

Current Economic Crisis in Sri Lanka, External Help and India's Credit Line

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Introduction

The current crisis of Sri Lanka lies in the economic mismanagement by the Sri Lankan governments. The main outcome of the crisis is balance of payment crisis. That means very low foreign reserve to foot the import bill. The present crisis was deepened by a substantial tax cut by the current Rajapaksa government as promised by an earlier election campaign in 2019 before the pandemic. This government decision considerably reduced the income of the present government. The tourism industry of Sri Lanka was badly hit by the Easter bombing in a church that affected the tourist inflow to the country. Tourism industry of Sri Lanka is the major foreign currency earner of the country. Another source of foreign earnings is the remittances from Sri Lankan workers working abroad which was affected by the COVID 19 pandemic. We can say that the current economic crisis of Sri Lanka was because the cumulative impact of factors mentioned above.

Background of the Crisis

The Sri Lankan government has borrowed vast sums of money from foreign lenders for various projects over the years. These borrowings has coincided with a series of blows to the Sri Lankan economy, from both natural disasters -- such as heavy monsoons -- to a government ban on chemical fertilizers that affected agricultural products. These problems were compounded in 2018, when the President's dismissal of the Prime Minister sparked a constitutional crisis in Sri Lanka and with that of the Easter bombings of 2019 and COVID 19 pandemic from 2020 onwards.

President Gotabaya Rajapaksa slashed taxes in an attempt to stimulate the economy. But the move backfired because of the low collection of taxes. Sri Lanka then had to fall back on its foreign exchange reserves to pay off government debt, shrinking its reserves from \$6.9 billion in 2018 to \$2.2 billion in 2022. This impacted imports of fuel and other essentials, which sent prices soaring. A severe shortage of foreign currency has left Rajapaksa's government unable to pay for essential imports, including fuel, leading to power cuts lasting up to 13 hours. To tide over the problem Sri Lankan government steeply devalued its currency ahead of talks with the International Monetary Fund (IMF) for a loan programme.

The Sri Lankan government also faced a massive political crisis with the resignation of entire cabinet on 3 April 2022 including the relatives of the President. There was massive defection of ruling party Member of Parliament to the opposition camps of the government. President Gotabaya tried very hard to form a national government with opposition parties but that also did not work out. President's own brother the Prime Minister Mahinda Rajapaksa also had to resign

because of the massive protest by the citizens. Recently a new government is installed under the Prime Ministership of Ranil Wikremesinghe.

External Support

India

Sri Lankan government tried to get help from various countries including India. Rajapaksa government was interested to get oil and loan from the Indian government. Sri Lanka and India have signed a \$1 billion credit line for importing essentials, including food and medicine. The Rajapaksa government has sought at least another \$1 billion credit from India. India has supplied over 270,000 MT fuel to Sri Lanka so far to help ease the power crisis in the island country. Sri Lanka is experiencing massive power shortages in recent times. There are long lines for cooking gas and other food items by the people at the shops.

India has announced another \$1 billion as a credit to Sri Lanka to help shore up the sinking economy of the island nation. The \$1 billion line of credit to Colombo will help in keeping their food prices and fuel costs under check.

China

China is currently involved in more than 50 projects in Sri Lanka. These are Hambantota and Colombo Port City, both of which have been given for 99 years of lease to China. It is a part of Belt and Road initiative of China. Chinese economic support for Sri Lanka was never meant only for trade and economic considerations. It was always a means to play a larger role in the region and to some extent check the rise of India. Foremost importance for Chinese is to safeguard the sea line for its trade especially the energy supply.

China is now the second-largest lender to Sri Lanka. China was holding more than 10 per cent of Sri Lanka's outstanding foreign debt till 2019. China became the largest investor in Sri Lanka between 2010 and 2020, displacing India from the position. China is also importing large amount of goods from Sri Lanka. Sri Lanka became closer to China despite the strong warning from India.

Sri Lankan efforts to restrict foreign debt obligations did not find favour with China. Beijing's current assistance offer is primarily to make Sri Lanka clear its previous dues to China. China was reluctant to help further Sri Lanka in this regard. China provided initial financial assistance for infrastructure development of Sri Lanka. But later on its assistance was used in budgetary support and mitigating the balance-of-payments crisis. This transition in the nature of financial support was allowed to thrust Sri Lanka deeper into the Chinese 'debt trap'. China has always had an eye on projects in the northern islets of Sri Lanka to come closer to India and offset New Delhi's advantages in the Indian Ocean region.

China is currently facing its own economic troubles, with lockdowns to contain the country's worst Covid outbreak since early 2020. Many of the companies are shutting down the technology and financial hubs of Shanghai and Shenzhen. China is worried and apprehensive about its economic growth in the current year. Therefore any action and initiative taken by China with regard to Sri Lanka will be misinterpreted. China is waiting for other actors specially IMF to take the initiative first.

IMF

Sri Lanka has requested loans from the IMF to ease the current financial crisis. The loan from IMF will be used for the import and to augment the depleting foreign reserves. But the negotiation with IMF is going on and no final outcome has come. On the political front, there was a political crisis with no cabinet for some time. Recently a new Prime minister and a cabinet are appointed. To add to the woes, there was no finance minister to take charge of negotiation with IMF and other countries for help. Recently the Prime Minister was given charge of Finance Ministry to negotiate with possible donors. Sri Lanka must tighten monetary policy, raise tax and adopt flexible exchange rates to address its debt crisis, according to IMF.

The former Sri Lankan Finance Minister Ali Sabry was in Washington recently to talk to the IMF, the World Bank, and others about financial help for his country, which has suspended payments on portions of its \$51 billion in external debt.

Conclusion

The current Sri Lankan crisis is the combination of various factors. The Easter bombing and COVID pandemic were responsible initially for the crisis. Because of the terrorist attack, tourists' visits to Sri Lanka considerably declined in recent past. As a result, the country lost a huge amount of foreign earnings as Sri Lanka was very much dependent on income from the tourism sector.

The pandemic is also responsible for the economic decline of many countries including Sri Lanka. Because of the pandemic, the internal production and external trade were hampered. The export, which is the main source of foreign earnings, was also declined. This affected the foreign reserve of the country.

The present government of Sri Lanka is also responsible for the mismanagement of the economy of the country. The huge tax cuts and the ban on the import of fertilizer are responsible for the sharp decline in the income of the country as well as the production of food crops. Once the foreign reserve dwindled, the government could not import essential items like oil and food stuffs from abroad, resulting in shortages of essential commodities. The government negotiated with IMF at the last hour for the bailout package. But the negotiation is still continuing, so is the hardship for the common people. The prices of all the essential items are skyrocketing and even not available in the market.

Sri Lankan government should take necessary steps to tide over the current crisis. The negotiations with IMF and other donors should be quickly done to help the common masses. In the meantime, the government of Sri Lanka should undertake policy reforms to resolve the crisis. In this regard, the government can bring in the Sri Lankan diaspora living abroad for help.

India is trying to help Sri Lanka in a best possible way. India and Sri Lanka have a historical, cultural, and civilizational relationship. There are many ups and downs in the relationship between India and Sri Lanka. In the recent past, Sri Lanka was trying to get closer to China for greater financial investment through Belt and Road Initiatives (BRI). On the other

hand India cannot match China in terms of financial clout. But the Chinese investments are all loans with high interest rates. The problem started with the repayment of loans with interests. Sri Lanka realised the gravity of situation much later when it became full blown. India as a good neighbor is trying to help Sri Lanka with aid, loan and essential supplies like oil, medicines and food stuffs. But India has its limitations and capacity to help Sri Lanka for a longer period of time. Sri Lanka has to tighten its belt and take necessary steps to resolve the economic crisis.

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