



## Sri Lanka's Economic Crisis

This editorial is based on [“Explaining Sri Lanka's economic crisis”](#) which was published in The Hindu on 31/03/2022. It talks about the causes of the economic crisis in Sri Lanka and India's role as the country's immediate neighbour.

**For Prelims:** India-Sri Lanka Relations, Forex Reserves, Debt to GDP Ratio, Fiscal Deficit, Sri Lanka's Civil War, Palk Bay

**For Mains:** Economic Crises in Sri Lanka, India-Sri Lanka Relations, India's Assistance and Role in solving the crisis in Sri Lanka, Significance of Sri Lanka for India

The [Sri Lankan economy](#) has been facing a crisis owing to a serious [Balance of Payments \(BoP\)](#) problem. Its [foreign exchange reserves](#) are depleting rapidly and it is becoming increasingly **difficult for the country to import essential consumption goods**.

The current Sri Lankan economic crisis is the product of the **historical imbalances in the economic structure**, the [International Monetary Fund \(IMF\)](#)'s **loan-related conditionalities** and the misguided **policies of authoritarian rulers**.

### Why is Sri Lanka Suffering from Crisis?

- **Background:** When Sri Lanka emerged from a [26-year long civil war in 2009](#), its post-war GDP growth was reasonably high at 8-9% per annum till 2012.
  - However, its average **GDP growth rate almost halved after 2013** as **global commodity prices fell, exports slowed down and imports rose**.
  - Sri Lanka's budget deficits were high during the war and the **global financial crisis of 2008** drained its forex reserves which led to the country borrowing a **loan of \$2.6 billion loan from the IMF** in 2009.
  - It again approached the IMF in 2016 for **another US\$1.5 billion loan**, however the **conditionalities of the IMF** further deteriorated Sri Lanka's economic health.
- **Recent Economic Shocks:** The **Easter bomb blasts of April 2019** in churches in Colombo resulting in 253 casualties, consequently, **dropped the number of tourists sharply** leading to a decline in foreign exchange reserves.
  - The newly led government by Gotabaya Rajapaksa in 2019 **promised lower tax rates and wide-ranging SoPs for farmers** during their campaign.
    - The **quick implementation of these ill-advised promises** further exacerbated the problem.
  - The **Covid-19 pandemic in 2020** made the bad situation worse -
    - Exports of tea, rubber, spices and garments suffered.
    - Tourism arrivals and revenues fell further

- Due to a rise in government expenditures, the **fiscal deficit** exceeded 10% in 2020-21, and the **debt to GDP ratio rose from 94% in 2019 to 119%** in 2021.
- **Sri Lanka's Fertiliser Ban:** In 2021, all fertiliser imports were completely banned and it was declared that Sri Lanka would **become a 100% organic farming nation overnight**.
  - This overnight shift to organic fertilisers heavily impacted food production.
  - Consequently, the Sri Lankan President declared an **economic emergency to contain rising food prices**, a depreciating currency, and rapidly depleting forex reserves.

The lack of foreign currency, coupled with the disastrous overnight ban on chemical fertilisers and pesticides, has sent food prices soaring. **Inflation is currently over 15% and is forecast to average 17.5%**, pushing millions of poorer Sri Lankans to the brink.

## How has India Assisted Sri Lanka in this Crisis?

- Beginning January 2022, **India has been providing crucial economic support** to the island nation in the grip of a severe dollar crisis that, many fear, might lead to a sovereign default, and a severe shortage of essentials in the import-reliant country.
- The **relief extended by India** from the beginning of 2022 **totals over USD 1.4 billion - a USD 400 million currency swap**, a **USD 500 million loan deferment** and a **USD 500 million Line of Credit for fuel imports**.
- More recently, India **extended a USD 1 billion short-term concessional loan** to Sri Lanka to help the country as it faces an unprecedented economic crisis.

## Why Helping Sri Lanka is in India's Interests?

- Crucially, any disillusionment in Sri Lanka with China **eases India's effort to keep the Lankan archipelago out of China's 'string of pearls' game** in the **Indo-Pacific**.
  - It is in India's interest to contain Chinese presence and influence in this region.
- To the extent India can extend low-cost **help to alleviate the hardships of Sri Lankans**, it should, however it must be done with due care keeping in mind that the **optics of its aid** matters too.

## What Can Be the Way Forward?

- **Measures for Sri Lanka:** The government should take **measures for economic recovery** of the country **as soon as the shortage of certain essential commodities ends**, which is expected before the start of the Sinhala-Tamil New Year (in mid-April).
  - The government should also **join hands with the Tamil political leadership to create a roadmap for the economic development** of the war-affected northern and eastern provinces, among the areas badly hit by the current crisis.
  - It would be best to **raise domestic tax revenue and shrink government expenditure to limit borrowing, particularly sovereign borrowing** from external sources.
    - Tough measures should be taken for **restructuring the administration of concessions** and subsidies.
- **India's Assistance:** It would be completely unwise for India to let the Chinese take over expanding chunks of Sri Lankan territory. India must **offer Sri Lanka financial help, policy advice and investment from Indian entrepreneurs**.
  - Indian businesses must **build supply chains** that intertwine the Indian and Sri Lankan economies in goods and services ranging from the export of tea to information technology services.
  - India, rather than any other nation, should **help steer Sri Lanka towards realising its potential**, to reap the rewards of a **stable, friendly neighbourhood**.
- **Preventing Illegal Refuge:** The state of Tamil Nadu has already started feeling the impact of the crisis with the **reported arrival of 16 persons from Sri Lanka through illegal means**.
  - Tamil Nadu was home to nearly three lakh refugees after the **anti-Tamil pogrom of 1983**.
  - The authorities, both in India and Sri Lanka, should **ensure that the present crisis is not used to step up smuggling activities** and trafficking or whip up emotions in both

countries.

- **Crisis as an Opportunity:** Neither Sri Lanka nor India can afford to have strained ties. As a much larger country, the **onus is on India**, it needs to be extremely patient and engage Sri Lanka even more regularly and closely.
  - There is also a need to **step up our people-centric developmental activities** while scrupulously staying clear of any interference in Colombo's domestic affairs.
  - The crisis should be used as an opportunity for New Delhi and Colombo to thrash out a **solution to the [Palk Bay fisheries dispute](#)** - a longstanding irritant in bilateral ties.

### ***Drishti Mains Question***

"Amid the ongoing economic crisis in Sri Lanka, India must offer Sri Lanka financial help, policy advice and investment from Indian entrepreneurs. It is in India's interest to contain Chinese presence in the country". Comment.

## **UPSC Civil Services Examination, Previous Year Questions (PYQs):**

### **Q. Consider the following statements: (2020)**

1. The value of Indo-Sri Lanka trade has consistently increased in the last decade.
2. "Textile and textile articles" constitute an important item of trade between India and Bangladesh.
3. In the last five years, Nepal has been the largest trading partner of India in South Asia.

### **Which of the statements given above is/are correct?**

- (a) 1 and 2 only
- (b) 2 only
- (c) 3 only
- (d) 1, 2 and 3

**Ans: (b)**

### **Q. Three of the following criteria have contributed to the recognition of Western Ghats, Sri Lanka and Indo-Burma regions as hot-spots of biodiversity: (2011)**

1. Species richness
2. Vegetation density
3. Endemism
4. Ethno-botanical importance
5. Threat perception
6. Adaptation of flora and fauna to warm and humid conditions

### **Which three of the above are correct criteria in this context?**

- (a) 1, 2 and 6
- (b) 2, 4 and 6
- (c) 1, 3 and 5
- (d) 3, 4 and 6

**Ans: (c)**

### **Q. Elephant Pass, sometimes seen in the news, is mentioned in the context of the affairs of which one of the following? (2009)**

- (a) Bangladesh
- (b) India

- (c) Nepal
- (d) Sri Lanka

**Ans: (d)**

PDF Reference URL: <https://www.drishtias.com/printpdf/sri-lanka-s-economic-crisis>