesting the arousal of economic crisis in Nepal. The GDP is growing, inflation is not beyond the policy control, and foreign exchange reserve has shrunk as a result of devastating rise in price of petroleum in global market which is highest import for the country which led rise in prices. The reserve is still adequate to fulfill imports of goods and services of more than six months (NRB). There is not much can be done to improve the export in nearest future but imports can be reduced once the price of petroleum diminishes in international market and as a result of government measures to control imports of non-essential goods and services. Shakya suggested Nepal to discourage development projects, particularly those that accumulate debts in foreign exchange with a very long gestation period (Shakya, 2022). However government must focus on development projects like dry ports or mega airports and fast tracks or railway tracks in order to enhance countries capacity to improve overall production so that sustainable growth and stability can be achieved in long term. Political interests at the cost of economic rationality should be rejected by any means in this regard otherwise; Nepal will inevitably face an economic crash like in Sri Lanka.

As this study have adopted the comparative study of two economies there would have several indicators taken to conclude better, however study is limited to external sectors indicators. Simple comparative quantitative tools, few ratios, tables and figures were used to present result of study.

## CONCLUSIONS

The crisis is the result of foreign currency reserve depletion due to compounding factors like tax cuts, fall of foreign remittances, tourism, increasing external debt and foreign trade deficit due to the effect of Easter bombings of 2019, COVID-19 pandemic and Russo-Ukrainian War. This deep rooted economic crisis provided warnings signs to other countries with similar economic characteristics.

Though there are several political economic differences between Sri Lanka and Nepal, these economies are identical in most respects. The Threat of economic crisis in Nepal is not looming currently as Nepal is in comfortable position in external sector's stable growth apart from 2019 and 2020 when economies around the world were hit hard by COVID-19. After COVID-19 Pandemic world economy fearing to go to recession and Nepal is not the exception, when world has started to see rays of hope of recovery from pandemic Russia Ukraine war presented some obstacles more on the road of recovery.

In the context of Nepal the Crisis in Sri Lanka has created a warning bell, and government has reacted well through its policies and practices for short term. For sustainable solution government should make structural and policy reforms to induce export; rather than controlling imports Nepal need to enhance productive capacity for substituting it instead. To maintain adequate foreign reserve to evade crisis like sovereign debt default in mid and long term policy makers and executors must turn their attention towards promoting tourism sector and receiving earning of migrant workers through formal (banking) channels.

## ACKNOWLEDGEMENTS

“Not Applicable”



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