



**FRIEDRICH NAUMANN  
FOUNDATION** For Freedom.

Pakistan

# ENERGY TRANSITION & FOOD SECURITY

Case Study: Impact of Ukraine War on  
Pakistan and Sri Lanka

Dr. Gareth Price, Aniqah Arshad, Mujtaba Khan and Navam Niles



ANALYSIS

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# 1. Foreword

Energy supplies and energy shortage have become a global issue since the Ukraine Russia war. However, for South Asia, energy supplies have been an issue even before the war. In December 2022 we invited Mr. Mujtaba Khan, CEO Reon Energy Pakistan, and Mr. Navam Niles, Research Consultant, Centre of Poverty Analysis, Sri Lanka, for an online web talk titled "*Impact of the Ukraine-Russia War on Energy Transition and Food Security in Debt Ridden South Asian Nations*". With moderator Dr. Gareth Price, panellists and participants discussed relevant issues ranging from the impact of global markets on the region to the severe national energy and political crises in 2022 in both Pakistan and Sri Lanka and their inter-linkages.

The situation and subsequent discussion here in South Asia, particularly in Pakistan, and Sri Lanka, is much different from the discussions happening in the industrial countries. In Europe due to Ukraine war, the discussion about energy supplies is currently very intense, however, experts and consumers discuss it more from a short or medium term perspective. In the winter of 2022, people were very careful about their consumption patterns and tried to reduce energy consumption at a domestic level. It was considered a short term disruption amid a price hike.

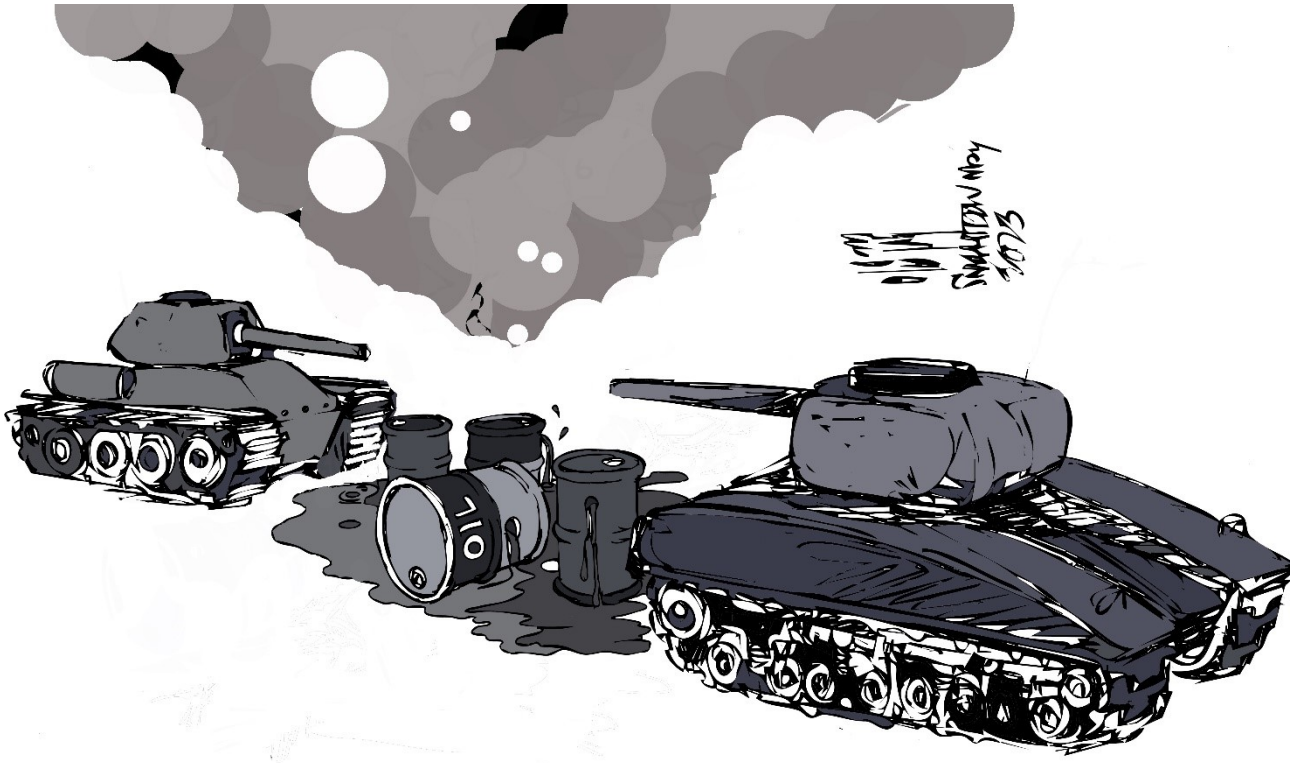
However, here in South Asia, the external energy crisis caused by the war in Ukraine exacerbates a general structural crisis, which has been in the making for years already. A lot of these structural issues are due to the demographic development. South Asia is demographically one of the fastest growing regions in the world. This rapid demographic shift results in an increasing energy demand. Simultaneously, the economic development to cater to this population growth requires more energy. Adding complexity to this issue, the energy grid in the region is either not well diversified or is mired with maintenance issues.

In South Asia, more than 60% of energy is actually bought on the international markets. Consequently, if you have an international disruption such as the Ukraine war, things get more complicated for South Asian countries, as compared to countries that have a more diversified energy supply chain, or countries that have robust home-grown energy supplies.

The Ukraine Russia war actually gave FNF the opportunity to reach a broader audience and highlight the structural issues that South Asia has to deal with in order to make their energy sectors fit for the future.

Birgit Lamm  
Head of Country Office  
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## 2. Russia-Ukraine conflict and its impact on South Asia by Dr. Gareth Price



Russia's conflict with Ukraine, and the consequent spike in the cost of fuel and food, served to demonstrate the vulnerabilities of countries in South Asia to exogenous shocks, and could serve to highlight steps needed to mitigate the future risks of climate change induced shocks.

For countries like Sri Lanka, the invasion proved a tipping point coming on top of a host of factors. First, **exposure to foreign debt** – the country had borrowed heavily following the end of the civil war – and this had driven economic growth. However, the COVID19 pandemic harmed tourist revenue along with remittances and foreign exchange reserves started to plummet. And this on top of **economic mismanagement** - a ban on fertilizer in an effort to conserve foreign exchange reserves and/or to move to organic farming led to a collapse in agricultural output making the country more in need of food imports. As the cost of imported fuel and food rose, Sri Lanka's foreign exchange reserves eventually ran out, leading to default (on its external debts) and inability to pay for imported fuel and food.

Sri Lanka's external debt was the key factor in its economic demise. Over the past decade, low interest rates in the

Global North had encouraged lending to riskier frontier markets. As interest rates started rising in the Global North, this capital started returning to the Global North, adding to pressure on foreign exchange in the south, particularly in countries like Sri Lanka that had borrowed heavily externally. In addition, Chinese lending for projects including a conference centre, revolving restaurant and an empty port and airport added to the country's debts, but not to its GDP.

### SRI LANKA'S RELIANCE ON IMPORTED POWER IS SHARED ACROSS SOUTH ASIA, AND COMMON IN MUCH OF THE GLOBAL SOUTH

Sri Lanka's reliance on imported power is shared across

South Asia, and common in much of the Global South. When prices rise, fuel exporters demonstrated a tendency to prioritize richer countries, better able to pay higher prices, than those in the South. Diversification of energy sources (and in particular renewable energy) would make countries more insulated from global price spikes, but energy systems in South Asia are trapped in a situation whereby the inability to provide power 24/7 makes consumers reluctant to pay for a service they do not necessarily receive, reducing the scope for investment. Furthermore, countries like Sri Lanka and Pakistan do not produce solar panels or wind turbines. When foreign exchange reserves come under pressure, imports – including of renewable energy sources – are blocked.

Pakistan's trajectory was not dissimilar – **remittance inflows declined during the pandemic** owing to shut-downs overseas and foreign exchange payments for external borrowing, though not as severe as in Sri Lanka, led to a potential foreign exchange crisis. Like Sri Lanka, Pakistan relies on imports for fuel, and rising costs triggered by Russia's conflict with Ukraine, exacerbated the problem. Finally, like the Rajapaksa family in Sri Lanka, Imran Khan's tenure as prime minister can be characterized as "populist": the immediate response of Imran Khan's government to the rise in fuel prices was to introduce **a subsidy on fuel**, which was clearly unaffordable. While the desire to protect consumers from the impact of price hikes is laudable, doing so for products priced in dollars when foreign exchange reserves are under threat is economically unviable (though left his successors to take the politically unpopular decision to roll back the subsidies).

## IN PAKISTAN'S CASE THE SITUATION WAS WORSENERD BY TWO, RELATED, EXTREME WEATHER EVENTS OWING TO CLIMATE CHANGE: AN UNSEASONABLE HEATWAVE AND MASSIVE FLOODING

But in Pakistan's case the situation was worsened by two, related, extreme weather events owing to climate change. First **an unseasonable heatwave** brought scorching

temperatures months before they were expected, harming numerous crops such as wheat. Second, the heatwave contributed to **massive flooding** which followed when the monsoon came. Unlike Sri Lanka, Pakistan managed to avoid defaulting in 2022, securing an International Monetary Fund (IMF) bailout package. But the economic challenges that led it to that position, not for the first time, remain unresolved. Both Sri Lanka and Pakistan face persistent current account and fiscal deficits, and in the long-term that is unsustainable in the absence of sustained domestic economic growth.

As countries globally are finding, the ability to secure energy self-sufficiency, both through diversification of sources and of reducing demand for energy (*loft insulation*<sup>1</sup>, for instance, in the colder north) is harder during an energy crisis when resources are scarcer. For countries in South Asia, the combination of economic development, urbanization and demographic trends all create rising demand for power. But energy provision is badly placed to deliver this.

One of the challenges faced by Pakistan and Sri Lanka is the under-pricing of resources such as power and water. If electricity were costed on the basis of global prices and took into account externalities such as pollution, the higher price would encourage its use in more productive sectors – that is, industry – rather than it being over-used in the less productive agriculture sector. But because large-scale industries have struggled to emerge in South Asia, with the exception of Bangladesh, understandable political expediency leads to continued subsidization of often small-scale farms. Price reform would result in better allocation and utilization of resources.

However, various factors combine to imply that Pakistan and Sri Lanka may struggle to emulate the Asian Tigers in their shift from agriculture to industry. Trends such as on-shoring were already underway before Russia's conflict with Ukraine exposed other vulnerabilities threatening countries in the Global South. The conflict in Ukraine could well trigger long term structural changes that will be negative for countries in South Asia, and the broader Global South. Economic development in the Global South is frequently dependent on engagement with global supply chains. Consequently, trends towards protectionism, "de-globalization", regionalism or reshoring each have negative implications and Russia's actions appear to have expedited moves in this direction. In addition, subsidies for domestic producers in the USA and the EU's carbon border tax each affect the ability of the Global South to participate in global trade. And along with apparent shifts to regionalism as well as the desire to shorten supply chains in the north, trends such as automation also threaten the ability of countries such as Pakistan and Sri Lanka to industrialize through approaches previously successful elsewhere.

<sup>1</sup> Loft/Attic insulation (roof insulation) is a thermally insulated, protective interior cladding procedure involving the use of various insulation materials. <https://www.thermal-engineering.org/what-is-attic->

[insulation-roof-insulation-definition/](https://www.thermal-engineering.org/what-is-attic-)

These on-going global shifts offer an existential threat to the plans of countries like Pakistan and Sri Lanka, even if their existing policies have served to perpetuate an over-dependence on agriculture at the expense of industry. As noted, within South Asia, only Bangladesh seems to have successfully replicated the industrialization strategies of East Asia's "tigers", and that too remains at the first stage, textiles.

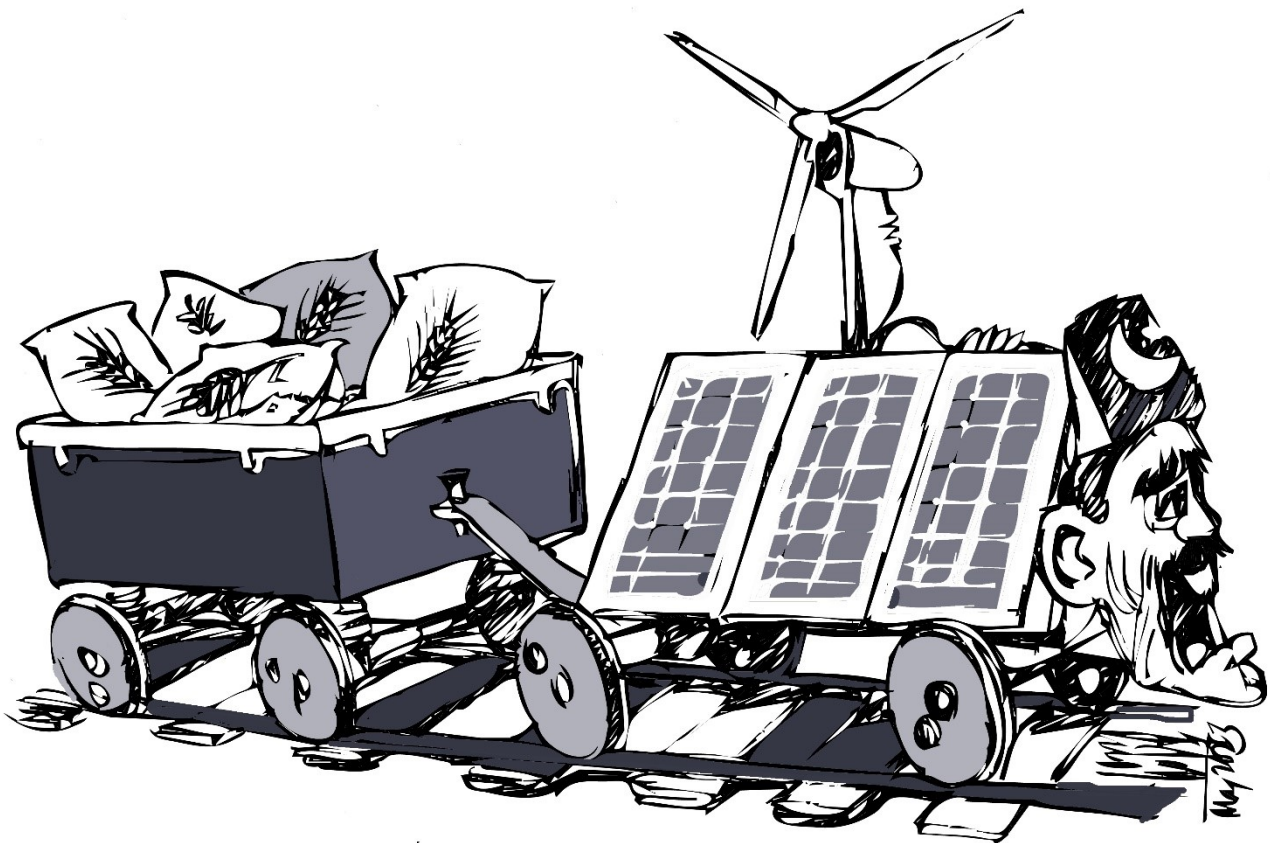
**IN SRI LANKA'S CASE, HAD THE MONEY BORROWED BEEN USED TO CONSTRUCT SOLAR OR WIND FARMS, THE IMPACT OF THE PRICE RISES WOULD HAVE BEEN LESS**

At the same time, increased division between the Global North and China/Russia bodes poorly for countries like Sri Lanka and Pakistan who would prefer not to have to choose between rival blocs and which are vulnerable to various side-effects of conflict such as sanctions.

Politicians in South Asia and elsewhere often argue that they are increasingly vulnerable to the impacts of climate change, and that they are scarcely responsible for it. Both arguments are undoubtedly true. But this vulnerability should not be an excuse for inaction. In Sri Lanka's case, for instance, had the money borrowed to construct various vanity projects instead been used to construct solar or wind farms, the impact of the price rises would have been less. Of course, the combination of a pandemic, a war and, for Pakistan, climate change, would always be difficult to navigate, but for Sri Lanka, and to some extent Pakistan, the combination of events served to expose previously expedient policy choices.

Difficult policy choices lie ahead, but **if one lesson can be drawn from Sri Lanka's experience it is that taking the easiest, self-serving or most popular decisions may not always be the right path.** Politicians, and their publics, should better value paths that build resilience rather than those that demonstrate most short-term gain.

### 3. Economic mismanagement and energy crisis by Aniqa Arshad



The government of Pakistan in February 2023 passed the Finance (supplementary) Bill 2023, conveniently tagging it 'IMF-Dictated'.

The government has termed the recent negotiations with the IMF as a clear win. For they convinced the Fund to bring down tax revenue from PKR 850 billion to PKR 170 billion during negotiations. The February 2023 minibudget introduced taxes on some new items while increasing the rates of several other taxes.

Minister Ishaq Dar deflected the responsibility of Pakistan's current economic misery onto the previous government, as is popular tradition among ruling parties. Mr. Dar in his speech informed the parliament that soon PM Shahbaz will also be announcing austerity measures which the government will be adopting soon as well. In his concluding speech before the final vote on this supplementary bill he further added that Pakistan's power sector is bleeding and it should be a primary reason of concern to those in power. He further identified that Pakistan currently incurred production costs of over PKR 3,000 billion and a mere collection of PKR 1,550 billion;

indicating an unrecovered amount of PKR 1,450 billion against line losses, theft and non-payment. However, despite holding the mismanagement of the power sector responsible, there was no indication of reforms for the power sector being introduced in this minibudget, or in the near future, by Mr. Dar.

In FY 2022, Pakistan imported USD 18.7 billion worth of products under the petroleum group, according to the State Bank of Pakistan. This amounts to around 26% percent of its total import bill. While the country has seen several attempts to curtail imports to alleviate the depleting foreign exchange reserves and worsening balance of payments crisis, petroleum imports remain a huge burden on Pakistan's ever deteriorating economy. Not much has been done to curb this expenditure unfortunately.

Pakistan, like any other developing country has seen an increase in energy demand due to growing population, and enhanced economic activity. Energy shortages impact the production and output of industries severely while tariff hikes hit impoverished segments of society the most

brutally.

Moreover, in 2022 Pakistan's Circular Debt<sup>2</sup> crossed PKR 2.5 trillion and continues ballooning. Over the past decade this situation has worsened and none of the governments in power have come up with an effective strategy to resolve the issue at hand. At max, superficial methods are adopted to park liabilities from circular debt elsewhere to display that the government is managing the problem at hand. But in reality, few impactful measures are being taken. **The root causes of the circular debt can be classified under inefficiencies, blanket subsidies, unregulated tariff adjustments and mismanagement.** These problems may be resolved by a few measures, which will initially be difficult to transition to. But in the long run will prove to be beneficial for Pakistan as well as for its energy consumers.

## **IN FY 2022, PAKISTAN IMPORTED USD 18.7 BILLION WORTH OF PRODUCTS UNDER THE PETROLEUM GROUP ~26% PERCENT OF TOTAL IMPORT BILL**

An issue the government seems to be unwilling to address is the privatisation of loss-bearing State Owned

Enterprises (SOEs). Under such circumstances Public Private Partnerships (PPP) can prove to be a beneficial means to generate funds for power projects. Based on the needs, size and existing structures of an area PPP programs may be designed, since there isn't a 'one size fits all' formula. These can prove to be extremely beneficial not just to access private capital, but also for technological upgradation. PPPs in a country like Pakistan may prove to be a useful tool to overcome the burgeoning infrastructure gap in its power sector in the short term. Over time such interventions can also help galvanise power sector reform and improve regulation and legislation. This in turn can help improve stability of the economy and aid in sustaining growth and maintaining social safety.

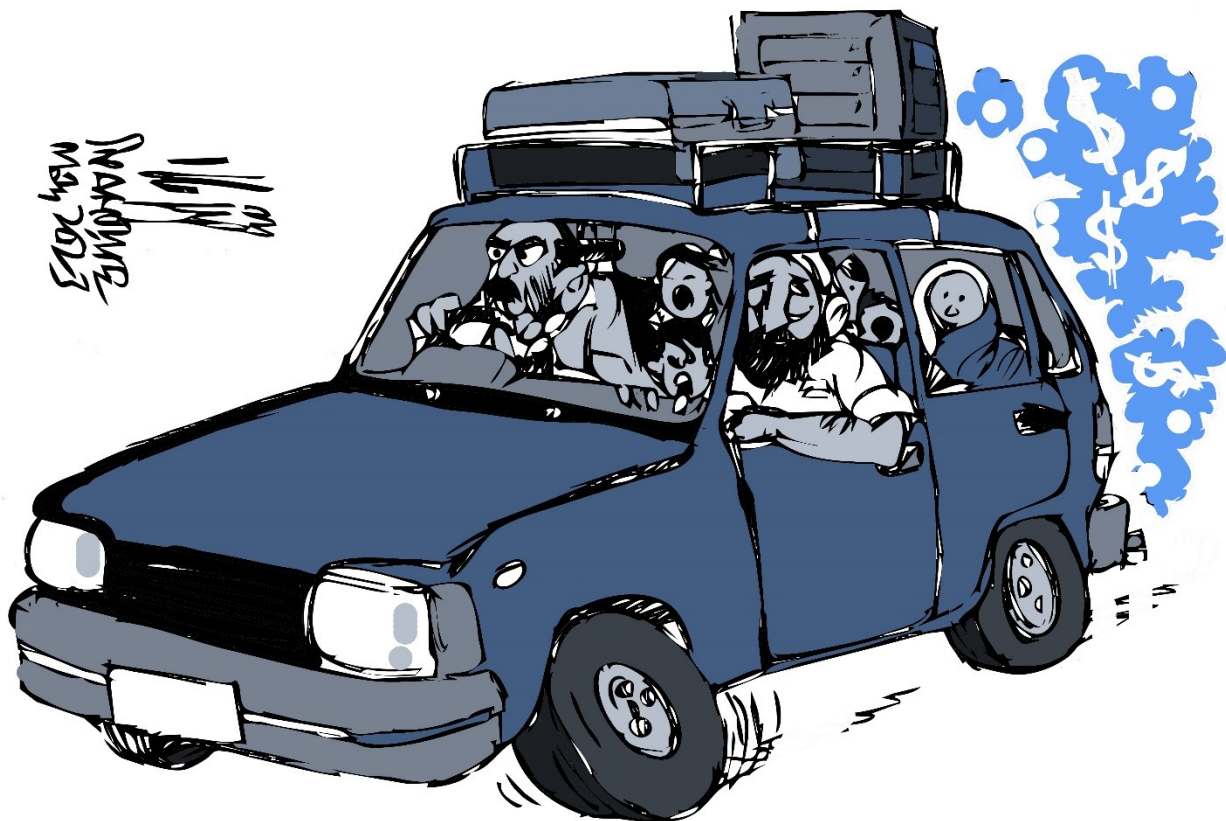
**It is pertinent that Pakistan assesses the need for sustainable and green energy sources for electricity production through PPPs. There is a lot of potential for solar, tidal and wind energy;** in addition to hydro (which is still comparatively better utilised than the others). Even though FY22 witnessed a record rise in solar panel installations in the country, yet the capital costs deter those most exposed to risks from availing such facilities. While there generally is discourse available on how the country needs to transition to these power sources, there is little to no debate regarding their accessibility, affordability and availability for the financially vulnerable segments of society.

Additionally Pakistan also falls in the top 10 countries that are most vulnerable to climate change. And as long as Pakistan remains a fuel import dependent economy, chances are that its economic and environmental conditions will keep deteriorating.

<sup>2</sup> For definition of Circular Debt refer to the document



## 4. Case Study: Pakistan by Mujtaba Khan



### Challenges Faced considering the Ukraine Conflict (Economic, Governance, Energy, Food)

There are two facets to consider – one is the energy issue, the crisis that has resulted from this conflict. On top of that, there is geopolitics. Not being part of a large economic union exposes these countries to further shocks from geopolitics that emanate. For Pakistan, the crisis did not start with Ukraine. It is critical to take into account where Pakistan was before the Ukraine war initiated.

**Energy is at the heart of the economic issue that Pakistan faces.** Historically, Pakistan has been an energy deficient country. Despite having vast reserves of indigenous energy resources, Pakistan has not been able to harness them. In the 1960's and 1970's some of the largest hydropower projects were developed in the North of Pakistan, which gave the country some energy sustainability until 1990's. Vast reserves of natural gas were also discovered in the province of Baluchistan. However, these reserves started depleting and no new exploration activity took place. This resulted in Pakistan

facing a greater energy deficit in the 90's. As a result, Pakistan started relying heavily on imported fuel to overcome the energy deficit.

2010 onwards, owing to the direction of certain policies, Pakistan's energy demand has been addressed by a combination of LNG, imported coal and furnace oil. By the time the crisis hit Pakistan, the energy system was already crumbling, and Pakistan was facing constraints of circular debt – losses across the whole value chain - and the energy deficit amounted to approximately PKR 2.1 trillion. Added to this, **Pakistan was reliant on USD 16 billion of fuel imports annually.**

Moving from energy to economics, **Pakistan has not been able to grow its exports significantly.** Over the last 30 – 40 years, the country has experienced short bursts of growth that have not been sustained. Total exports of the country are around USD 30 billion (2018-2019). And the current account deficit already at \$16 billion due to fuel imports. This results in an economic collapse and every 4- 5 years, Pakistan has to reach out to the IMF and the multilaterals to bridge the fiscal financing gap since all imports are in dollars. Since the remittances and exports were not filling the economic deficit, Pakistan was already facing a

shortage of dollars and import restrictions were being initiated when the crisis hit in February 2022.

As a result of the crisis, fuel prices started going up globally, and the dollar percentage of overall fuel imports increased. In an environment already constrained for dollars, there were less dollars available to import everything else, and the economy had to go into a slowdown. Industry needs raw materials, and unfortunately, Pakistan does not have adequate indigenous resources such as gas. Global suppliers started defaulting on the obligation to supply to Pakistan simply because they could set a higher price in Europe, as Europe's demand for gas rose sharply. With Pakistan not being able to fulfil its gas requirements, there was heavy load shedding of gas. 50% of industrial energy demand locally is addressed using gas through captive power systems, which means that industry will either shut down or use more expensive furnace oil to cover the energy demand.

Ultimately, this results in incurring a higher cost. As **Pakistan is importing all its fuel in dollars, the US Dollar appreciated while the Rupee depreciated with almost a 26% appreciation for the US Dollar** over the last 8 months (stated in November 2022), the highest it has ever been historically. Ultimately, this leads to less money left for importing anything else.

## GLOBAL SUPPLIERS STARTED DEFAULTING ON THE OBLIGATION TO SUPPLY TO PAKISTAN SIMPLY BECAUSE THEY COULD SET A HIGHER PRICE IN EUROPE, AS EUROPE'S DEMAND FOR GAS ROSE SHARPLY

In June 2022, the **worst impact of climate change was experienced by Pakistan in the form of floods**. Not having done much in terms of mitigation, adaptation or disaster management, **Pakistan lost essential crops like wheat, maize and corn that were ready for harvest** to the worst floods ever in the history of the country. In addition to the energy crisis, a food crisis also kicked in. Despite having a large cultivable area, Pakistan has recently become an importer of food items. Roughly 50-60% of Pakistan's import bill was channeled towards energy and food, which resulted in reduction of dollar availability for everything else in the economy. As a result, the country is now at a standstill – the current account deficit has been curtailed primarily by means of demand contraction where all non-

essential imports such as renewable energy equipment, power equipment, industrial parts and equipment, raw material are being squeezed. This may result in a further downward spiral and ultimately lead to Pakistan running out of foreign exchange.

The overall cycle described above was already in motion and Pakistan would not have been able to survive without assistance from multilaterals at a later point, however this was exacerbated by the Ukraine war.

## Possible Steps to Make Pakistan More Resilient to these Challenges

There is no shortage of demand for renewable energy in Pakistan and significant growth can be observed in various scenarios. However, Pakistan doesn't produce technology and equipment like solar PV panels, batteries and wind turbines for example. Because this equipment is imported, they are the first to get curtailed in a financial crisis. Even though there is a huge demand, supply is constrained at this point.

Political uncertainty in the parliamentary system is an overarching problem. If there were a group of policy makers that could draft a set of long-term policies, the current scenario may have been slightly different. Given that even the best managed economies have struggled in this crisis, the policy makers can't really be blamed for not being able to procure gas or maintain stability in the energy prices.

However, there are some policy recommendations that can be made for long term impact:

1. **Curtailing demand for energy** - starting by identifying and analysing, where the demand for energy is arising from. The biggest challenge Pakistan faces is the rising population. The world has a bigger problem of declining population, but Pakistan is one of the fastest growing populations in the world. If the population keeps growing at the current rate, the demand for food and energy will keep rising in the country.

2. **Curtailing demand for the wrong types of energy**. In Pakistan, the government has incentivized the use of imported fuel for example by giving subsidies on the use of gas for generating power for export related industries. On the converse, indigenous fuels need to be promoted.

3. **Energy and food efficiency needs to be promoted**. There is a huge amount of wastage in the current system. According to the Sankey study of 2018, which looks at the value chain of energy in Pakistan, almost 35% of the energy is lost in the power distribution system, during transmission from source to user. At the user end, the appliances are not very energy efficient either. For example, almost half of the demand for transport fuel comes from motorbikes. In the absence of good public transport options, the users need to revert to bikes – so either the use of bikes can be curtailed by improving the public transportation options or alternatively making

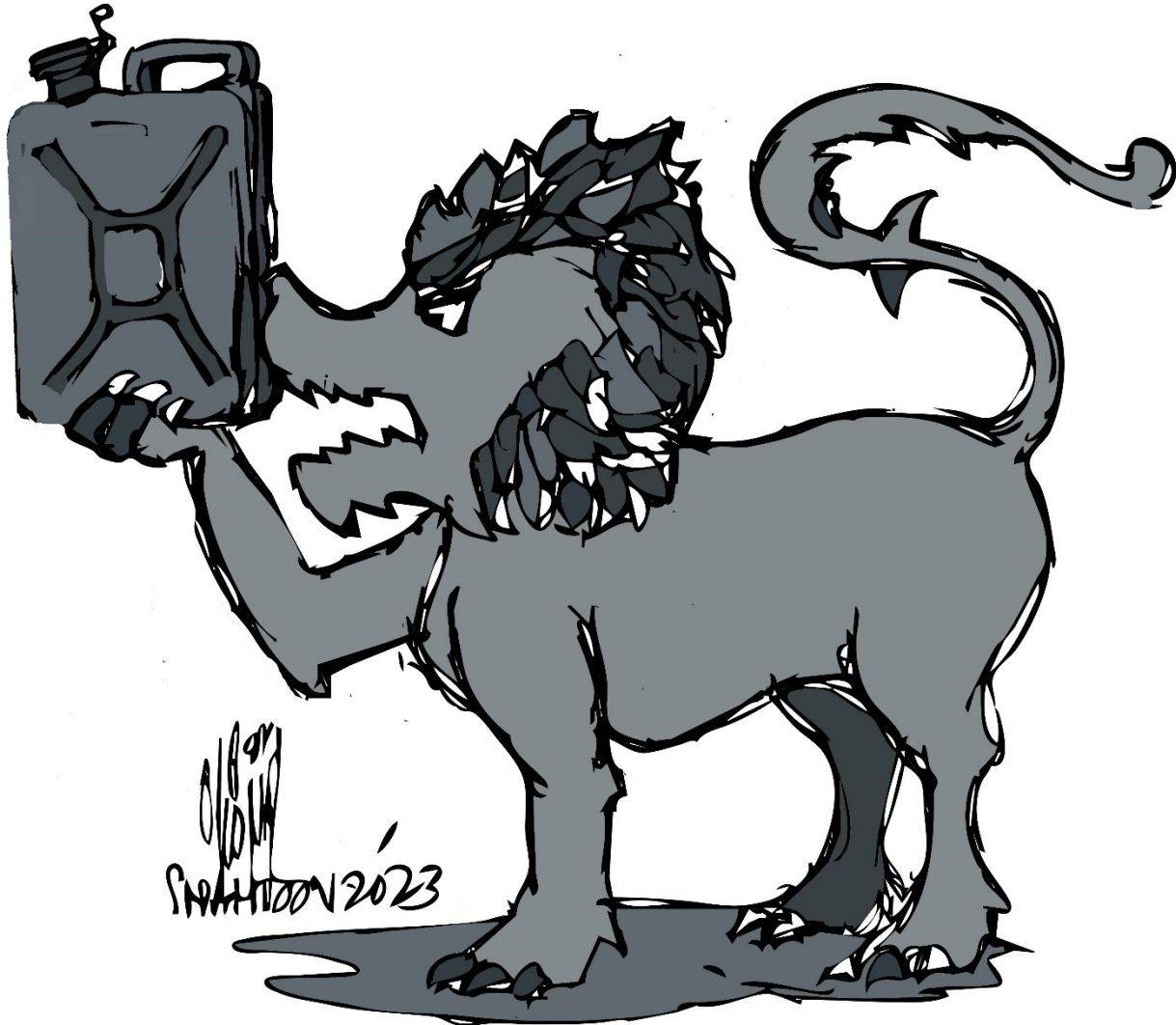
electric bikes mainstream, thus reducing fuel demand by approximately \$3 billion. Policies that drive more energy efficiency through the economy and reduce wastage are key. This includes increasing proportion of renewable energy in the system, as well as focusing on improved appliances that are more energy efficient.

4. **The government policies need to promote indigenization of fuel and transition towards renewable energy** along with industrial policies to promote production of equipment and technology within the country. Pakistan has very large

amounts of cultivable land and also different renewable energy sources like wind corridors and high solar irradiation. Pakistan also has great hydropower potential and unexplored gas reserves. For agriculture, farm productivity needs to be improved to fulfil the needs of the population.

The bottom line is that productivity needs to be improved and wastage needs to be reduced in both energy and food supply chains.

## 5. Case Study: Sri Lanka by Navam Niles



When Russian tanks rolled into Ukraine on the 24th of February 2022, the outcome was thought to be a foregone conclusion: a quick removal of the Ukrainian government followed by business as usual. Instead, President Zelensky's government held firm. What has followed in Ukraine in more than one year of brutal fighting that has displaced millions of Ukrainians and forced policymakers around the world to reevaluate their food and energy supply chains. In the meantime, President Gotabaya Rajapaksa's government in Sri Lanka did come crashing down. What has followed in Sri Lanka is months of political and economic instability and the stunning realisation that a once thriving peacetime economy has defaulted on its debt and is struggling with both food and energy insecurity. The FAO claims one in four people are food

insecure and most of the country has to endure two and a half hours of power cuts every day.

But are these two events really related? The Russian invasion of Ukraine was neither necessary nor sufficient for the immediate collapse of the Sri Lankan economy. **It was economic mismanagement that caused the collapse.** The country simply ran out of foreign currency and access to credit markets. The broader structural reason for the collapse is the transformation of the state into a large patronage machine. One of President Rajapaksa's campaign promises was to create over 150,000 public sector jobs for unemployed graduates and low-income earners. At the same time, the President removed and slashed taxes. **In effect, the state was expanding while**

revenue was declining. These policies eventually led to a series of credit downgrades, which eventually shut the country out of global credit markets.

In the background, **two important sources of Sri Lanka's foreign income - tourism and apparel exports - were crippled by the COVID 19 pandemic.** Tourism all but collapsed because of travel restrictions imposed both at home and abroad. These restrictions also affected the apparel sector and other export industries that were heavily integrated into global supply chains - exports decline by about a quarter. As economic mismanagement and the pandemic shock rocked the Sri Lankan economy the state's response to the crisis itself was tragic.

By 2021, after the damage caused by the pandemic became clear, instead of unwinding tax cuts, cutting public expenditure, or reaching out to the IMF, the government officials simply sat on their hands. Ali Sabry, the current foreign minister who was also serving in the Rajapaksa cabinet, first as Justice Minister and then briefly as Finance Minister, claimed the cabinet was simply "clueless" of the economic collapse. Whatever the government tried simply compounded problems. For example, the Central Bank initially refused to ease the peg on the Sri Lankan Rupee, which was below market rates, to maintain the illusion of economic stability. Remitters, who are responsible for simply resorted to informal networks to secure higher market rates and foreign currency inflows shrank by as much as 61.6% between the first quarter of 2021 and January of 2022.

## **FAO CLAIMS 1 IN 4 PEOPLE ARE FOOD INSECURE AND MOST OF THE COUNTRY HAS TO ENDURE 2.5 HOURS OF POWER CUTS EVERY DAY.**

Perhaps the most egregious response involved banning synthetic fertilisers. In an ill-advised scheme to reduce import expenditure and meet various environmental goals, the **government decided to immediately ban commonly used synthetic fertilisers in favour of organic fertilisers.** This scheme, implemented despite opposition from within the bureaucracy and with no real consultation with farmers was **a shocking example of bad policymaking.** It became tragic when it was clear that the government did not have any reliable infrastructure or supply chains to produce the necessary fertilisers, train farmers, or compensate for the decline in yields. Year-on-year, rice production declined by about 40% or a little over one million metric tonnes.

As Russian tanks started rolling into Ukraine on February 24th, 2022, economic mismanagement and the self-inflicted damage to food security meant that the country

could neither afford to import the necessary fuel to power its economy nor produce the food necessary to feed its people. As Ukrainians were rushing to defend their cities from a Russian onslaught, Sri Lankans were rushing to cities to protest and demand accountability.

So where does the Russian invasion of Ukraine fit in this picture? The invasion did lead to a spike in food and energy prices. Global food and energy prices rose because of the invasion. Food prices for a variety of commodities, including wheat, peaked a month into the invasion. This may have added to the misery in Sri Lanka, but the damage was done well before Putin decided to invade Ukraine. But if Russian invasion of Ukraine did not cause the crisis in Sri Lanka, it could certainly play a role in the next crisis.

In response to the Russian invasion, the forces of deglobalisation are intensifying. Sri Lanka and much of the Global South may be forced to choose between Russia and China, on the one hand, and Western markets on the other hand. Moreover, if global supply chains start fragmenting, Sri Lanka and other developing countries may lose access to foreign investment, technology, and expertise. Sri Lanka's weak government institutions extends to the foreign ministry as well, which has failed to articulate a clear post-cold war foreign policy by clearly articulating its goals or building closer ties with important partners. Thus, this invasion will be more one more shock that many countries in the developing world could do without.

## **AS UKRAINIANS WERE RUSHING TO DEFEND THEIR CITIES FROM A RUSSIAN ONSLAUGHT, SRI LANKANS WERE RUSHING TO CITIES TO PROTEST AND DEMAND ACCOUNTABILITY**

In terms of absolute impacts, the Ukraine conflict may not be as significant for the Global South as most people would like to think. But in the long term, the Global South will face severe disruptions because of the impacts of globalization and regionalization.

To put this into perspective, since the prices for food and fuel are determined by global markets, the Ukraine conflict has created price spikes for food and fuel globally and this of course trickles down to the Global South. Countries in the Global South, like Sri Lanka depend on global supply chains and global markets for access to food and energy, to participate in global trade and investment. And this conflict is bad news because it has disrupted the global

supply chains. However, these are just short-term disruptions to global commodity prices.

In the long term, there may be serious structural changes that will affect the competitiveness of countries like Sri Lanka and Pakistan. The conflict will result in a significant division between Western Democratic Capitalist countries and Russia, China and other countries. This will be particularly difficult because Sri Lanka and Pakistan are in the list of other countries. The chance to choose between the two is not really easy as they (Sri Lanka and Pakistan) do not have the European Union or an American economy to back them up. This is also a challenging scenario because of the close association of these countries with China, which exposes them to sanctions and possible secondary effects of this conflict. Despite this scenario, the conflict has not been a major source of Sri Lanka's economic crisis. **Sri Lanka's economic crisis predates the Russian invasion of Ukraine. The invasion merely exacerbated existing circumstances.** In other words, it was a perfect storm. A shock from this global external environment came together with extremely weak circumstances within the country. This disrupted the economic system's resilience because there was no money. Sri Lanka was shut out of financial markets; it had a very uncompetitive economy and huge liabilities at that point. The problem was not so much that there wasn't enough fuel or food or other access to raw materials, but rather, the country ran out of money and couldn't afford to access these markets. While this conflict has caused short term pain for Sri Lanka and could result in long term structural changes that will be quite negative for Sri Lanka, the bulk of the problems are really those that have emerged from within Sri Lanka's political economic system.

Sri Lanka has no natural energy deposits and imports all its fuel. Hence, there is no option of energy independence unless Sri Lanka somehow manages to invest significantly in nuclear energy. Even then, there is no domestic source of uranium. Sri Lanka is part of an energy interdependent system and has to comply with international commitments, especially those on the climate front with regards the import and use of energy to reduce overall emissions. Fortunately, Sri Lanka didn't suffer a serious or any direct impact from Russia because it does not use a lot of gas. Import of Russian oil for Sri Lanka is also miniscule compared to that for European countries.

However, one major problem for Sri Lanka is low productivity in its economy. **A lot of energy is misallocated, and a classic example is the use of hydropower in Sri Lanka.** Water is used for generating energy, but there is no water pricing system in Sri Lanka. Water is diverted based on consensus for agriculture and energy production. Instead of being used for electricity production, water is allocated to irrigation, which is important but less valuable

economically. Hence Sri Lanka does not produce enough electricity and then has to rely on import of coal for energy which is highly polluting and affects Sri Lanka's international commitments on climate.

## Possible Steps to Make Sri Lanka More Resilient to these Challenges

A structural transformation is critical for Sri Lanka. Agriculture is still a large part of the Sri Lankan economy, at 7% of GDP, and employs 35% of the workforce. This is one of the reasons that water is attributed more towards agriculture than towards energy. However, if this water was used to produce electricity for industries, the revenues produced from that would be enough to meet import requirements of cleaner, safer and less polluting energy. So, one thing Sri Lanka has to do is **to encourage structural transformation from agriculture to industry and services, as well as help 35% of the workforce to transition from agriculture as well.**

Another aspect is **appropriate pricing mechanisms.** For a long time, Sri Lanka has struggled to update prices reflecting international market prices, which has resulted in automatic subsidies. Subsidies are generally very bad ways of transferring or redistributing resources in an economy because rich households use more energy than poorer households. Users are not pushed to adopt renewable energy delivered through decentralized systems. The subsidy system also encourages private transportation so the reliance on imported fossil fuels of lower quality with higher polluting content remains. Removing subsidies, direct or indirect, and bringing the cost of energy in line with externalities, especially pollution and congestion is very important for reducing unnecessary consumption and encouraging more effective allocation of energy. In addition, incentives to encourage public transport also need to be in place. The fact is that Sri Lanka does not make enough money to import the energy it requires. For a long-term energy transition, it is critical that **instead of spending on energy R&D, the government uses the money to acquire off the shelf mature technology products that will enable Sri Lanka to leapfrog and have access to the energy it needs.**

Finally, public service reforms are critical and need to be implemented at earliest. Public service is very large and unproductive. A lot of talented people who could contribute to the local economy, get lifetime jobs without being very productive in the public sector. This encourages corruption. Thus, **rationalizing the public sector will reduce expenditure of the government, leaving more money for import of energy and food,** necessary to provide a cushion against shocks.

## 6. Policy Recommendations

Some of the key messages for policy interventions (for both Pakistan and Sri Lanka) based on policy brief and webtalk are highlighted below:

- **Removing subsidies on fuel** that encourage import of low quality and highly polluting fuels for the production of energy for industrial / commercial use and transportation
- Encourage consumption of **renewable / clean fuels by acquiring mature technologies** for energy production as opposed to spending on R&D or imports of fuel for energy
- Encouraging efficiency of resource use by **promoting public transportation**
- Building up the energy and food value chain to **minimize loss and wastage** i.e. streamline the production and distribution mechanisms in order to reduce inefficiencies
- **Audit of public expenditure and rationalization of spending** on agriculture and energy (local development vs import)
- **Institutional reforms** to enhance productivity and delivery of public service
- **Promote competition and innovation** within local markets

