Helping out Sri Lanka

Why in news?

India, which held an all-party meeting on the crisis in Sri Lanka, promised to support Sri Lanka that is struggling to deal with the devastation caused by the economic crisis.

> The Government of India said that "fiscal prudence and responsible governance" are the lessons to be learnt from the situation in Sri Lanka and that there should not be a "culture of freebies".

What are the reasons for the Sri Lankan crisis?

- At the end of the civil war [with the Liberation Tigers of Tamil Eelam] in 2009, Sri Lanka had to go to the International Monetary Fund (IMF) for support.
- Over the years, there has been **economic mismanagement** (fiscal and budgetary) and **political malfeasance** caused by the successive Sri Lankan government.
- The crisis is a consequence of the **twin deficit problem** - an unsustainable current account deficit and an unsustainable fiscal deficit.
- **Tourism collapsed** starting with the Easter bombings, then the pandemic.
- Again because of the pandemic, **remittances from migrant workers declined**.
- The import bill rose because of the **war on Ukraine** and the **spike in oil prices**.
- On the domestic front, however, the fiscal crisis is completely home-made by the Rajapaksa government. It was responsible for three specific things,
    1. Unaffordable populism by cutting taxes,
    2. Erratic economic management - for example, the abrupt shift to organic farming; and
    3. It did not go to the IMF early enough.
- The big tax holiday that Mr. Gotabaya Rajapaksa gave, soon after he assumed office, had precipitated the crisis.

Could the global powers have moved in sooner to try and help?

- Sri Lanka's crisis was so deep that no country by itself could have averted it.
- If a country had moved in by itself to solve the problem, it would have taken on more burden without actually solving the crisis.
- What countries can do bilaterally is provide a bridge loan, which is what India has done, but the structured solution has to come through the IMF.
- So, a crisis like this requires IMF assistance, and for other countries to come on board in support of the IMF programme.

What did India do to help?

- Sri Lanka came to India at the end of the year 2021, asking India to reschedule the debt repayment.
- Recently, India's assistance to Sri Lanka was about $3.8 billion. India could not have restructured all its loans or given all the money that Sri Lanka wanted.
- India gave aid on time and in sufficient quantity for Sri Lanka to get some breathing space in order to approach the IMF and reach an arrangement with the IMF.
- India's help has been unprecedented - other countries have come up with very small amounts of humanitarian assistance at the very most.
- The Indian Government by itself cannot solve Sri Lanka's problem. Sri Lanka needs everybody who it owes debt to - the IMF, the World Bank, the Asian Development Bank and all other partners - to come together and give it some breathing space.

What did China do?

- On China's involvement, Sri Lanka's debt problem has two egregious sins.
    1. Over-dependence on one country for a bilateral partner China, and
    2. Sovereign borrowing in a foreign currency.
- Given that many of these loans went into infrastructure projects that have taken too long or have been underutilised, debt has piled up, but there are no revenues to repay for it.
- To that extent, China is responsible for loading on debt, irresponsible lending, and now responsible for not coming soon enough to Sri Lanka's aid.

Around 10% of Sri Lanka's debt being held by China.

Are there other alternatives to the IMF that India should be tapping or helping Sri Lanka to tap?

- Countries around the world have been trying to find an alternative to the IMF, because of the concern that IMF conditionality is too harsh and does not result in long-term structural adjustment.
- But nothing has proved to be an adequate substitute for the IMF - neither bilateral arrangements nor the regional ones.
- The fact is that if a country is under an IMF programme, external investors, external creditors become confident that they can go back into the country.
- And that's why Sri Lanka should have gone to the IMF sooner so that that confidence levels would not have sunk.

To what extent is the situation in Sri Lanka comparable to that in Indian States?

- Some Indian States are borrowing money and using it on freebies, which do not add to productivity or future economic activity or production capacity.
- But they add to current consumption. So, they do not support long-term growth.
- But, Indian States can't be compared to Sri Lanka as Sri Lanka is an independent economic entity whereas the Indian States are part of a national economic entity.

- States in India do not have their own balance of payments, they do not have debt denominated in external currency like Sri Lanka.
- Sri Lanka can deal with domestic debt by printing currency, as it did, but States in India cannot do that.

The Supreme Court has said there must be some norms about how much can be spent on freebies.

How can India prepare for crises in the rest of South Asia?

- India should be looking hard at Nepal because Nepal is tied to us in many ways.
- But one redeeming factor is that Nepal's currency is pegged to ours and its trade being landlocked, it is completely dependent on India.
- If we apply the regionalisation of the Indian rupee, make it possible for us to trade in rupees with Sri Lanka, it will help Sri Lanka save on hard currency.
- The digital interface payments that India have, like BHIM, can be used in countries in the neighbourhood such as Nepal and Bhutan.
- With Sri Lanka, those discussions have not been able to go forward.

Reference

https://www.thehindu.com/opinion/op-ed/what-can-the-world-do-to-help-sri-lanka/article65666597.ece

