Verité insights
September 2021
Vol 10, No. 3

Verité Research
Strategic Analysis for Asia

Verité Research is an independent think-tank based in Colombo that provides strategic analysis to high level decision-makers in economics, law, politics and media.

Raj Prabu Rajakulendran
Research

Malathy Knight
Associate Editor

Nishan de Mel
Series Editor

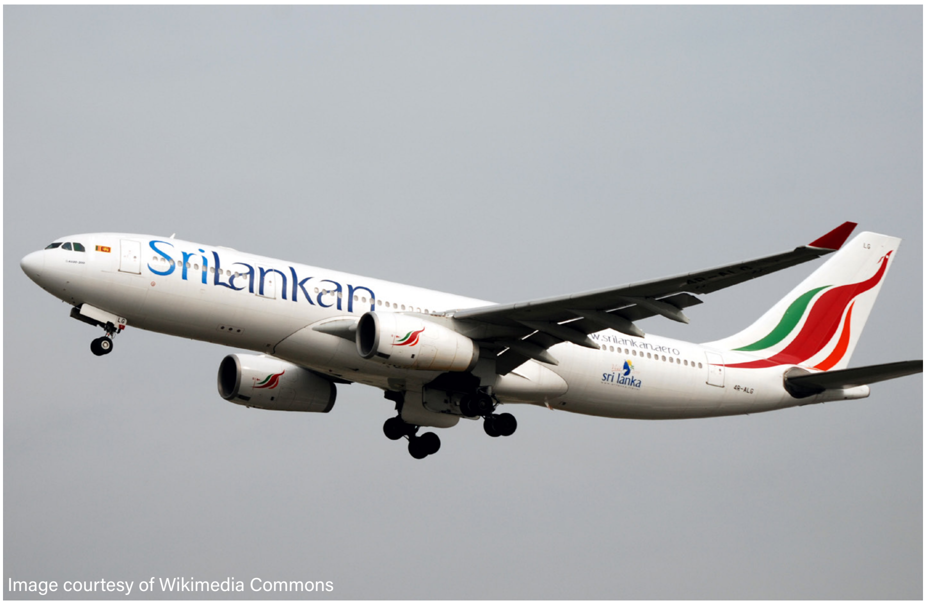

Image courtesy of Wikimedia Commons

Tourism Could Not Have Solved Sri Lanka's Foreign Exchange Shortage

181
USD
Sri Lanka's estimated spending per tourist per day (2019)

129
USD
Indonesia's estimated spending per tourist per day (2019)

164
USD
Thailand's estimated spending per tourist per day (2019)

A key debate during Sri Lanka's economic crisis is whether the current dollar shortage is a short-term liquidity problem or a more protracted and systemic issue that requires debt reduction. This insight responds to the view that the dollar shortage is a short-term liquidity problem primarily caused by reduced tourism revenue since the onset of Covid. As this insight describes, there are three reasons to be skeptical of this argument.

Sri Lanka lost access to credit from international financial markets following the rating downgrade in April 2020. The official view of the government was that Sri Lanka could sustainably finance its external debts, provided tourism returned to normal levels post-pandemic. The expectation was that tourism would bring in an additional USD 4.9 Billion in foreign currency inflows as the industry returned to pre-pandemic levels.

This view bolstered the position that Sri Lanka was facing only a short-term foreign currency liquidity problem until the Covid-19 related impact on tourism was overcome. As such, policy makers continued servicing the debt instead of restructuring it. This continued until Sri Lanka ran out of reserves and was forced to suspend debt payments with

> **Sri Lanka's estimates of tourism spend a day from its survey is extraordinarily high compared to peer countries, and even those with higher per capita GDP**

Exhibit 1:

Country	Foreign exchange receipts per tourists per day		GDP per capita (2019)
	Average (2015 - 2019)	2019	
Sri Lanka	USD 168	USD 181	USD 3,852
Thailand	USD 158	USD 164	USD 7,817
Indonesia	USD 136	USD 129	USD 4,135
India	USD 126	USD 130	USD 2,101
Vietnam	USD 114	USD 133	USD 2,715
Nepal	USD 54	USD 48	USD 1,195

Source: Sri Lanka Tourism Development Authority | Ministries of Tourism of relevant countries | OECD

The Sri Lanka Tourism Development Authority (SLTDA) reports that from 2012 to 2019, on average, only 11% of tourists stayed in five-star hotels in Sri Lanka

an announcement to that effect on the 12th of April 2022.

This insight sets out three mistakes that were made in buying into the optimism that normalizing tourism would resolve Sri Lanka's external debt servicing problems. They are: (1) over-estimating tourism inflows; (2) failing to understand the two-way street of tourism; and (3) neglecting the current account dynamics.

Over-estimation of tourism inflows

Sri Lanka estimates its tourism earnings based on an exit survey conducted at the airport (see Box 1). In 2018-2019, 5,033 tourists were surveyed. However, as the sample selection method is not disclosed, whether this is a representative sample of tourists is unknown. Comparative analysis indicates that there may be serious flaws in the survey design. As shown in Exhibit 1, Sri Lanka's estimates of tourism spend a day from its survey is extraordinarily high compared to peer countries, and even those with higher per capita GDP.

The year 2019 is taken for comparison purposes as 2020 and 2021 were not typical years. These years saw significant shocks (2020 COVID pandemic and the 2021-22 economic crisis), which disrupted normal trends in tourism.

In 2019, Indonesia's GDP per capita was 7.3% more than Sri Lanka's. Yet, Indonesia estimates spending per tourist per day to be almost 30% less. Thailand has a GDP per capita that is more than double that of Sri Lanka. Yet, it estimates spending per tourist per day to be about 10% less.

The Sri Lanka Tourism Development Authority (SLTDA) reports that from 2012 to 2019, on average, only 11% of tourists stayed in five-star hotels in Sri Lanka. This low take up of the higher end accommodation, does not support the estimated spending for a tourist couple being at USD 362.50 per day.

According to SLTDA, Sri Lanka experienced the highest reported earnings in tourism in the year 2018 at USD 4.4 Billion. This earnings figure is a calculation done using three variables:

Number of tourists arrivals counted by Department of Immigration in 2019

in 2019 - 1.91 Mn

Estimated average duration of stay by a tourist

in 2019 – 10 days

Estimated foreign exchange receipts per tourist per day in 2019

USD 181.2 /tourist.day

Exhibit 2:

Year	Tourist arrivals (in thousands) (A)	Average duration of stay (number of nights) (B)	Average spending per tourist per day (USD (C)	Earnings from tourism (USD Thousands (A*B*C)
2015	1,798	10	164.1	2,980,653
2016	2,051	10	168.2	3,518,489
2017	2,116	11	170.1	3,924,932
2018	2,334	11	173.8	4,380,628
2019	1,914	10	181.2	3,606,930
2020	508	8	158.1	682,407
2021	194	15	172.6	503,548

Tourism is a two-way street

Relaxing of COVID regulations and encouraging tourism flows is a two-way street. This increases foreign exchange inflows as well as outflows, as Sri Lankans also travel as tourists to other countries.

> **...it was not reasonable to expect that tourism earnings could compensate for the loss of access to financial markets.**

For instance, in 2019, India accounted for 19% (355,002) of Sri Lanka's total tourists. However, in the same year 350,000 Sri Lankans visited India as tourists. As such, while tourists coming from India would have added to foreign currency inflows, this benefit is significantly reversed by outflows on the two-way street of tourism between India and Sri Lanka. In the case of India, net inflows could have even been negative.

Therefore, the key variable should be expected net foreign exchange inflows from the two-way street of tourism, rather than expected one-way inflows from tourism. Focusing exclusively on inflows from tourism (already over-estimated) led to misplaced confidence that tourism returning to normal would enable Sri Lanka to fully recover its rapidly deteriorating balance of payments position.

Neglect of current account dynamics

The third visible indicator that was neglected was the inadequacy of tourism inflows to cover the balance of payments shortfall, within normal current account dynamics. These dynamics were already evident from past years. In the years that tourism was normal and high and there was a high estimate of foreign exchange inflows from tourism, Sri Lanka's balance of payments position was maintained only by being able to borrow much of what was repaid in debt. Hence, expecting tourism to compensate for the foreign exchange deficit was overly optimistic.

For example, in 2019, Sri Lanka reported a total cumulative receipt of USD 4.3 BN from tourism. However, in the same year, Sri Lanka issued ISBs worth USD 2.5 BN. This shows that even with tourism bringing in high foreign exchange inflows, Sri Lanka still needed to issue bonds to meet its foreign exchange requirements. Therefore, the existing current account dynamics already showed that it was not reasonable to expect that tourism earnings could compensate for the loss of access to financial markets.◆