

## SRI LANKA'S ECONOMIC CRISIS AND ITS IMPACT ON INDIA

By

**Raja Bilal Ajmal**  
*Intern*  
*India Study Centre (ISC), ISSI*

Edited by  
**Dr Arshad Ali**

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*(Views expressed in the brief are those of the author, and do not represent those of ISSI)*



Sri Lanka is facing the worst economic crisis since its inception in 1948. Months of political and economic turmoil in the country culminated in protestors gathering at the Presidential residence in the second week of July.<sup>1</sup> Consequently, President Gotabaya Rajapaksa fled the country to the Maldives and later resigned.<sup>2</sup> Currently, Mr. Ranil Wickremesinghe is heading the country, who is still struggling to gain popularity among the masses.<sup>3</sup>

Experts say that this crisis has been in the making for years. From the 1970s to the mid-2000s, Sri Lanka had multilateral loans at low-interest rates.<sup>4</sup> In the mid-2000s, the country turned towards foreign lenders.<sup>5</sup> In 2007, Sri Lanka issued its first international bond,<sup>6</sup> a specific debt instrument issued by the government to raise money for financing government programs, or to pay down old debts etc. However, unfortunately, the money was mostly used for political gains like Colombo Lotus

<sup>1</sup> "How Serious is the Sri Lanka Crisis? What Happens Next?," Al Jazeera, last modified July 13, 2022, <https://www.aljazeera.com/news/2022/7/13/sri-lanka-in-crisis-what-when-and-why-explainer>.

<sup>2</sup> Frances Mao and Anbarasan Ethirajan, "Sri Lanka: Ranil Wickremesinghe Elected President by MPs," BBC News, last modified July 20, 2022, <https://www.bbc.com/news/world-asia-62202901>

<sup>3</sup> Ibid.

<sup>4</sup> Yolani Fernando, "Paradise squandered – what really happened to Sri Lanka's economy," Dev Policy, accessed August 1, 2022, <https://devpolicy.org/paradise-squandered-sri-lankas-economy-20220331/>.

<sup>5</sup> Ibid.

<sup>6</sup> Talal Rafi and Brian Wong, "The Deep Roots of Sri Lanka's Economic Crisis," *The Diplomat*, last modified July 22, 2022, <https://thediplomat.com/2022/07/the-deep-roots-of-sri-lankas-economic-crisis/>.

Tower,<sup>7</sup> a massive scandal replete with corruption allegations.<sup>8</sup> The economy has been on a free fall ever since then and a plethora of reasons have contributed to it.

Firstly, over the course of a few years, the Sri Lankan government has borrowed a huge amount of money from different countries and international markets.<sup>9</sup> With a massive debt of more than 51 billion USD, the country is officially bankrupt now.<sup>10</sup> The Sri Lankan Finance Minister has warned that Sri Lanka has only 25 million USD in foreign exchange reserves.<sup>11</sup> Moreover, the pandemic also declined remittances that came from Sri Lankan workers working abroad, which were a major source of foreign exchange for the country.<sup>12</sup>

Owing to its insufficient foreign exchange reserves, the country is unable to import food, fuel, and medicines. According to the Central Bank, inflation reached 54.6% in June and could rise to 70% further.<sup>13</sup> It has created a shortage of fuel and consequently long and frequent blackouts in the country.<sup>14</sup>

Secondly, the 4.4 billion tourism industry<sup>15</sup> which was the backbone of the Sri Lankan economy has undergone several blows. For example, in 2019 hundreds of people were killed in Easter bombings resulting in a 70% decline in tourism in May 2019.<sup>16</sup> Furthermore, the arrival of Covid-19 in 2020, increased the government's expenditure on health and imposed travel restrictions. Due to these restrictions, the Sri Lankan economy lost more than 3 billion USD in the first nine months of Covid-19 in the tourism industry alone. <sup>17</sup>

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<sup>7</sup> S.Cogan and Dr.Dilbar Ahlawat, "Sri Lanka's Economic Crisis: An Opportunity for India to Reclaim Influence," *The Diplomat*, last modified April 6, 2022, <https://thediplomat.com/2022/04/sri-lankas-economic-crisis-an-opportunity-for-india-to-reclaim-influence/>.

<sup>8</sup> "China firm vanishes with billions in Sri Lanka Lotus Tower scam," *Economy Next*, last modified September 16, 2019, <https://www.businesstimes.com.sg/government-economy/sri-lanka-partially-opens-troubled-chinese-built-tower?amp=>.

<sup>9</sup> Jessie Yeung, "What You Need to Know About Sri Lanka's Economic Crisis," *CNN*, last modified April 7, 2022, <https://edition.cnn.com/2022/04/05/asia/sri-lanka-economic-crisis-explainer-intl-hnk/index.html>.

<sup>10</sup> "What Happens Next"

<sup>11</sup> Rafi and Wong, "The Deep Roots"

<sup>12</sup> Ibid.

<sup>13</sup> "What Happens Next."

<sup>14</sup> Ibid.

<sup>15</sup> S.Cogan and Dr.Dilbar Ahlawat , "Sri Lanka's Economic Crisis: An Opportunity for India to Reclaim Influence," *The Diplomat*, last modified April 6, 2022, <https://thediplomat.com/2022/04/sri-lankas-economic-crisis-an-opportunity-for-india-to-reclaim-influence/>

<sup>16</sup> S.Cogan and Dr.Dilbar Ahlawat , "Sri Lanka's Economic Crisis: An Opportunity for India to Reclaim Influence," *The Diplomat*, last modified April 6, 2022, <https://thediplomat.com/2022/04/sri-lankas-economic-crisis-an-opportunity-for-india-to-reclaim-influence/>.

<sup>17</sup> Ibid.

Thirdly, to strengthen the faltering economy, the then President Gotabaya Rajapaksa tried to stimulate it by cutting taxes but these cuts increased fiscal deficits and international rating agencies downgraded Sri Lanka to near default levels, shutting the country's access to overseas markets.<sup>18</sup>

Fourthly, the sudden decision by the government to turn towards organic farming by banning chemical fertilisers in 2021, led to a 50% drop in tea production, 35% drop in rice, 30% in coconut, and 50% in corn.<sup>19</sup> Banning fertilisers affected the tea industry which was again a major source of foreign currency for the country.<sup>20</sup>

Fifthly, the ill-planned public sector expenditure also contributed to the crisis. Sri Lanka has a population of over 22 million people, with around 1.4 million public sector employees.<sup>21</sup> In 2019, about 30% of the government's revenue was spent on the salaries and pensions of its employees. This hardly left any money for the health and education sectors which received less than 1% of the GDP.<sup>22</sup> Factor in the losses by Covid-19, and the economic conditions in Sri Lanka became a befitting recipe for disaster.

In the aftermath of this turmoil, neighbouring countries like China and India offered economic aid. However, it was insufficient to rescue the collapsing economic order in the country. IMF's bailout seems the only hope in this crisis, however, the possibility of acquiring one seems improbable in the near future.

Being Sri Lanka's immediate neighbour, many argue that the recent crisis provides a chance for India to increase its influence in the region. Also, the economic collapse of Sri Lanka provides new opportunities for Indian exporters. For example, Sri Lanka is the world's largest supplier of orthodox tea.<sup>23</sup> Due to the recent crisis, there has been a sharp decline in tea production in the country and consequently, in the world. Big Sri Lankan tea importers are now turning towards Indian tea plantations with their demands. As a result, the average price of orthodox tea in Kolkata has

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<sup>18</sup> Yeung, "Sri Lanka is Facing an Economic and Political Crisis."

<sup>19</sup> Ted Nordhaus and Saloni Shah, "In Sri Lanka, Organic Farming Went Catastrophically Wrong," *Foreign Policy*, last modified March 5, 2022, <https://foreignpolicy.com/2022/03/05/sri-lanka-organic-farming-crisis/>

<sup>20</sup> Ibid.

<sup>21</sup> Yeung, "Sri Lanka is Facing Economic Crisis"

<sup>22</sup> Cogan and Ahlawat, "Sri Lanka's Economic Crisis"

<sup>23</sup> Bhaswar Kumar, "How the Economic Crisis in Sri Lanka is Affecting Indian Businesses?" *Business Standard*, accessed July 25, 2022, [https://wap.business-standard.com/podcast/economy-policy/how-the-economic-crisis-in-sri-lanka-is-affecting-indian-businesses-122062400100\\_1.html](https://wap.business-standard.com/podcast/economy-policy/how-the-economic-crisis-in-sri-lanka-is-affecting-indian-businesses-122062400100_1.html).

increased up to 41% compared to last year's sale price. <sup>24</sup> It means greater profit for the Indian tea exporters on these plantations.

Moreover, the fuel shortage has crippled the Sri Lankan clothing industry. According to the US International Trade Administration, the apparel export industry made about 44% of Sri Lanka's total exports.<sup>25</sup> Due to the agricultural crisis in Sri Lanka, its cotton production has also declined. This has created a vacuum in the market and consequently, many orders from the UK, Latin America, and other European countries for cotton and textile are now being diverted to India.<sup>26</sup>

However, there is a flip side to the issue too, where few sectors in the Indian economy are suffering due to the Sri Lankan crisis. In April 2022, many Indian automobile companies like Mahindra, Tata Motors, and TVS Motors stopped their exports to Sri Lanka and halted production at the Sri Lankan units due to fuel shortages and unstable foreign exchange reserves.<sup>27</sup> It worsened the crisis as thousands of workers became jobless due to the closure of these factories. Moreover, according to a briefing note by Dezan Shira and Associates, a multidisciplinary services firm, instability in Sri Lanka could affect big companies like Airtel, Dabur, Indian Oil, Taj Hotels, Asian Paints, and the State Bank of India. <sup>28</sup>

In addition, the threat of an influx of migrants in India also looms upon the country. Political instability and shortage of food and medicine can potentially force poor families from Sri Lanka to flee to southern India. So far, over 28 Sri Lankan families are recorded by Indian authorities that have arrived through boats into the country.<sup>29</sup> It poses a serious threat of an unfolding humanitarian catastrophe in the region as India is not a signatory of the 1951 Refugee Convention or the 1967 Protocol relating to the Status of Refugees.<sup>30</sup> Neither has India any internal regulations for the entry and stay of people seeking asylum in the country. With the Modi regime in office, chances are that these refugees will be treated as "illegal migrants" under The Foreigners Act of 1946 <sup>31</sup> which will further contribute to their worsening condition.

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<sup>24</sup> Ibid.

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

<sup>27</sup> Ibid.

<sup>28</sup> Ibid.

<sup>29</sup> Deutsche Welle, "Sri Lanka Tamils Fleeing to India to Escape Economic Crisis," Dw.com, accessed July 25, 2022, <https://amp.dw.com/en/sri-lanka-tamils-fleeing-to-india-to-escape-economic-crisis/a-61915724>

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.