

Sri Lanka Crisis

[UPSC Notes]

Why is Sri Lanka Facing Crisis?

Sri Lanka is going through the most damaging economic predicament for the first time in history. The condition the Sri Lankan economy faces today is a culminated effect of years of backwardness.

- The primary causes are poor economic management, corruption, and agricultural policies.
- The crisis took shape in 2019 following the suicide bombings, which resulted in a significant drop in tourism. In addition, the immediate implementation of new policies promised during the 2019 and 2020 elections on tax cuts affected the government's revenue.
- With the severe problem of a shortage of foreign currency in early 2021, the Sri Lankan government declared the country to be facing the worst economic crisis.
- The country faced a balance of payments (BoP) problem, and the depletion of foreign exchange reserves made the process of essential goods more expensive.
- The condition got worse after the pandemic in 2020. All of these resulted in raising the cost of living.
- Gradually, it was accompanied by a food shortage, which can be viewed as a result of both the implementation of the organic farming policy and the country's economic condition.
- People got triggered by these unbearable living conditions and objections across the country. A situation of political uncertainty prevailed due to the demonstration of protest, which later grew to the extent of storming the prime minister's office.
- This pressured the President and prime minister to pledge their resignation. But then, President Gotabaya Rajapaksa fled from Sri Lanka without giving his resignation application.

Reasons for Sri Lanka Economic Crisis:

Various factors result in Sri Lanka Economic Crisis, and we have mentioned them all below.

Civil War Repercussions

- The expenses of the civil war between 1983 and 2009 had a significant impact on the foreign exchange reserves. The internal war expense is predicted to be around \$ 200 billion.

- This is often blamed on the mismanagement of the government. Once the war ended, the country preferred the domestic market instead of concentrating on improving foreign trade. This made the imports higher than the exports, which means more expenses.
- Between 2012 and 2013, the period post-war saw a decline in the average GDP growth rate, which almost halved due to the price fall of global commodities, an increase in imports, and a reduction in exports.
- On the whole, the expenses of the war and the global financial crisis led the country to borrow from the International Monetary Fund (IMF) in 2009 and later in 2016. But unfortunately, the terms and conditions of the IMF made the country's condition even poorer.

Effects of a shift to organic farming

- By June 2021, the Sri Lankan government announced a National Agricultural policy to promote the use of organic fertilizer.
- Their ultimate aim was to make their country the first to produce 100% organic agricultural products. So they imposed a ban on chemical fertilizers, insecticides, and pesticides overnight.
- However, though the idea and purpose were appreciable, it was still unrealistic and might bring a negative impact by making an immediate transfer.
- Many people disagreed with this policy, especially those of scientific and agricultural backgrounds.
- Organic farming is expensive, dependent on rainfall, and a complex process to practice. Ultimately this resulted in a food shortage as the agricultural produce was reduced. The farming industry's production was reduced by 50%.

Decline in tourism

- The bomb blast of 2019 and the pandemic contributed to a gradual decline in tourism, a major source of revenue for Sri Lanka.
- Tourism in Sri Lanka accounts for 12% of its GDP. Tourism directly or indirectly employs Sri Lankans. This has been steadily increasing until the year 2019, during which fell by more than 70% due to a suicide bomb blast in Colombo.
- On Easter day, April 21, 2019, the island was subjected to a series of bomb blasts in the island nation. Churches and luxury hostels in the capital Colombo were targeted.
- Eighteen places were targeted, including housing and guest houses in other regions. Almost 269 citizens were slaughtered, counting 45 foreigners. Also, more than 500 people were severely injured. This set a sense of fear, resulting in the decline of foreign tourists.
- The pandemic, later followed by Ukraine-Russia, has severely affected the line of tourism in Sri Lanka.

China's Debt trap Policy

- Amidst other factors, it is evident that many blame China for being the sole reason for Sri Lanka's economic crisis. Hence, it has been popularly referred to in the media as "debt trap diplomacy".
- According to this theory, the creditor keeps on extending or otherwise is free to lend to more borrowers for their personal or political beneficiary, which leaves the borrower in a state where they will not be in a condition or pushed to a situation where they will not be able to pay back the money. Thus the borrower becomes prey to the creditor.
- The loan for the construction of Hambantota port is a significant factor in the economic downfall. Sri Lanka borrowed a loan from China to construct this port, but the port ended up running at a loss. As a result, Sri Lanka had no other go but to lease the port to China for 99 years. It's a sort of political strategy by China.

Foreign Exchange Reserves

- The primary reason Sri Lanka ran out of foreign currency was that income from exports remained low, whereas the expenses of imports increased.
- The government again blamed this for improper management, which concentrated on the internal market instead of promoting foreign trade.
- The country imports \$ 3 million more than the exports. The foreign exchange reserves saw a drastic decline rescued by 70% over the past two years and ended at US \$ 2 billion in February 2022. In contrast, the country had a US \$ 7 billion foreign debt.

Impact of Ukraine- Russia war

- For its part, the Russia- Ukraine war contributed to the downfall of the island nation's economy.
- Sri Lanka is a country that is widely dependent on its imports for products, right from medicine to fuel.
- As the war between Ukraine and Russia has resulted in a price hike of fuel, the world is facing the effects, and in the case of Sri Lanka, it has worsened the condition.
- It has raised the fuel price by 60%. This has left the people to stand in queues to buy fuel. The rise in oil prices has also affected the production of electricity. Factories have been shut down as they ran out of fuel.

Effects of Tax Cuts

- Tax cuts remain one of the major contributing factors to the economic crisis faced by Sri Lanka.

- In the November 2019 election, Gotabaya Rajapaksa announced a tax cut as one of his promises in election propaganda.
- This Rajapaksa is often criticised for making such an unrealistic plan. The value added tax was also reduced from 15 per cent to 8 per cent.
- The taxpayer dropped from 1,550,000 in 2020 to 412,000 in 2021. Thus Sri Lanka lost 500,000 of its taxpayers, which led to a loss of government income of more than \$ 1.4 billion.

Steps Taken to Face the Sri Lanka Crisis

As the Island country has been facing a severe crisis and due to the rising distress among the people, President Gotabaya Rajapaksa fled from the country, leaving the position of President to Prime minister Wickremesinghe. Ranil Wickremesinghe announced a curfew until the situation came under control.

Ranil Wickremesinghe has decided to make the state-owned airlines privatized and proposed to print money to pay the employees. However, it was also added that this decision would further increase inflation, resulting in a price hike. And as the oil price is concerned, the country has asked for a low price for oil supply from Qatar and Russia.

World's Contribution to Help with the Sri Lanka Economic Crisis

As the country owes \$ 51 billion, many foreign lenders, including China, have decided to reconstruct the loans. The G7 countries have decided to help Sri Lanka with debt repayments. The IMF also discusses providing a loan for Sri Lanka, whereas the World Bank has decided to lend \$ 600 million.

India, for its part, has decided to lend \$ 1.9 billion to help the country in the process of exporting essentials. In addition, India has agreed to extend \$ 500 million for fuel purchasing.

Impact of Sri Lanka Crisis on India

The impacts of the Sri Lanka Crisis can be seen in India as well.

Colombo Port

One of the significant aspects concerning India because of the Sri Lankan crisis is the Colombo Port. Colombo Port is one of the essential ports for India as it handles more than 30% of its container traffic and 60% of transshipment. However, since the Island nation is facing severe economic backlash, they cannot transfer the container. Due to this, thousands of containers and several transshipments of India are stagnant there.

Refugee crisis

- To address the ongoing economic crisis, India and several other countries, along with international organisations, have extended their helping hands to Sri Lanka.
- However, still, it isn't enough for the nation to revive itself to a stable position yet. Also, going through history, one of the essential aspects to be observed is that whenever there is a crisis in Sri Lanka, refugees tend to come into India from the island nation.
- At present, it has been recorded that about 16 refugees have fled Sri Lanka and arrived at Tamil Nadu through illegal means due to the effects of the economic crisis.
- If the situation persists, then India might witness an increased number of refugees from Sri Lanka. This would put India in a socially and economically tricky position.

Business

Due to Sri Lanka's poor condition of foreign exchange reserves and fuel shortage, several automotive firms like Tata Motors, Mahindra & Mahindra, Ashok Leyland, and TVS Motors have ceased the exports of vehicle kits and also stopped production in the assembly units situated in Sri Lanka. Also, Sri Lanka's share in India's total export has reduced to 1.3 percent.

Tea Market

Sri Lanka is recognized among the major suppliers of orthodox tea to the world market. But, the current situation has drastically affected the production and supply to the market, resulting in a condition where many foreign buyers are turning to India. Importers from Turkey, Iran, Iraq and Russia are reportedly visiting Kolkata and Assam. This has led to a rise in the orthodox leaf's average price by 41 % compared to the past year's sales.

Apparel sector

Sri Lanka's apparel sector is facing a severe threat due to the crippling economic condition. The manufacturers and exporters cannot import raw materials, which has led to a decline in apparel exports. The apparel export contributes to 44% of the country's total export. But the market is witnessing a downward trend in export value.

Due to this, the United Kingdom and many countries of Latin America have turned towards India for the apparel market. As a result, Tirupur, the textile industry hub of Tamil Nadu, has received several orders from these companies.