



## ARTICLE

# Analysing Macroeconomic Precarities in the South Asian Neighbourhood

Soumya Bhowmick <sup>ID</sup>, Arya Roy Bardhan <sup>\*</sup> <sup>ID</sup>

Observer Research Foundation, Rouse Avenue Institutional Area, New Delhi 110002, India

## ABSTRACT

A global slowdown is impending as the post-pandemic recovery was overturned by the Russia-Ukraine war, worsening geopolitical strife and disruption of global value chains. Although the contractionary effect will be felt worldwide, the emerging economies of South Asia, rife with internal political struggle and economic turmoil, require scrupulous inspection. This paper analyses the series of events which culminated in the unmanageable economic state of affairs in Bangladesh, Pakistan, Nepal, Sri Lanka and Myanmar. It is found that despite the unique economic structure of each nation, there is a currency crisis in the offing or has already led to the collapse of each exchange rate. The disposition delves into those systemic and economic factors that inadvertently lead to currency crises and irrecoverable Balance of Payment deficits. The International Monetary Fund seems to be the short-term answer to the problem but long-term measures that structurally reform these economies are essential. This paper delves into the fault lines for such macroeconomic instabilities and suggests a few structural measures to circumvent economic shocks in the longer horizon. This paper provides a thorough analysis of the events and global circumstances during the COVID pandemic that led to the onset of a silent crisis in South Asia.

**Keywords:** South Asia; Currency Crisis; Russia-Ukraine War; IMF

### \*CORRESPONDING AUTHOR:

Arya Roy Bardhan, Observer Research Foundation, Rouse Avenue Institutional Area, New Delhi 110002, India; Email: [arya.bardhan@orfonline.org](mailto:arya.bardhan@orfonline.org)

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## 1. Introduction

The 2023 crisis in Sri Lanka has triggered heated debates among policy analysts and the general public alike, regarding a similar foreign exchange crisis among other world economies. While studies have examined isolated fiscal and exchange rate crises, such as Radelet & Sachs (1998)<sup>[1]</sup>, on East Asia or Reinhart & Rogoff (2009) on sovereign defaults, very few have systematically compared the open economy-related issues affecting multiple South Asian economies in the post-pandemic context<sup>[2]</sup>. Further, the looming threat is palpable, more so, for the economies in the South Asian region that are coming to grips with Sri Lanka's cautionary tale. Although Sri Lanka's downfall is attributable to internal parameters<sup>[3]</sup>, such as years of economic mismanagement, poor governance and irrational policy choices, the neighbouring economies are also at threat of a currency crisis.

Characterised by higher-than-average fiscal and trade deficit levels even pre-COVID, the crisis-hit economies in India's neighbourhood reeled under the impact of the twin adversities: the Ukraine-Russia war and COVID-19. Besides leaving South Asian governments scrambling for adequate food grains and fuel reserves to provide to their citizens, the Ukraine-Russia war has served as a crippling blow to the dwindling foreign exchange reserves and the external debt-repayment capacity of these economies amidst a severe BOP imbalance. We undertake an in-depth analysis of the South Asian crisis and the factors driving the ongoing turmoil in Sri Lanka, Pakistan, Bangladesh, Myanmar, and Nepal. For the purpose of this study, we define these countries as the South Asian neighbourhood, with Myanmar included due to its economic ties and geopolitical significance and linkages with the region. Myanmar's 2021 coup d'état saw military forces oust the ruling National League for Democracy led by Aung San Su Kyi<sup>[4]</sup>. Following the junta's takeover of state activities, Myanmar's foreign exchange—the price of domestic currency with respect to another currency—started to diminish. To remedy this, the junta ordered a series of austerity measures. In August 2021, the junta pegged the currency at 2100 Kyat/US\$<sup>[5]</sup>. But the currency pegging miscarried and the currency speculators overwhelmed the exchange ratio leading to broken pegging—wherein speculative attack overwhelms the pegged currency and the monetary authority is unable to defend the fixed rate, leading to tumbling depreciation. In August, 2022, as the currency nearly depreciated

by 40 per cent, the Central Bank of Myanmar decided to inject US\$200 million to defend the Kyat<sup>[6]</sup>. The plummeting currency has raised inflation to as much as 16 per cent in the two years since the Junta's takeover, threatening almost 25 per cent of the population with food insecurity. Under the Junta's fixed exchange rate regime, the currency is definitely susceptible to a speculative attack with foreign investors fleeing the nation, but the military government claims that it has sufficient forex reserves to avert a Sri Lanka-like crisis<sup>[7]</sup>.

On the other hand, the nation's closest neighbour Bangladesh has been facing a severe forex crunch amidst falling remittances and over-reliance on the Ready-Made-Garments (RMG) industry<sup>[8]</sup>. Whether these are the signs of an impending crisis is debated, since few structural shortcomings have been observed but what is concerning is the central bank's failure to implement the usual policies of raising interest rates or depreciating the currency to reconcile the trade deficit<sup>[9]</sup>. Although Bangladesh professes maintaining a floating exchange rate, it practises a managed floating or pegged floating regime where it pegs the Taka at an overvalued rate to the US dollar, putting the current account under immense pressure<sup>[10]</sup>. Thus, the forex reserves have plunged by almost one-third amidst increasing geopolitical tension and domestic political unrest.

With no respite in sight, Pakistan with little recovery from the debilitating floods of 2022, is currently staring at a road paved with bankruptcy as it grapples with an inflation and energy crisis further exacerbated by the Ukraine-Russia war, internal political instability and widening trade deficit. In the aftermath of the floods, while the nation is suffering from a mortifying food crisis, the Pakistan Prime Minister is ousted by the opposition, worsening the political turmoil with even the resurgence of military courts on the table.

Furthermore, India's immediate neighbour Nepal copes with a fuel crisis that has prompted the government to increase non-working days in a week and reduce production, thus setting-off inflation and declining investment. With a projected economic growth of only 2.16 per cent, the country is facing its first recession in 60 years. Despite policies undertaken to rejuvenate the economy, the conditions are worsening and loans from foreign institutions can place the country in a vicious debt trap.

Policy missteps and accumulating external debt amidst lowered budgets have further led to many of these economies'

demand for International Monetary Fund's (IMF) help. While the IMF has come forward to assist with bailout packages, the road to recovery lies in ensuring fiscal and financial management of the economy. A dwindling foreign exchange reserve can restrict essential imports, leading to supply shortages and consequently, inflation. This inflation would disproportionately impact vulnerable populations who have limited resources, in crushing macroeconomic conditions. Even though the pandemic and the war have a lot to do with the present economic situation in these countries, the causes are widespread. As these countries show similar symptoms of rising trade deficits and continue to confront the domino effect of dwindling forex reserves and a depreciating currency, we examine the common tell-tale signs of an impending economic catastrophe.

Deteriorating trade balances and recessionary pressure in the domestic economy taken together prove lethal for a fixed exchange rate system. This leaves the currency wide open to speculative attacks where the central bank is left with no means to defend the currency as forex reserves are exhausted<sup>[11]</sup>. The East Asian Crisis of 1997 was unforeseen given the robust growth exhibited by the emerging economies prior to the catastrophe, setting it apart from the textbook first and second-generation crises<sup>[12]</sup>. The underlying structural weaknesses were overlooked by exuberant investors chasing hefty returns from the fast-growing nations. The South Asian crisis at hand, unlike the 1997 crisis, has portrayed all signs of an imminent catastrophe which should be dealt with caution and averted making use of all prior knowhow of crisis management. We discuss the events and series of decisions, both economic and political, that have surrounded these nations with an ominous uncertainty.

This paper seeks to identify open-economy vulnerabilities in India's neighbourhood, where countries exhibit distinct domestic structures, divergent policy responses, and varied corrective measures. Despite these differences, the IMF consistently emerges as the common recourse during periods of external shocks and macroeconomic distress. The study is informed by broader macroeconomic thinking on balance of payments pressures, exchange rate dynamics, and crisis vulnerability, and is grounded in open-economy macroeconomic theory. It draws on first- and second-generation currency crisis models), balance-of-payments constraint frameworks<sup>[13]</sup>, and exchange rate regime vulnerability theory<sup>[14]</sup>. These

frameworks help explain how weak fundamentals, investor sentiment, external debt burdens, and institutional fragilities interact to heighten economic risk, framing the paper's examination of fiscal stress, foreign exchange management, and external sector imbalances across the selected countries. By combining cross-country comparison with both qualitative insights and empirical trends, the study contributes to ongoing debates on economic resilience and policy reform in the South Asian region.

In that context, section 2 specifies the methodology, section 3 discusses the role played by persistent trade deficits, section 4 explores the diverse nature of the currency crisis, section 5 delves into the multifaceted vulnerabilities that existed in these nations, section 6 attempts to engineer a way out of the crisis with the help of the IMF, and section 7 concludes the discussion.

## **2. Methodology**

The study adopts a qualitative approach, using secondary sources such as central bank reports, IMF and World Bank data, news articles, documented policy events, and academic literature on trade dynamics, economic crises, and exchange rate management. This method fits the exploratory and policy-focused nature of the paper, which aims to assess macroeconomic vulnerabilities across several South Asian economies.

Source selection was based on credibility, institutional reliability, and relevance to the countries under study. Priority was given to official statistics, reports from multilateral organizations, and well-established economic analyses, following a purposeful sampling approach to ensure sources provided the most relevant and informative insights. Where possible, a maximum variation strategy was employed by consulting sources representing diverse perspectives, including government reports, academic studies, and policy briefs. To minimize bias, data and insights were cross-checked across multiple reputable sources, and theoretical sampling guided the inclusion of additional sources when emerging patterns required deeper exploration.

The use of secondary data on trade balances, foreign reserves, and policy responses supports the interpretive framework and helps identify broader structural patterns across Bangladesh, Pakistan, Nepal, Sri Lanka, and Myanmar.

These data have been obtained from official sources like central banks, of the respective nations in study, the IMF and UNCTAD.

### 3. Trade Imbalances: A Persistent Adversary

The South Asian economies of Pakistan, Bangladesh, Sri Lanka, Myanmar, and Nepal are all characterised by different economic and political structures, diverse weather conditions and dissimilar nature of debt crises, yet the one coinciding phenomenon that has consistently been observed is the depreciating forex reserves and a rapid fall in the domestic currency value, causing the value of imports to rise.

A trade deficit is the excess of imports over exports (in value terms) and for decades now, these nations have drawn up huge import bills, particularly on essential commodities. Considering this, a rise in the import value of

essential inputs owing to an identical pattern of increased merchandise trade deficit during an active war in the post-COVID era has spelt doom for these fragile economies (**Table 1**). Some of the top imports of these countries include petroleum products, petroleum crude, natural gas, and palm oil—most of them coming from Russia and Ukraine. Energy shortages and supply cuts in cereal production by Russia and Ukraine and a ban on crude palm oil exports by Indonesia have led to global inflation, which has caused turmoil in the South Asian economies. With one-third of the land inundated by floods that haven't completely receded in most parts of the country, Pakistan is on the brink of a debilitating wheat crisis ("Pakistan faces severe wheat crisis", 2022); and while its major exporters of this commodity—Ukraine and Russia—continue to be at war, import prices have breached affordable levels despite the disbursal of government subsidised wheat ("Pakistan: As flour price shoots up", 2023).

**Table 1.** Merchandise Trade Deficit as a Percentage of GDP: Pre- and Post-COVID-19 (in Percentage).

Country	Trade Deficit as a Percentage of GDP (2019)	Trade Deficit as a Percentage of GDP (2021)	Percentage Change in Trade Deficit
Pakistan	6.57	11.20	70.41
Sri Lanka	8.97	9.17	2.21
Bangladesh	5.28	7.98	51.11
Myanmar	3.78	1.79	−52.59
Nepal	26.88	37.26	38.62

**Source:** Central Bank of Pakistan, Central Bank of Sri Lanka, Nepal Rashtra Bank, Bangladesh Bank, Central Bank of Myanmar and World Bank. Author's calculation.

Higher food prices have constrained production and consumption in India's neighbourhood. Only Myanmar has managed to record a robust improvement in the current account (trade deficit is included in the current account), as shown in **Table 1**. For Sri Lanka, however, the trade deficit percentage change is smaller than in neighbouring countries. Reduction in demand from its trading partners and certain policy fallacies by the Government have resulted in lower production of its exportable commodities. Tea comprises Sri Lanka's primary export item and is one of the significant sources of foreign exchange earnings. The nationwide experiment of adopting organic farming with an outright ban on fertiliser imports in 2019 increased the cost of tea production multi-fold. This adversely affected the production of tea within the economy<sup>[15]</sup>. In the absence of a corresponding increase in domestic production due to rising input costs like fuel and electricity, the country is suffering from severe

inflation. Although inflation indices took a downward trend after September, 2022, when they had reached a record high of 70 per cent, inflation still hovers around 55 per cent, at almost tenfold of the pre-pandemic levels<sup>[16]</sup>.

While Myanmar and Sri Lanka are facing electricity outages due to rising domestic fuel prices and transportation costs, the rising input prices have given rise to swollen inflation rates in these nations. A troublesome trade balance always puts the currency under pressure, leading to macroeconomic difficulties with a depreciating exchange rate.

### 4. Decoding Foreign Exchange Difficulties

In most cases, a trade deficit is indicative of dwindling foreign exchange (forex) reserves. The IMF defines foreign exchange reserves as the official public sector foreign as-

sets that are readily available and can be controlled by the monetary authorities<sup>[17]</sup>. These foreign assets consist of foreign currency, most notably the US\$, and gold<sup>[18]</sup>. Forex reserves play an essential role in the macroeconomic stability of the currency, especially in the present interconnected world. They act as a buffer for maintaining the currency's value and the financial system's stability, especially during an external shock<sup>[19]</sup>. These reserves also played an essential role by ensuring enough liquidity during the COVID-19 pandemic, which disrupted the production and exports of goods, thus, hampering countries' ability to pay for imports.

A UNCTAD (2021) report stated that Global merchandise trade fell by more than 20 percent in the second quarter of 2020 relative to the same quarter in 2019<sup>[20]</sup>. Apart from the fall in exports and imports, capital flows reflected a downward trend and hit rock bottom compared to previous crises, including the 2008 Global Financial Crisis and 2013 Taper Tantrum. Emerging economies have intervened in the forex market and relied on forex reserves to defend their currencies, provide liquidity support to the domestic sector, and relax capital flow measures. An ample amount of forex reserves also comes in handy in meeting international obligations. While no one theory can be applied to determine the adequacy of the forex reserves a country should hold, the traditional 'rule of thumb' suggests that reserves must cover

100 per cent of short-term debt or at least three months of imports<sup>[21]</sup>.

A forex crisis is a situation where the foreign exchange reserves of a country begin to fall, due to which the monetary authority does not have sufficient forex at its disposal to stabilize the currency, triggering additional pressure on the currency. This leads to depreciation, thus aggravating the problem, by increasing the cost of imports in the short run without causing much change in the value of exports. In the event of a trade deficit, the home country is under-resourced to pay for its imports. As a remedy, the government depreciates the domestic currency. This makes the domestic goods more economically competitive in the international market, thus increasing their demand, leading to an inflow of foreign currency, thus replenishing the forex reserves<sup>[22]</sup>. Given this scenario, a forex crisis brews when there is no proportionate increase in exports in the short run—a direct result of reduced production, lower demand for domestic goods and services from trading partners, and capital flight from the country owing to higher interest rates overseas or lack of confidence in the economy. External public debt and debt servicing commitment also contribute to a forex crisis by increasing the outflow of forex reserves from the country. **Table 2** shows the foreign reserves for the countries in the study, pre- and post-COVID-19.

**Table 2.** Foreign Reserves Pre- and Post-COVID (Figures in Million US\$).

Country	Foreign Reserves in 2019–20	Foreign Reserves in February 2023
Sri Lanka	7,125	2,184
Bangladesh	43,170	32,267
Pakistan	18,886	8,751.3
Nepal	12,565	4,053.74

**Source:** Central Bank of Bangladesh, State Bank of Pakistan Central Bank of Sri Lanka and Nepal Rastra Bank.

**Note:** The figures for Nepal are in million local currency.

It is often argued that inflation is given too much weight as a policy target. Periods of moderate and stable inflation, though not ideal, are tolerable. However, Central Banks' focus on controlling inflation has often led them to use exchange rates as nominal anchors, i.e., pegging the exchange rate to a foreign currency to stabilise the economy. This often led to real appreciation of the exchange rate<sup>[23]</sup>, which causes piling of external debt and an inevitable currency crisis. Currencies of Sri Lanka, Myanmar and Nepal which follow a pegged exchange rate regime were caught in the clutches of an imminent collapse as their foreign reserves

were rapidly depleting in the face of rising domestic and external pressure.

While the COVID-19 pandemic had a massive impact on people's health across countries, it also triggered economic and financial consequences for emerging and developed economies. The disruption caused in supply chains due to restrictions in the movement of goods and people affected the level of international trade like never before. The Russia-Ukraine war has further aggravated the situation by impacting energy, non-energy, and food prices across the globe. Characterised by outflows of foreign currency, the

impact of a forex crisis is particularly hard on South Asian economies with a precarious Balance of Payments (BOP) history and debt obligations. This paper examines the key internal and external factors responsible for the erosion of foreign exchange reserves and their subsequent effects on South Asian polities.

## **5. Chinks in the Armour: Other Economic Challenges**

The South Asian countries have been grappling with a series of economic challenges, including policy missteps, mounting external debt, and reduced budgets. These factors have necessitated their reliance on the International Monetary Fund (IMF) for assistance. However, the path to recovery lies in effective fiscal and financial management of their economies. One of the pressing issues is the persistent rise in inflation rates, driven by deficiencies in foreign exchange reserves and shortages, which disproportionately affect the poor and vulnerable populations. While the pandemic and ongoing conflicts have certainly contributed to the current economic situation, the causes extend beyond these immediate factors. These countries exhibit common symptoms such as rising trade deficits, diminishing foreign exchange reserves, and depreciating currencies, all of which indicate an impending economic catastrophe. This section discusses the shortcomings in detail.

### **5.1. Flawed Domestic Economic Structures**

Ready Made Garments (RMG) exports constitute about 82 per cent of Bangladesh's total export earnings, exceeding the country's foreign reserves<sup>[24, 25]</sup>. However, geopolitical tensions, shortages of oil and gas, hazardous working conditions, and a persistent price rise in the developed countries of Europe and America have reduced their demand for textiles from Bangladesh. Excessive dependence on a single category of exports has not boded well for the country since trade deficits have increased by almost 80 percent in the last two years. The country's overall exports are precarious and have fallen by ten percentage points between 2012 and 2021.

One reason behind the low production is the country's insufficient domestic and foreign investment. Even though the government has provided various concessions and rebates on taxes and duties, FDI as a percentage of GDP has stalled

at around 0.5 percent. The inherent economic structure of the country, with poor transportation and infrastructure, complex bureaucratic processes, and a high level of corruption, have affected the cost of doing business, deterring foreign investors from investing and diversifying the country's production and export composition. Following a visit in May, 2023, the IMF released a statement expressing its pessimism about the country's at-risk currency, foreign reserves, as well as, economic growth.

Suffering from an identical fate is the country of Nepal. With a high cost of production due to a lack of availability of raw material and substandard infrastructure, Nepal has largely suffered from chronic levels of low productivity and production for decades<sup>[26]</sup>. As per the Transparency International Corruption perception index - the leading global indicator of public sector corruption—Nepal is ranked 117th, while Bangladesh is ranked 147th out of 180 countries. Poor governance in the two countries is mainly responsible for delays in the implementation of laws and infrastructural projects, thereby restricting the export earning potential of the countries.

### **5.2. Political Instabilities**

Sri Lanka is facing the worst economic crisis caused by untimely and careless decisions by the Rajapaksa government. The mindless tax cutting introduced in 2019 reduced VAT and corporate taxes and eliminated capital gains tax, among others. Continuously rising fiscal expenditure with diminishing public revenue has led to the government's inability to secure essentials like food supplies and medical equipment. A second blow was served when the Rajapaksa government decided to shift to organic farming overnight, reducing the rice production of a country otherwise known to reap self-sufficient rice yields. In 2021, Sri Lanka was compelled to import around US\$450 Million worth of rice (Nordhaus & Shah, 2022).

In a similar turn of events, the military junta's takeover of Myanmar's helm of state affairs in February 2021 has had an adverse impact on the economic and sociopolitical front of the country<sup>[27]</sup>. An estimated 1.8 million people were internally displaced as of May 1, 2023 while thousands are expected to leave the country as their purchasing power is being depleted by continuous devaluation of the currency. Negative investor confidence has led to muted

production and declining FDI into the country. The garment sector, which contributed about 30 percent of total exports in 2019, is now under pressure due to lower domestic and global demand. The currency has lost more than 50 percent of its value since the coup<sup>[28]</sup>. To prevent forex outflow, the Central Bank has now removed exemptions given to foreign companies from mandatory currency conversion and reinstated the fixed exchange rate regime. Forex shortages have led to reduced imports of essential commodities and a higher inflation rate.

Similar distress is being experienced in Pakistan, where the deepening economic and political crisis in the aftermath of the pandemic and floods has left the majority of the population susceptible to food insecurity. There is severe migration of skilled labour out of the country as the environment has been rendered inhospitable under political turmoil<sup>[29]</sup>. As the struggle between supporters of the former Prime Minister, Imran Khan and the current government, led by Shahbaz Sharif turns violent, the Pakistani Rupee is plummeting, pushing the economy into a state of severe inflation. The situation is no better in Nepal, where political instability and high inflation haunt the citizens. The political situation is tumultuous as Prime Minister, P.K. Dahal had to seek a vote of confidence in the parliament after his allies pulled out of the coalition over the nomination of the President (“Nepal PM”, 2023)<sup>[30]</sup>. A country that is highly dependent on imports as a tax base has been dragged into recession with a fiscal deficit owing to low imports and sluggish economic activity, in general<sup>[31]</sup>.

### 5.3. Rising External Debt and Debt Service Payments

China has slowly but gradually earned a reputation of being the developing world’s largest fair-whether ally, lending billions to countries in crisis and expanding its debtor base<sup>[32]</sup>. Among a long list of its debtors are Pakistan and Sri Lanka, both having a history of borrowing heavily from China and continuing to do so. At present, both Pakistan and Sri Lanka’s external debt constitutes 27 percent and 20 percent of all foreign debt that these countries owe China, respectively<sup>[33]</sup>. These commercial loans from China have shorter maturities and higher interest rates, leading to increased pressure on repayment.

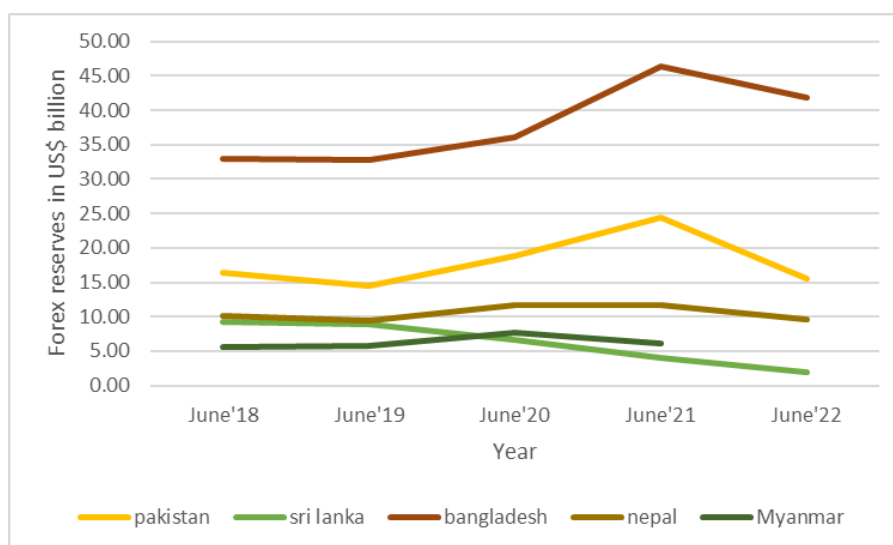
External debt servicing commitments are a major source of forex outflows. In Pakistan, inflows of workers’

remittances are offset by public external debt, as they pale in comparison to external outflows<sup>[34]</sup>. It has fuelled the total external debt servicing commitment to US\$15 Billion from US\$13 billion during FY22<sup>[35]</sup>. On the other hand, Sri Lanka’s external debt service payments amounted to US\$7 billion against forex reserves of US\$1.9 billion at the end of March 2022<sup>[36]</sup>.

As per data from the State Bank of Pakistan (2023)<sup>[35]</sup>, the country’s total liquid forex reserves have reduced by almost 30 percent, while the reserves with SBP have fallen to single digits (**Table 2, Figure 1**). The World Bank projects the forex reserves of Pakistan, Sri Lanka, and Myanmar, respectively, at two, three and three months of imports. Pakistan is currently facing a dual crisis, a forex crunch accompanied by a rising fiscal deficit that had widened to 20.6 percent due to vaccine procurement and other developmental projects. The fiscal deficit still stands at 3.7 per cent with most of it being financed by internal borrowing (Abasi, 2023). The unprecedented floods in the country due to climate change have compounded the difficulties for the authorities. Although the devastating floods ravaged Pakistan in 2022, swathes of land continue to remain inundated with water, pushing millions into monetary poverty<sup>[37]</sup>.

A slew of accommodative policies pursued during COVID-19 and spillovers from the war have led to unrestrained pressure in the internal and external sectors of these South Asian economies. Mindless tax-cutting and other populist policies by the Sri Lankan government, the concentration of exports, inherent difficulties in project implementation in Bangladesh and Nepal, lower FDIs and capital inflows in Myanmar have restricted the growth of these countries along with raising the fiscal deficit and government debt.

One interesting observation is that the forex reserves for the South Asian economies (**Figure 1**) increased between 2019 and 2021 before falling. This is attributed to remittance inflow, one of the primary sources of forex in Pakistan, Bangladesh, and Nepal. Remittances constitute up to 50 percent of the total reserve pool in Nepal (Nepal Rashtira Bank, 2023). As per a World Bank analysis report<sup>[38]</sup>, the main reason behind this surge was the heightened role of remittances in poverty alleviation in these low-income countries. A rise in savings repatriation, loss of jobs and reverse migration by emigrants to support their families, coupled with the fintech revolution and digital transfers, made transfers cheaper and increased the overall volume of remittances.



**Figure 1.** Forex Reserves in Four South Asian Economies (2018–2022).

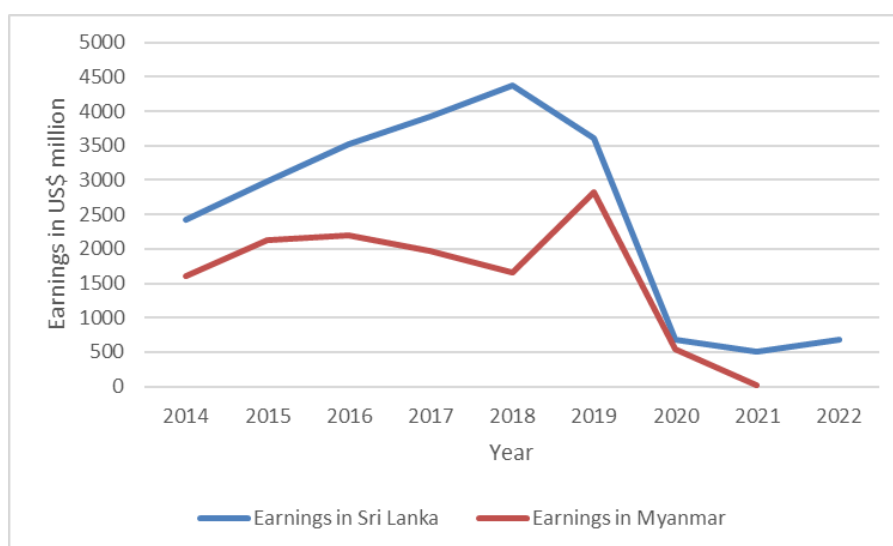
Source: Central Bank of Pakistan, Central Bank of Sri Lanka, Nepal Rashtra Bank, Bangladesh Bank and World Bank.

## 5.4. Dwindling Tourist Footfalls

The Sri Lankan tourism industry saw pandemic-induced constraints and a plunging decline in tourist footfalls (**Figure 2**). The industry accounts for 12 percent of the GDP and is the third largest source of foreign exchange reserves<sup>[39]</sup>. Between 2018 and 2020, the total number of tourists fell by almost 80 percent. The 2019 Easter Bombings further contributed to the pessimistic air pervading around leisure tourism in the country. The high inflation rate that breached the 80 percent level in June 2022 owing to food inflation in the aftermath of the Russia-Ukraine war followed by social unrest in the country

which added fuel to the fire. While, earnings from the tourism sector have fallen by 88 percent, from US\$4.3 billion in 2018 to US\$0.50 billion in 2021, foreign exchange reserves have dwindled to US\$1.85 billion. The tourism minister claims that the crisis is behind them and the sector is ready to make a comeback with about 2 million tourists in 2023.

Similarly, the hospitality and tourism sector in Myanmar has suffered redundancy with a drop of over 80 percent in earnings and job losses. The tourism sector is nearly non-existent since the junta took over, eliminating the source of livelihood for many and forcing them to switch to alternative occupations, disrupting the economic balance<sup>[40]</sup>.



**Figure 2.** Tourist Arrivals and Earnings in Sri Lanka and Myanmar (2014–2022).

Source: Central Bank of Sri Lanka and Central Bank of Myanmar.



## 6. All Roads Lead to the IMF

The worsening BOP situation in South Asian countries has led to a fall in the value of their currencies. Higher inflation and sluggish growth rates have further delayed recovery, while political instability, social unrest, precarious policies, and persistent structural imbalances have compounded these crises, compelling governments to reluctantly approach the International Monetary Fund (IMF) as the lender of last resort. Unlike the World Bank, whose focus lies in poverty alleviation and long-term development, the IMF intervenes during crises, whether on the BOP front, when reserves cannot cover import needs and debt servicing, or on the fiscal front, when high deficits and mounting public debt necessitate austerity measures. This reliance illustrates the “international lender of last resort” framework<sup>[41]</sup>, whereby sovereign states in distress depend on IMF support to restore macroeconomic stability. It also reflects the core of stabilization and austerity debates<sup>[42]</sup>, where fiscal contraction and currency devaluation are imposed as corrective measures but often at the cost of social welfare. Sri Lanka,

Pakistan, and Bangladesh have all recently turned to the IMF for precisely these reasons, seeking external financing to replenish reserves and meet import and debt obligations. The pattern also resonates with dependency perspectives<sup>[43]</sup>, where periphery states remain structurally reliant on multilateral institutions for cyclical stabilization, limiting their policy autonomy. In 2019, the IMF allowed Pakistan’s authorities to draw US\$1.1 billion for which Pakistan had to make various economic modifications to prove eligibility for the IMF sanction<sup>[44]</sup>, which comes as part of a US\$6.5 billion bailout agreed to in 2019 (see **Table 3**). IMF also struck a preliminary agreement to extend US\$2.9 billion to Sri Lanka under the EFF<sup>[45]</sup>. Bangladesh has also requested the IMF for a US\$4.5 billion bailout. The disbursement will help regulate the situation by ensuring an immediate supply of goods while providing some time to implement the reforms aimed at attaining macroeconomic and financial stability in the countries. Primary target areas include addressing corruption and vulnerabilities faced by the poor, fiscal consolidation, and proactive monetary policy in the respective country to tackle inflation.

**Table 3.** Latest IMF Lending to South Asian Economies.

Country	Lending Facility	Latest (After July 2020) Amount Drawn	The Last Amount Drawn
Pakistan	Extended Fund Facility	Aug 29, 2022 SDR 894 million (US\$1.1 billion)	Jul 03, 2019 SDR 2,144.00 million
Sri Lanka	Extended Fund Facility	March 20, 2023 SDR 2.2 billion (US\$2.9 billion)	Jun 03, 2016 SDR 952 million
Bangladesh	Extended Credit Facility, Extended Fund Facility & Resilience and Sustainability Facility	January 30, 2023 SDR 2.5 billion (US\$3.3 billion) & SDR 1 billion (US\$1.4 billion)	Jun 02, 2020 (RFI-SDR 177.77 million; RCF-SDR 355.53million) (US\$732 million)
Nepal	Emergency Credit Facility; Rapid Credit Facility	May 1, 2023 ECF-SDR 117.70 million (US\$157.40 million)	May 08, 2020 RCF-SDR 156.90 million
Myanmar	Rapid Credit Facility & Rapid Financing Instrument	January 13, 2021 (RFI-SDR 172.3 million; RCF-SDR 86.1 million)	June 26, 2020 (RFI-SDR 172.3 million; RCF-SDR 86.1 million)

Source: International Monetary Fund.

In 2019, the IMF approved an EFF to Pakistan of SDR 4268 million (about US\$6 billion) and later in the same year allowed the authorities to draw SDR 894 million (US\$1.1 billion)<sup>[44]</sup>. It has also concluded a staff-level agreement with Sri Lanka with a 48-month arrangement of US\$2.9

billion<sup>[45]</sup>. The aim of the former program back then and even today is to put the country on the path of balanced and sustainable growth<sup>[46]</sup>. The IMF requires both countries to reduce public expenditure and mobilise revenue to reduce government debt. This conditionality reflects the logic of

orthodox stabilization programs<sup>[47]</sup>, which prioritize fiscal consolidation and monetary tightening to restore market confidence, even at the cost of short-term welfare. Progressive taxation and widening the VAT and Corporate tax base would lead to higher public revenue. This would also help correct the wrongs inflicted upon the state by mindless tax cutting in Sri Lanka. Some other agendas include supporting the vulnerable section by increasing social spending and promoting economic investment by ensuring transparency and good governance practices. On the BOP front, it is required to maintain a buffer of forex reserves to protect the country from external shocks by managing the market-determined exchange rate, accompanied by the other policy programs. This reflects the “reserves-as-insurance” perspective<sup>[48]</sup>, where holding sufficient reserves is viewed as a safeguard against sudden stops and external volatility. The high inflation rate requires proactive monetary tightening along with Central Bank Reforms in Sri Lanka<sup>[49]</sup>. This would provide autonomy to the bank to carry on an effective inflation-targeting program based on real-time data.

In addition, the highest ever fiscal deficit was recorded at 7.9 percent of the GDP in Pakistan<sup>[50]</sup>, while in Sri Lanka, it is projected to be above 9.9 percent in FY 2022<sup>[51]</sup>. To reduce this, the IMF has imposed higher levies on fuel and energy conditions. The state of Pakistan’s economy suggests that not much progress has been made since the earlier program in the last three years. The finance minister has ruled out the possibility of debt structuring, as debt servicing and defence payments pile up, pushing the country further into a debt trap<sup>[52]</sup>. In Sri Lanka, greater dependency on Chinese loans and a large foreign debt-to-GDP ratio have put pressure on its reserves and led to a subsequent default on its US\$51 billion debt in April 2022. These outcomes mirror debt overhang theory<sup>[53]</sup>, which suggests that high external liabilities reduce the incentive for both governments and investors to commit to productive activities, thereby perpetuating stagnation. The pandemic and the war have further increased the challenges for both countries.

Rising tensions in Bangladesh have also made it follow its counterparts. The increased trade deficit results from increasing energy import costs while falling demand for its exports in the international market. The remittance inflow has also been hit hard amidst job losses and other problems in developed nations. Even though the forex reserves are

there for another 5–6 months, they are rapidly falling. The recent decision by Russia to stop the gas supply to Europe could worsen the overall situation by increasing inflation. Bangladesh’s power sector is reeling under pressure as power plants sit idle due to rising oil and gas shortages. The country is also facing challenges of climate change due to its low-lying structure and rampant urbanisation. As a result of the above problems, the government has sought a bailout package of US\$4.5 billion from the IMF. The deal has been finalised and the sum is to be paid in seven instalments till December 2026. Still, it would impose stringent conditions like higher energy tariffs and reduced petroleum and oil corporations’ subsidies to keep fiscal spending under control.

IMF also extended funds to Bangladesh, Nepal and Myanmar to mitigate the impact of the pandemic. Bangladesh was provided US\$732 million by the IMF in May 2020 under the RCF and RFI, while it also approved Nepal under ECF with an immediate disbursement of US\$110 million in January 2022. This came amidst a high Current account Deficit and a Fiscal deficit. The program augmented the funds of the government to carry on with its social sector programs like health sector management, food distribution, cash transfers and wage payments to sectors affected by COVID to reduce poverty and maintain economic stability. The tourism industry in Nepal and Myanmar and the textile industry in Bangladesh faced heavy losses due to the lockdown. IMF funding helped in debt restructuring and increasing efficiency in investments with a long-term goal of public finance and reserves management.

South Asian countries have long had a contentious past with the IMF, fraught with hit-and-miss policy conditions and restrictions. When India saw its worst economic crisis in 1991—a BOP crisis accompanying a high fiscal deficit and higher inflation with reserves barely enough to cover three weeks of imports—it reluctantly reached the IMF to borrow US\$2.2 billion under two standby arrangements. The structural reforms imposed under conditionality are a textbook case of structural adjustment policies, codified in the Washington Consensus<sup>[54]</sup>, which posited that liberalisation and deregulation would unleash efficiency gains. While critics of the liberalisation reforms exist, the government has attained a higher growth rate for an extended period after the reforms, along with accumulating forex reserves that rank the fifth largest in the world.

While India's history with the IMF has largely reaped successful results, the same cannot be said about its neighbours. Considering the magnitude of flood-inflicted loss on Pakistan's economy, the country requires at least US\$41 billion against the amount sanctioned by the IMF<sup>[55]</sup>. Similarly, amidst social unrest in Sri Lanka and shortages of necessities like food, fuel and medical equipment, the IMF funding will not be able to take the country fully out of the crisis. In addition, carrying on with austerity measures along with persistent inflation could give rise to recessionary circumstances in the countries. The IMF aims to restore its debt sustainability while ensuring its bilateral and other multilateral creditors develop confidence in the country. However, this could impose an additional burden on the state by increasing its debt servicing payments in the future. Sri Lanka and Pakistan today risk falling into the moral hazard trap<sup>[56]</sup>, where repeated reliance on IMF bailouts discourages domestic reform and incentivises governments to postpone politically costly adjustments. Similarly, dependency theory highlights how structural reliance on external financing—whether IMF loans or Chinese credit—locks these economies into cycles of external vulnerability and limited autonomy<sup>[57]</sup>.

Debt sustainability and policy restructuring can be achieved only if IMF assistance is complemented with matched efforts from the respective debtor nations. In the last few years, countries have not taken any serious action to improve their performance even after getting loans from multilateral lenders. For instance, many infrastructural projects in Bangladesh and Nepal have been delayed due to raw material shortages and corruption. Politics has also significantly influenced economic decision-making in Sri Lanka and Pakistan. Populist schemes of taxation and subsidies have contributed to financial instability. The countries have done little to improve the economy's fundamentals, preventing foreign and domestic investors from investing. India, on the other hand, has shown resilience over the years. Diversification of export items and destinations has reduced its dependence on a few regions while ensuring enough forex reserves. Like all other countries, the Indian government also rolled out a series of schemes during COVID to protect the vulnerable section, which drove its fiscal deficit to an all-time high. Still, the emphasis on industrial growth, manufacturing and ease of doing business has made it a favourable destination for FDI. This is not so much the case with other South Asian

economies. Excessive dependence on the developed world for essential commodities has also increased the odds of facing a similar crisis if nothing is done to address the inherent problems in the economy. The contagion observed across South Asian economies parallels crisis-transmission models<sup>[58]</sup>, where trade linkages, financial interdependence, and investor sentiment transmit external shocks regionally. The rising debt burdens and limited fiscal space seen across Pakistan, Sri Lanka, and Nepal ultimately align with debt overhang theories<sup>[53]</sup>, suggesting that large external obligations deter investment and hamper recovery in low-growth environments.

## 7. Conclusions

Trade and investment have long been the primary drivers of growth in South Asian economies, yet the post-pandemic slowdown and the Russia-Ukraine crisis have exposed deep structural vulnerabilities. While previous studies have largely examined isolated fiscal or currency crises in single countries<sup>[1, 2]</sup>, this study systematically compared multiple South Asian economies—Sri Lanka, Pakistan, Bangladesh, Myanmar, and Nepal—to identify shared open-economy risks and policy challenges. In doing so, it addresses the gap highlighted in the introduction regarding the lack of cross-country analysis in the post-pandemic context.

Our findings reveal that these countries face acute fiscal stress, balance-of-payments pressures, and depreciating currencies, amplified by political instability, structural imbalances, and over-reliance on external financing. Monetary tightening to counter inflation has crowded out investment, slowing growth, while high import dependence and heavy external debt have heightened vulnerability to external shocks.

It was found that a crucial role is played by trade in driving these economies out of their low- and middle-income traps. Trade contributes to a significant fraction of GDP, and hence it is imperative that necessary measures are undertaken to promote an environment that facilitates the flourishing of trade. Diminishing trade in the face of geopolitical friction, rising prices and a global slowdown has taken a toll on the national income of these emerging economies. Considering the geographical setting, regional cooperation and joint action seem to be a plausible exit strategy from the imminent crisis. It is also evident that South Asian economies are fac-

ing an acute crisis. Vulnerabilities have grown due to the depletion of forex reserves, rising import bills, and foreign debt servicing. Therefore, it is necessary to manage fiscal spending and rebuild forex reserves. This would require the countries to work on their import dependence in the short run while focusing on domestic production in the long run, in addition to cutting down and diversifying foreign debt to help reduce the servicing commitment in the future. Managing the current political and economic situation will involve fiscal consolidation with an immediate focus on increasing revenue via reimposing taxes on high-income groups. Higher social spending to reduce the impact on the poor section and at the same time minimise corruption susceptibility through fiscal transparency and a public financial management system is necessary to stabilise the economy.

Looking ahead, a comprehensive policy restructuring program, coupled with support from both the IMF and the World Bank, is essential for reviving disintegrating economies and steering them out of recession. While IMF programs can help build internal resilience and reduce dependence on multilateral lenders, their effectiveness will rely on complementary domestic reforms, particularly in the tax and banking sectors. Fiscal consolidation should be prioritized to reduce state pressure and create space for targeted social sector initiatives, while expanding direct and indirect tax revenue can lower fiscal deficits and foreign debt ratios. Reducing reliance on global markets for food and energy through renewable power generation and domestic food self-sufficiency will enhance economic stability, and investing in infrastructure with stronger transparency and anti-corruption measures will accelerate project completion and improve supply chain management. The path to sustainable growth in South Asia will therefore require joint efforts from multilateral institutions and domestic policymakers, focusing on structural reforms, economic diversification, and institutional strengthening to build long-term resilience. Finally, by systematically analysing these economies side by side, this paper provides a cross-country, post-pandemic perspective on open-economy vulnerabilities in the South Asian neighbourhood, directly filling the research gap identified at the outset. However, the study is limited by its reliance on secondary data and qualitative assessments, which may not fully capture the dynamic and rapidly evolving economic conditions in each country. Future research could build on

this foundation by conducting country-specific case studies, applying quantitative methods to empirically test the relationships highlighted here, or integrating high-frequency data to examine short-term shocks and policy responses more precisely. Addressing these limitations would further strengthen the understanding of fiscal, monetary, and external sector vulnerabilities in South Asian economies.

## Author Contributions

All tasks including conceptualization, methodology, validation, formal analysis, investigation, resources, data curation, writing—original draft preparation, writing—review and editing, visualization, supervision, and project administration, were shared between S.B. and A.R.B. equally. All authors have read and agreed to the published version of the manuscript.

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All data used for analysis in the study has been cited and is publicly available.

## Conflicts of Interest

The authors declare no conflict of interest.

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