



The Geopolitics of India, China and Sri Lankan Economic Crisis

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Abstract

Over the past decades, China had lent over USD 5 million to Sri Lanka for development projects of airports, roads, and ports. Cooperation between the two countries continues to grow in terms of trade and tourist over the past decades. Colombo imports more goods from China than other countries including its closest neighbour India. However, China's financial support did not come for free of cost rather the small Island country had to repay them with high interest. Since the past few years problem of the debt crisis began to hit the country very hard that it had to put up more than 80 percent of the country's GDP for debt payment. The slyness technique applied by the red dragon dragged Colombo into a massive debt trap. It doesn't stop there, the breakout of the COVID-19 pandemic further worsen the situation that President Gotabaya had no choice but to declare Financial Emergency within the country.

Keywords: *Financial Emergency, Economic Crisis, Geopolitical.*

Introduction

Sri Lanka one of the most important geopolitical Islands nations in the Indian Ocean faces a deepening financial and humanitarian crisis where inflation rises to a record level high. The country's financial crisis was brought to light when the Sri Lankan Government declared a national emergency in August 2021. The Island country achieved independence from British rule in 1948, one year behind India. First, it was granted the Dominion of Ceylon until 22nd May 1972, when it became the Republic of Sri Lanka. The countries decided to remain under the Commonwealth as a means for safeguarding their security interest against the possible annexation from bigger and more powerful neighboring countries like India (Mendis, 1992).

In the meantime, being a small country with miniature economic sources Sri Lanka had to depend on another country to import even its basic food supplies. Today Sri Lanka is

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known by the global community as a country that had fallen into the debt trap of Beijing to investment projects sponsored by the Red Dragon under its Belt and Road Initiative (BRI). While struggling to pay its debt Beijing did not hesitate to take it as an opportunity to make expansion within the Island country by gaining control over several strategic important infrastructure projects. The situation put India into an alarming position since Sri Lanka is only a few kilometers from India's southernmost tips. The introduction of Organic farming by banning chemical fertilizer in farming has further aggravated the economic crisis by dampening agriculture production (Perumal, 2021). This article will highlight the role played by the two global rivals India and China in the geopolitically significant Sri Lankan economic crisis by adopting a descriptive as well as histo-empirical approach.

Beijing Choose Sri Lanka

Sri Lanka and China began developing diplomatic relations in the year 1957. When Sirimavo Bandaranaike became Prime Minister she took the non-alignment policy more firmly. She canceled all the sanctions and also began closer communications with communist countries such as the Soviet Union and China (Kodikara, 1973). This was followed by the initiative to explore and maintain trade and economic relations. During the Sirimavo Bandaranaike regime between 1960-65, many textiles items from India were banned. Imports of dried fish from India were also diverted to Pakistan since 1959. Growing China's influence on the Island also reduced India's exports of Coal, taken over by China itself. It was under the reign of Rajapaksa the two countries developed close connectivity both commercially and strategically (Abi-Habib, 2018). Since then the Island country lives under the mercy of China's financial aid and support. Based on the World Bank, report Sri Lanka's economy contracted by 3.6 percent in 2020, the worse performance on record. Other than the Government's high spending, tax reduction and introduction of organic farming the massive loan payment to China played crucial parts leading to the Island country's economic crisis beyond redemption.

Beijing's growing interest in Sri Lanka was due to its unique geographical location at the center of the Indian Ocean. China imports about 80 percent of its energy supply from the Arabia Gulf which is transit through the Strait of Malacca. Since the Malacca Strait happens to be one of the busiest checks points Beijing opts to control Sri Lanka's most important port (Hambantota) makes sense (Singh, 2021). Keeping away from the trouble of American competition in the Pacific, the red dragon decides to expand power over the Indian Ocean. China introduced itself to Sri Lanka as a conveyor of infrastructure development and financial aid. However, the real image of China was soon revealed when it began to show much interest in territorial extension towards smaller nations. This became a great concern for India because sooner or later Chinese increasing presence in South Asia and the Indo-Pacific could hamper the peace and harmony in the region.

Sri Lanka Economy and Debt Trap

Sri Lanka's huge foreign debt burden is one of the main reasons for its economic crisis. The alarming state of the Sri Lankan economy could be traced back to the past several years. The 25 years of the Civil war could be best described as the period of a drain of the

country's economic wealth. Above all factors, it was the massive loans on high interest that Colombo took from China in the name of infrastructure development that underline the current crisis. The leasing out of Hambantota port to CM Port back in 2017 had already indicated the depth of the Sri Lankan economic crisis (Lakshmi, 2021). The pandemic dealt a heavy blow to Sri Lanka's economy depends heavily on tourism and trade. The Island country loses approximately about USD 4 billion of annual foreign currency inflows due to pandemic. Scholars around the world opine various reasons for Sri Lankan economic crisis such as weak economic foundation, insufficient hematopoietic capacity, Government failure to maintain proper debt structure, and most importantly the pandemic. Since the beginning of the pandemic, more than two lakh people lost their jobs in the travel and tourism sectors. The Island Country owes huge debt from three countries such as China, India, and Japan. However, Sri Lankan debt owed to China, in particular, is undoubtedly the tip of the iceberg for its financial crisis. President Gotabaya Rajapaksa openly requested Chinese Foreign Minister Wang Yi to provide a moratorium on debt payment highlighting the bottomless problematic nature of Chinese debts (Jayasinghe, 2022).

During the past decades, China paid over USD 5 million as a gesture of their commitment towards Sri Lankan friendship. Almost all big project within the Island falls at the hand of Chinese company including Hambantota Port and Colombo Port City (Ethirajan, 2022). In 2018 Sri Lanka obtained a Foreign Currency Term Financing Facility (FCTFF) of USD 1 billion from the Chinese Development Bank (CDB). It was further extended to another FCTFF of USD 500 million by the CDB in 2020 to strengthen Sri Lanka's forex reserved position. In 2021 the CDB again provided USD 500 million and another 2 billion Chinese renminbi for a grace period of three years and a payback period of 10 years. The interest rate was the LIBOR six months USD and a 2.51 percent margin. However, under the low performance of the country's significant infrastructure projects Sri Lanka's debt was ballooning over the years. They were not in a position to make enough revenue even by the time the loan payment came due. Leaders in Colombo faced the pressure of compensating the debt and stabilizing the economy in the meantime. Besides, it continues borrowing from the international capital market through issuing ISB which amounts to 36 percent of the Island country's outstanding foreign debt stock in 2021.

Based on the data provided by the Central Bank of Sri Lanka, its foreign reserves drop by 24.8 percent to USD 2.36 billion in January 2022. The country saw the fastest inflation in Asia in February, with consumer prices rising by 15.1 percent from the previous years. However, Colombo is still committed to paying the debt with money obtained from port leasing or any other source of income. Since the end of 2021, Sri Lanka already faced an increasing price rise from 9.9 percent in November to 12.1 percent in December. In the meantime, the soaring food inflation within the country touched almost 22 percent (India, 2022). The Island country is expected to repay USD 4.5 billion to China in 2022. Basil Rajapaksa, the Finance Minister ensured the country would be in a position to repay the international sovereign bond estimated USD 500 million in due time. The money for such payment came only from the economic relief package around the world including India. The depressing situation the country dives into should be a wake-up call for Colombo to consider

serious initiatives of economic reform to save them from submerging deeper into a Chinese debt trap.

Why it's a Concern for India

By the year 2020, India became Sri Lanka's second-largest bilateral trading partner. Over the past decades, New Delhi has also prevailed as the top three financial lenders for the Island country. The declining foreign reserves worried traders and investors in India since the country could further face payment problems due to the curbs placed on imports and exports. According to experts India's exports and imports would be the first to become affected if things could not turn into normalcy in due time. Its engagement in the area of developmental projects, hotels and tourism, investment sectors, infrastructure, real estate, and financial services would be the worst hit if the financial problem continues (Karthi, 2022). In the meantime leaders in Beijing might want to turn the desperate situation of Colombo to deepen its dependency on them. For India neighboring countries like Sri Lanka provides the most crucial geopolitical importance to safeguard its peace and security in the Indian Ocean where the Chinese infringement was frequently experienced during the past few years. Shared similar historical, religious, cultural, and traditional values what happens in Sri Lanka had an impact in India directly or indirectly just like the experience during Sri Lanka Civil War. Therefore, considering what the future holds New Delhi needs to come up with a careful review and calculation of the economic crisis in the Island country.

Impact of Financial Emergency

Because of the shortage of forex, there's a severe shortage of oil, gas, medicines, and food items in Sri Lanka. The emergency move followed sharp price rises for essential commodities such as rice, sugar, potatoes, etc. To get their supply people formed long queues in front of stores and shops waiting for their turn to come. After declaring an emergency the responsibility of overseeing the selling of goods and commodities was handed over to the military. They are responsible for supervising all shops and stores followed Government regulated price rates. Authorities in Sri Lanka imposed rolling power cuts across the country as deepening financial crisis leads to a shortage of fuel import which handicaps its power grid (Gupta, 2022). The Public Utility Commission announces that power will be provided on a rotation basis with fixed allotment timing. Motorbikes and vehicles formed a long queue waiting for fuel supply while many stations remained closed down.

As a measure of tackling the ongoing economic crisis, the Island Government had imposed restrictions on 357 items that have been dubbed as non-essential. The Central bank also hiked interest rates and urged the Government to increase taxes (Uditha Jayasinghe, 2022). The World Bank estimated that due to the Covid-19 pandemic about 5 lacks of the Sri Lanka population lives under poverty which is estimated as equivalent to five years of periods of non-progress (Minoli de Soysa, 2022). Not only the poor family but even the well-off families are now facing grave problems to make their end needs.

Approach to Counter Financial Problem

Sri Lankan Government faced the dual challenges of managing overseas debt payments while assembling domestic needs at the same time. To counter its financial problem Sri Lanka had the option of seeking financial relief funds and loans from the international community including the International Monetary Fund. However, the Island Government decided to stay away from a bailout offer opted out of an offer from IMF instead seeks support from two competing rivals India and China to tackle the unprecedented economic crisis (Bala, 2022). They did not want to cooperate with certain economic reform systems imposed by the IMF. In opposition to the recommendation made by IMF, the Central Bank of Sri Lanka (CBSL) has a policy of controlling the exchange rate. In other words, accepting IMF assistance would mean revising most of the Government's economic policy would come with a high political cost. The country's policymaker then resorted to temporary relief measures such as credit lines to import food, medicines, and fuel from a neighbouring country like India. Colombo also opted for currency swaps with India, China, and Bangladesh and a loan to purchase petroleum from Oman. A demand was made by senior Parliamentarians to immediately initiate a multistep process towards an orderly negotiated postponement and restructure the repayment of its sovereign debts. Sri Lankan leaders prefer financial assistance from India and China because it could save them from reframing their policies and program.

Sri Lanka had been facing the difficulty of balancing ties between the two giants of the Asian continent India and China. The Island country shared strong bilateral ties with both countries. During the past years, Beijing emerged to become the biggest bilateral lender and FDI provider to Sri Lanka (Muramudali, 2022). Though China is leading the competition with infrastructure development and financial loans, the closest neighbour India happens to be Sri Lanka's best export destination sits at the third position among the international community only next to U.S.A and U.K. Considering the commercial relationship between Beijing and Colombo the trade imbalance amounted to a negative USD 3.35 billion in 2020 (Khanna, 2022). This clearly emphasized how China's method of trade dealing always focuses on a self-centric model.

China cleverly structured its dominion infrastructure development projects within Sri Lanka giving them the power to control important strategic assets like Hambantota Port and Colombo Port city. When Sri Lankan President requests his counterpart to restructure the debt payment structure with the hope of buying some more time to settle the country's financial problem, Beijing chooses to remain quiet. It agrees on currency swept amounting to USD 1.5 billion, the request for a relook on debt restructuring has been effectively ignored. In 2020 China had already bailed out Sri Lanka with USD 1 billion in loan and USD 1.5 billion in currency swept. The new proposal made by Beijing is to revive the 1952 Rubber-Rice Pact where Sri Lanka would supply rubber in return for rice from China. However, such a proposal would never be accomplished because Colombo is not in a position to supply rubber to China, and secondly what the Island country requires is financial support in terms of dollars to improve its financial reserves. Knowing the complicated financial position of the

Island country, India did not hesitate to step up with a pledge of a whopping USD 2.4 billion to Colombo to overcome its financial crisis (Srinivasan, 2022).

The 'Neighbourhood First Policy' of Prime Minister Narendra Modi once again paid off its significance which delivers timely with meaningful impact. It came in the form of USD 500 million on oil line of credit, USD 1 billion lines of credit for essentials to be imported from India under negotiation, currency swept of USD 400 million, Deferral of USD 515 million under Asian Clearance Union, 40,000 MT of fuel on credit, 100,000 Rapid Antigen Kits and supply of 1,000 tons of liquid medical oxygen (Standard, 2022). Despite Beijing's warning, Colombo shows the will to boost its relationship with India by offering a project on Trincomalee Oil Tanks, the West Container Terminal, and several renewable energy projects. Presently, more than 60 percent of Sri Lanka's export benefits of the India-Sri Lanka Free Trade Agreement came into effect from 2000.

Conclusion

Today Sri Lanka faces its worst economic crisis, as a big brother India took every initiative to convene the demand made by the Island country. On the other hand, Beijing the immodest guest chooses to ignore the request on restructuring debt but instead offers more loans to deepen its cavity. Though India and Sri Lanka experienced certain levels of bilateral differences which are familiar attributes in foreign relations, the initiative New Delhi showed towards Colombo during the crisis indicates it's a decisive moment for the two nations to upgrade their cooperation to the next level. So long the Hambantota port and Colombo Port City are under the control of Beijing, Sri Lanka would continue to stick in its relationship with China for years to come. This occurrence must teach them a lesson to become more cautious about protecting their national interest in entering economic deals with countries like China whose interest lies in enhancing its economy alone but never had the accountability towards the host nation. The message of understanding and benevolence delivered by New Delhi towards Colombo is plain and obvious that could no more be misread by its leaders. If Sri Lanka has to benefit from its geopolitical allies it will arrive only from its closest neighbour India. The circumstances convey the best situation for the two nations to extend their cooperation under calculated wits to realize the food and health security packages, and the energy package to attain that height where they could brave Chinese expansion within the Island. In addition to this, the Island country must navigate further cooperation towards other South Asian countries instead of being isolating it from them while coping with the BRI. India had been raising concern over the importance of commercial initiatives where everyone has the chance of winning. Such initiatives are important not only for the recovery of the Sri Lankan economy but would also be necessary for sustaining peace and harmony in the South Asian region.

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