JETIR.ORG ISSN: 2349-5162 | ESTD Year : 2014 | Monthly Issue
JOURNAL OF EMERGING TECHNOLOGIES AND INNOVATIVE RESEARCH (JETIR)
An International Scholarly Open Access, Peer-reviewed, Refereed Journal

Economic and Political Crisis in Sri Lanka and India's Role

Dr. Bharati Hiremath

Head and Coordinator, Department of International Relations
Maharaja's College, University of Mysore, Mysuru

Abstract:

The Sri Lankan crisis which is considered as the worst economic situation for Sri Lanka since its independence in 1948 is began in 2019. It resulted in soaring inflation, nearly empty foreign exchange reserves, shortages of medical supplies, and higher prices for basic goods. The paper examines the economic and political crisis in Sri Lanka and India's role in addressing it. It sheds light on the causes and consequences of Sri Lanka's economic and political collapse, India's assistance to Sri Lanka and its broader implications, the role of China and international actors in Sri Lanka's crisis and the potential for Sri Lanka to adopt governance reforms. The descriptive and analytical methods are followed in this paper.

Key Words: Russia-Ukraine war, Nation Building Tax, Global Supply Chain, Sri Lankan Crisis

1. Introduction

Due to insufficient foreign exchange reserves, Sri Lanka faced sovereign default in March 2022. In June 2022, Prime Minister Ranil Wickremesinghe declared the economy had collapsed leaving it unable to afford essentials. The paper examines the economic and political crisis in Sri Lanka and India's role in addressing it. It provides insights into Sri Lanka's economic collapse, the governance crisis, and India's diplomatic and economic interventions.

2. Understanding Sri Lanka's Economic Collapse: Key Causes of the Crisis

The economic crisis in Sri Lanka did not occur overnight but resulted from a combination of structural weaknesses, poor policy decisions, and external shocks. Internal and external factors such as COVID-19 and Russia-Ukraine War worsened the Sri Lanka's condition. Some of the factors are explained below.

Historical Dependence on Borrowing

Sri Lanka heavily borrowed from China, the World Bank, and other international lenders for infrastructure projects like Hambantota Port and the Mattala Rajapaksa Airport. Many of these projects were economically unviable and created a debt trap. The country's external debt reached 119% of GDP by 2021, making repayment impossible.

Tax Cuts and Fiscal Mismanagement

In 2019, President Gotabaya Rajapaksa implemented drastic tax cuts, reducing VAT from 15% to 8%, abolishing the Nation Building Tax (NBT), 28% to 24% reduction in Corporate Tax and eliminating the economic service charge. Such tax cuts led to a 50% drop in indirect tax revenue, worsening the budget deficit. This led to worry among lenders and made it harder for the Sri Lankan economy.

The Impact of the COVID-19 Pandemic

Tourism, one of Sri Lanka's primary sources of revenue, collapsed due to travel restrictions, prolonged and extended lockdowns. Exports of tea and garments, another major source of foreign exchange, also declined. Remittances from Sri Lankan workers abroad fell sharply, reducing foreign currency inflows. Sri Lanka's tourism industry generated USD 4,380.6 million in 2018, and it dropped to USD 507 million in 2021.

Foreign Exchange Shortages and Fuel Crisis

Sri Lanka relied on imports for essential goods, including fuel, medicine, and food. Due to foreign exchange shortages, the country couldn't pay for imports, leading to severe shortages and power cuts of up to 15 hours per day.

Misguided Agricultural Policies

In 2021, the government banned both the import and use of chemical fertilizers, forcing farmers to switch to organic farming overnight. This decision cut food production by nearly 50%, increasing inflation and worsening food insecurity. The decreased agricultural production impacted the country's economy causing food prices to soar and in turn affecting the already struggling economy.

Russia-Ukraine War and Global Inflation

The war in Ukraine has had a severe impact on Global Supply Chain and on International Peace and Stability. Ukraine and Russia account for 2.2% and 2% of Sri Lanka's exports and imports in 2020, respectively. Rising fuel and food prices due to the Ukraine war worsened Sri Lanka's import bill. Inflation reached nearly 40%, making daily life unaffordable for citizens. Sri Lankan exports to Russia declined 41% from 46 million kg in 2013 to 27 million kg in 2021.The increase in crude oil prices also impacted Sri Lanka's energy sector severely leading to energy insecurity.

3. The Political Crisis and Governance Failure

Sri Lanka's economic crisis soon turned into a political crisis, with mass protests demanding the resignation of the Rajapaksa government.

Rajapaksa Family's Role

The Rajapaksa dynasty dominated Sri Lankan politics, with Gotabaya Rajapaksa as President and Mahinda Rajapaksa as Prime Minister. Widespread corruption, nepotism, and authoritarian rule alienated the public. Protesters accused the Rajapaksas of mismanaging the economy and serving Chinese interests over national interests.

Mass Protests and Government Resignations

Starting in early 2022, thousands of protesters gathered in Colombo under the slogan "Gota Go Home", demanding the resignation of President Gotabaya Rajapaksa. On May 9, 2022, violent clashes erupted between government supporters and anti-government demonstrators. Mahinda Rajapaksa resigned, and later, Ranil Wickremesinghe was appointed as the new Prime Minister.

The Role of Sri Lankan Military

While Sri Lanka has historically avoided military coups, concerns grew that the army might intervene in politics. However, the military largely remained neutral, despite sporadic crackdowns on protesters.

4. India's Role in Sri Lanka's Crisis

India has played a crucial role in helping Sri Lanka during its economic collapse, aligning with its Neighborhood First Policy.

Economic Assistance Provided by India

India emerged as the first responder to Sri Lanka's crisis, providing over $3.5 billion in financial aid, including:

- Credit lines for essential imports like fuel, food, and medicines.
- A currency swaps arrangement to stabilize Sri Lanka's foreign reserves.
- Emergency supplies of fuel and food to mitigate shortages.
- Support for IMF negotiations to secure a bailout package.

India's Strategic Interests

India's assistance is not just humanitarian—it is strategically motivated:

- Preventing Chinese dominance: India does not want China to expand its influence in Sri Lanka through debt diplomacy.

- Regional Stability: A stable Sri Lanka is critical for India's security in the Indian Ocean region.
- Trade and Economic Ties: Sri Lanka is an important trading partner, and its collapse could hurt Indian businesses.

Challenges for India

- Avoiding direct political interference to maintain diplomatic neutrality.
- Balancing relations with Sri Lanka while countering China's growing influence.
- Ensuring that economic aid is used effectively rather than propping up corrupt regimes.

5. China's Role in Sri Lanka's Crisis

China has been a major player in Sri Lanka's economic collapse, using its Belt and Road Initiative (BRI) to gain influence.

Chinese Investments and Debt Trap

China provided high-interest loans to Sri Lanka for infrastructure projects like: Hambantota Port (later leased to China for 99 years after Sri Lanka couldn't repay the debt), Mattala Rajapaksa Airport, dubbed "the world's emptiest airport" and Colombo Port City, a Chinese-funded commercial project.

China's Hesitation in Offering Help

Unlike India, China has been reluctant to restructure Sri Lanka's debt. China opposed Sri Lanka's IMF bailout and instead offered debt refinancing, which wouldn't solve the crisis. Beijing's cautious approach suggests it wants strategic leverage over Sri Lanka rather than offering genuine relief.

6. Future Prospects and Reforms for Sri Lanka

Sri Lanka faces a long road to recovery, requiring major political and economic reforms. Some of the immediate challenges are mentioned below:

1. **Securing an IMF Bailout**
    - Sri Lanka is negotiating a $3 billion IMF package to stabilize the economy.
    - However, IMF conditions include raising taxes, cutting subsidies, and restructuring debt.
2. **Political Stability**
    - Protesters continue to demand President Gotabaya Rajapaksa's resignation.
    - The new government must implement anti-corruption measures and restore public trust.
3. **Economic Restructuring**
    - Sri Lanka must diversify its economy beyond tourism and exports.
    - Agricultural reforms are needed to prevent food shortages.
    - Foreign investment and privatization of state enterprises could revive growth.

Conclusion: Lessons from Sri Lanka's Crisis

The Sri Lankan crisis serves as a warning for other developing nations, including India. India's support has helped stabilize Sri Lanka in the short term, but long-term solutions depend on Sri Lanka's own reforms. The coming years will determine whether the country can recover from its worst crisis since independence. Key lessons from Sri Lanka's crisis include:

- Sound economic policies and responsible governance are critical.
- Excessive dependence on foreign debt is dangerous.
- Strategic infrastructure investments should be economically viable.
- China's Belt and Road loans come with geopolitical risks.
- Political stability is crucial for economic resilience.

Reference

1. Kataria, Sunil (22 April 2022). "Sri Lanka's economic crisis dashes hopes for post COVID-19 tourism recovery"
2. Perumal, Prashanth (6 September 2021). "Explained – What caused the Sri Lankan economic crisis?"
3. Parkin, Benjamin (7 March 2022). "Ukraine crisis batters Sri Lanka's tea and tourism recovery strategy"
4. Srinivasan, Meera (5 April 2022). "Gotabaya Rajapaksa loses parliamentary majority"
5. Silva, Dulya de; Perera, Neshella (8 March 2022). "Sri Lanka's street light decision would be setback for female labour force- IPS economist"
6. Silva, Dulya de; Perera, Neshella (22 March 2022). "Sri Lanka deploys military personnel to filling stations as queues for fuel lengthen"
7. "India to help Sri Lanka with USD 2.4 billion to overcome financial crisis: Report" ANI News. 20 January 2022.
8. The Economic Times (6 July 2022) "India delivers 40,000 metric tonnes of fuel to Sri Lanka to help ease energy crisis"
9. 2018 Annual Statistical Report by Sri Lanka Tourism Development Authority.
10. Paul Teng, Jose Ma. Luis P. Montesclaros, (28 October 2022) "The Danger of Misguided Food Production Policies: The Case of Dri Lanka".
11. Rizwie, Rukshana; Athas, Iqbal; Hollingsworth, Julia (3 April 2022). "Rolling power cuts, violent protests, long lines for basics: Inside Sri Lanka's unfolding economic crisis"