

SRILANKA – TROUBLE IN PARADISE



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Context

- Sri Lanka is going through a **catastrophic economic crisis**, with widespread **public unrest and suffering** that necessitates immediate action.

A summary of the Sri Lankan crisis

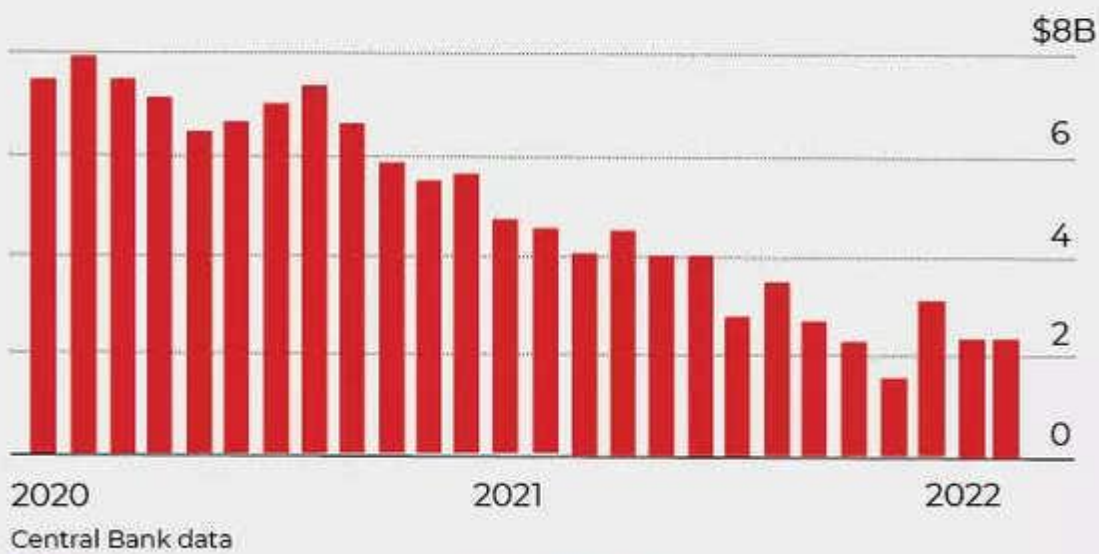
- The massive economic crisis in Sri Lanka is thought to have a strong **political undercurrent**.
- This is likely the source of people's dissatisfaction with the government of **Gotabaya Rajapaksa**, whose leadership has been called into doubt on the basis of **accountability and credibility**.
- To deal with the public uproar, **Sri Lanka's president imposed a 36-hour curfew, which many protestors refused to accept**.
- The **President declared a state of emergency**, which **sparked more rallies and was criticised** by opposition leaders. As a result, the **state of emergency was lifted**.
- There are **long queues for fuel, cooking gas, and other needs, as well as long periods of power outages**.
- Many officials resigned from their positions as the ruling political leadership failed to maintain the people's faith, with **41 parliamentarians leaving the ruling party's alliance**.

The Crisis's Possible Causes

- The main causes of the ongoing economic crisis, according to analysts, are **economic mismanagement and a lack of realistic financial policy.**
- A **budget shortfall**, which means the **country's national expenditure has surpassed its national income, as well as a current account deficit**, has resulted from mismanagement.
- Sri Lanka's foreign exchange reserves have **plummeted by 70% to \$2.31 billion**, leaving the country unable to **import basic necessities** such as food and fuel.
- Rajapaksha **promised deep tax cuts during the 2019 election campaign**, and their implementation has wiped off a significant portion of the GDP.
- The pandemic also **lowered the value of Sri Lanka's wealthy tourism business and remittances from overseas workers**. Credit rating agencies responded by keeping the country out of international financial markets.
- The government's decision to **prohibit the use of all chemical fertilisers** had **an impact on the agricultural industry, resulting in a decrease in the production of vital rice crops.**
- Sri Lanka's foreign debt is dominated by **international sovereign bonds**, which account for \$12.55 billion and are held by the **Asian Development Bank (ADB), Japan, and China, among others.**
- The government has **ignored the economic problem from the beginning and has refused to seek aid and guidance from IMF experts.** The situation was exacerbated as **oil prices skyrocketed as a result of Russia's invasion of Ukraine.**

Tumbling Reserves

Sri Lanka's forex reserves depleted after two years of the pandemic



Current Account Deficit

- The current account accounts for the inflow and outflow of products, services, and investments into and out of a country.
- It is a component of a country's Balance of Payments, just like the capital account, and indicates a country's foreign transactions (BOP).
- If the value of goods and services imported exceeds the value of those exported, there is a current account deficit.
- The formulae for calculating CAD is
- **Current Account = Trade gap + Net current transfers + Net income abroad**
 - Trade gap = Exports – Imports

Olive Branch to Sri Lanka

- Both India and China have offered assistance to Sri Lanka at this time of distress.
- A \$500 million credit line has been agreed with India, and a diesel supply will come to cover the fuel demand.
- India and Sri Lanka have agreed to a \$1 billion credit line for the purchase of basics such as food and medication. Sri Lanka has made a request to New Delhi for an additional \$1 billion.
- The Central Bank of Sri Lanka has received a \$1.5 billion swap and a \$1.3 billion syndicated loan from China.
- A credit facility of \$1.5 billion and a supplementary loan of up to \$1 billion have also been guaranteed by China.

How is it an opportunity for India?

- The economic crisis in Sri Lanka has the potential to allow India to expand its influence in its neighboring region, which is crucial to India's national interests.
- During the period 2005-15, the India-Sri Lanka relationship deteriorated, notably after India accused the government of human rights breaches during the three-decade-long civil conflict.
- A 99-year lease has been granted to Beijing for the disputed Hambantota port and over 15,000 acres of land which China will use these ports as important places to operate in the Indian Ocean region, which was a huge issue for India.
- The Sri Lankan administration began to develop its predisposition towards India after realising the limitations of economic and geopolitical collaboration with China.
- Sri Lanka's declaration of a "India first" policy sent a pro-India message, noting that India has always stepped in to help the island country in times of need.
- The recent economic crisis in Sri Lanka may provide India with an opportunity to reestablish the spirit of its Neighbourhood First policy and extend its assistance.

What is the way forward?

- Sri Lanka's monetary policy needs to be **overhauled to deal with the country's huge current account deficit and rapidly dwindling foreign reserves.**
- Sri Lanka's **internal economy must be modernised and transformed** because the country has no place in the global industrial supply chain.
- Sri Lanka's export sector, which is now **dominated by textiles and agricultural products such as tea and rubber, needs diversification,** and it is past time to broaden the scope of exports.
- The country must put **measures in place to encourage the manufacture of key goods** for which it is heavily reliant on imports.
- At this time, the **focus must be on establishing social stability,** which is necessary for other advancements to occur.
- Sri Lanka should make **long-term strategic decisions with its tried-and-tested partners.**
- Through a responsible administration backed by accountability that ensures **inclusive growth, the spirit of independence, self-improvement, unity, and mutual help among bilateral partners** must be revived in the country.

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