

# FAQs

## Sri Lanka's economic crisis

### Q Why is it in News ?

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On 31 August 2021, Sri Lanka declared a state of economic emergency, as it is running out of foreign exchange reserves for essential imports like food.

### Q How is Economic cooperation between India and Sri Lanka ?

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- India is Sri Lanka's **third-largest export destination**, after the US and UK.
- More than 60% of Sri Lanka's exports enjoy the benefits of the **India-Sri Lanka Free Trade Agreement**, which came into effect in March 2000.
- India is also a **major investor in Sri Lanka**.
- Foreign direct investment (FDI) from India amounted to around \$ 1.7 billion over the years from 2005 to 2019.
- **Concessional financing** of about \$ 2 billion has been provided to Sri Lanka through various Indian government-supported Lines of Credit across sectors like railways, infrastructure and security.
- India's **development partnership** with Sri Lanka has always been demand-driven, with projects covering social infrastructure like education, health, housing etc.
- The Reserve Bank of India (RBI) had signed a currency-swap agreement with the Central Bank of Sri Lanka (CBSL) under the **Saarc Currency Swap Framework 2019-22**.

### Q What are Factors responsible for economic emergency in Sri Lanka ?

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- **Tourism:** Tourism, a big dollar earner for Sri Lanka, has suffered since the Easter Sunday terror attacks of 2019, **followed by the pandemic**.
- **Declining FDI:** Earnings fell from \$3.6 billion in 2019 to \$0.7 billion in 2020, even as **FDI inflows halved from \$1.2 billion to \$670 million** over the same period.
- **Debt distress:** Its public debt-to-GDP ratio was **at 109.7% in 2020**, and its gross financing needs remain high at 18% of GDP, higher than most of its emerging economy peers.

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- The external debt-to-GDP ratio stood at 62% in 2020 and is predominantly owed by its public sector.
- More than \$2.7 billion of foreign currency debt will be due in the next two years.

## Q How economic crisis may push Sri Lanka to align its policies with China ?

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- **Reliance on Chinese credit:** Sri Lanka has increasingly relied on Chinese credit to address its foreign debt burden.
- Unable to service its debt, in 2017, Sri Lanka lost the unviable **Hambantota port** to China for a 99-year lease.
- **Increasing bilateral trade:** China's exports to Sri Lanka surpassed those of India in 2020 and stood at \$3.8 billion (**India's exports were \$3.2 billion**).
- **Strategic investment by China:** Owing to Sri Lanka's strategic location at the intersection of major shipping routes, China has heavily invested in its infrastructure (estimated at **\$12 billion between 2006 and 2019**).
- In May, Sri Lanka passed the Colombo Port City Economic Commission Act, which provides for establishing a special economic zone around the port and also a new economic commission, **to be funded by China**.

## Q What will be Implications for India ?

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- Relations between India and Sri Lanka seem to have plummeted since the beginning of this year.
- In February, Sri Lanka backed out from a tripartite partnership with India and Japan for its **East Container Terminal Project** at the Colombo Port, citing domestic issues.
- Sri Lanka's economic crisis **may further push it to align its policies with Beijing's interests**.
- India is already on a diplomatic tightrope with Afghanistan and Myanmar.
- Other South Asian nations like **Bangladesh, Nepal and the Maldives** have also been turning to China to finance large-scale infrastructure projects.

## Q What can be Way forward ?

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- Nurturing the **Neighbourhood First policy with Sri Lanka** will be important for India.

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- **Explore possibility through regional platforms:** The **BIMSTEC** and the **Indian Ocean Rim Association** could be leveraged to foster cooperation in common areas of interest like technology-driven agriculture and marine sector, IT, renewable energy, and transport and connectivity.
- **Cooperation on private sector investment:** Both countries could also cooperate on enhancing private sector investments to create economic resilience.
- With its economy in deep trouble, Sri Lanka may get further pushed towards China, India has to deliver on its Neighbourhood First policy to protect itself from the adverse fallout.

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