

## **Sri Lanka's political and economic crisis: Implications for India**

### **Introduction**

The economies of India's neighbours are in crisis. Pakistan's western border is experiencing political upheaval, and the economy is becoming worse due to high inflation, currency depreciation, and a massive foreign debt. Sri Lanka is experiencing an economic crisis that has turned into a political crisis, with large-scale protests demanding the overthrow of the current administration, led by President Gotabaya Rajapaksa. India must make every effort to assist Sri Lanka, where the people are suffering as a result of the pandemic's combined consequences with a number of poor legislative efforts.

Sri Lanka's problems started in 2019 when a slew of terrorist strikes on Easter Sunday abruptly stopped tourist arrivals. Being a significant source of income for the country, the hospitality industry was severely impacted. But there was optimism that things will change in 2020.

The Rajapaksa administration continued with a number of significant tax cuts, further aggravating the situation. Over the past two years, this has resulted in significant income shortages and a sharp increase in foreign debt. It increased dramatically from 42 per cent of the GDP to 119 per cent of GDP in 2021. There are currently concerns about achieving the next debt repayment schedule for the year as the country's foreign exchange reserves dropped to USD 2.3 billion.

It is important to consider how quickly Sri Lanka's GDP has declined in light of the country's historically greater per capita income than that of India. In terms of purchasing power parity (PPP), it was USD 12,870 as opposed to USD 6,390 in Sri Lanka.

Thus, an economy that first appeared to be performing better than its larger northern neighbour, took a sudden turn for the worse, leaving the populace without access to basic necessities. According to estimates from the World Bank, the epidemic alone had pushed 5,000 individuals into poverty. As inflation reached 17 per cent and fuel and energy shortages have gotten worse, prices for basic goods have skyrocketed. Hospital procedures had to be suspended owing to a lack of medical supplies, and exams were delayed because of a paper shortage.

India responded correctly by offering the struggling economy a USD 1 billion line of credit, in addition to the USD 500 million it had already given for gasoline expenditures. Additionally, rice and gasoline cargoes that were urgently required were sent. China has not lagged behind and has made an effort to intervene in order to maintain its influence over Sri Lanka, which has been growing in recent years. However, if Sri Lanka's political and economic condition worsens, the consequences for India will be considerably more severe than other, farther-off regions. India must thus keep offering as much support as it can to lessen the pain of the general populace.

These effects might include an increase in the flow of refugees, which has only been a trickle up to this point. However, there is a good chance that things might become worse and turn into a deluge that would be challenging to control. Second, as Colombo ports serve as a trans-shipment centre for nearly 60 percent of India's international commerce, the country's own exports would be impacted. Any delays at the port will increase the cost of shipping. Additionally, there is a sizable amount of bilateral trade, nearly USD 5 billion, and Indian businesses have made extensive investments in Sri Lanka that may be impacted by the disturbance.

However, the economic crisis too has resulted in a political emergency. The Rajapaksa family, who had ruled the nation for the previous 17 years, had to eventually step down. Despite President Gotabaya Rajapaksa's best efforts to avoid this from happening, the people have been asking for his resignation in the protests. Due to the departure of more than 40 lawmakers from the ruling party, the government was already a minority. On July 21, Ranil Wickremesinghe, a seasoned politician, was sworn in as Sri Lanka's next president to lead the country. However, political pundits suggest that Wickremesinghe is also an ally of Rajapaksa family and his appointment was ensured by Rajapaksa's party only.

### **Sri Lanka's economic crisis: Impact on India**

First, the COVID-19 pandemic has pushed many people into poverty in Sri Lanka and the present economic crisis made their situation even worse. As India is the immediate neighbour of Sri Lanka, many people are migrating to India seeking refuge to escape from hunger. India has to provide food, shelter and employment opportunities to the refugees from Sri Lanka. It

can become an additional burden to the Indian economy, which is already struggling to tackle rising inflation.

Second, India's exports to Sri Lanka are shrinking because the traders in Sri Lanka are unable to pay for imports. Moreover, many Indian exporters are worried about the stalled payments. But at the same time, it gave an opportunity to the tea and textile industries in India to replace Sri Lankan exporters and to export their products to European and American countries. Due to fuel shortage, transportation became costly. Moreover, there is uncertainty as to when the ongoing political and economic situation will stabilise. So, importers of Sri Lankan products may prefer India over Sri Lanka.

Third, many Indian companies invested in Sri Lanka in several sectors such as manufacturing, tourism, hotel, banking etc. The economic crisis can affect the companies negatively.

### **Issues in India-Sri Lanka relations**

Since independence, Indian and Sri Lankan governments have had a relatively stable relationship because of India's support to Lankan government in fighting terrorist elements and maintain peace in Indo-pacific. However, over time, the relationships appear to have deteriorated owing to a number of ongoing and recent issues:

**First, fishermen's issue.** Conflict involving fishermen has always been a source of tension between the two South Asian neighbours. Indian fishermen have been caught fishing illegally in Sri Lankan territorial waters across the Palk Strait for a long time. India also holds fishermen from Sri Lanka for engaging in illicit fishing. Over 185 Indian boats were seized, 188 Indian fishermen were killed, and 82 Indian fishermen are still missing between January 2015 and January 2018 alone.

Fishermen from Sri Lanka and India have coexisted peacefully in each other's seas for many years. The situation was altered when, between 1974 and 1976, India and Sri Lanka signed four maritime boundary agreements outlining their different interpretations of the international maritime border between them.

These agreements were designed to make resource management and law enforcement in the Palk Strait easier. Without consulting the state government of Tamil Nadu, the Indian government transferred the Katchatheevu Island to Sri Lanka under the accords. Since that

time, the island has only been "accessible" to Indian fishermen for resting, drying nets, and the annual St. Anthony's festival but not for fishing. The lack of a clearly defined maritime border between the two nations, in spite of the accords, causes Indian fishermen to trespass into Sri Lankan seas in pursuit of a greater catch. According to the 1974 agreement, the federal government acknowledges Sri Lanka's sovereignty over the island. However, Tamil Nadu asserted that Katchatheevu is part of Indian territory and they consequently wish to maintain their right to fish there.

**Second, issue with the Colombo port.** In February 2021, Sri Lanka withdrew from a tripartite cooperation with Japan and India for its East Container Terminal Project at the Colombo Port, citing local problems. India depends on the Colombo port since it handles 60 percent of its trans-shipment goods.

**Third, non-extension of currency swap agreement.** The RBI and the Central Bank of Sri Lanka (CBSL) had signed a currency swap agreement under the SAARC Currency Swap Framework 2019–22, which allowed for withdrawals of up to USD 400 million. The deal was set to expire on 13 November 2022, but India declined to extend it further in the absence of an IMF programme to resolve Sri Lanka's present macroeconomic imbalances.

**Fourth, Sri Lanka's drift towards China.** Sri Lanka has tended to turn to China over time for economic assistance and sees Beijing as a more trustworthy partner in promoting local economic growth. In addition, the Rajapaksa family-led government is recognised historically for having stronger ties to China. India is worried about China's expanding influence in the waterways of the Indo-Pacific. For instance, China is getting ready to start building a USD 13 billion township on the coast of Sri Lanka, not far from Colombo.

### **Implications for India**

**First, India's strategic interests.** Colombo assumes importance for India since almost 70 per cent of all container cargo for and from India is trans-shipped there, mostly at Chinese-operated terminals. Thus, a long-term economic crisis in Sri Lanka will threaten India's strategic interests.

**Second, opportunity for China.** The growing economic crisis in Sri Lanka offers more opportunities for China to increase its dominance in the Indian Ocean region. Allowing this

to continue will adversely affect India's strategic interests. The economic crisis may further push Sri Lanka to align its policies with Beijing's interests. This comes at a time when India is already in a difficult situation diplomatically with Afghanistan and Myanmar.

**Problem for exporters:** Decreasing forex reserves of Sri Lanka has Indian exporters worried about the possible payment of dues by Sri Lankan importers. Indian exporters continued to send goods to Sri Lanka despite the nation's economy spiralling south because Colombo was able to pay for the majority of its purchases using a line of credit that India had granted to the country. India's lines of credit in 2021 included USD 500 million for petroleum goods and USD 1 billion for the importation of food, medicine, and other necessities. The money swiftly ran out. In 2022 also, despite Indian financial assistance of approx. USD 3.8 billion, the goods trade deficit is declining.

*This article originally appeared on National Institute of Advanced Studies (NIAS), Global Politics.*

[https://globalpolitics.in/view\\_cir\\_articles.php?ArticleNo=807&url=Explained&recordNo=904](https://globalpolitics.in/view_cir_articles.php?ArticleNo=807&url=Explained&recordNo=904)

*Dr. Beena is Maharishi Kanad Post-Doctoral Fellow at Delhi School of Transnational Affairs, Institution of Eminence, University of Delhi, India.*