



International Relations

Sri Lanka's Debt Crisis and Paris Club

Tags:

- **GS Paper - 2**
- **Effect of Policies & Politics of Countries on India's Interests**

For Prelims: Sri Lanka's Debt Crisis and Paris Club, IMF (International Monetary Fund), Debt Management, Asia-Pacific, Russia's invasion of Ukraine.

For Mains: Sri Lanka's Debt Crisis and Paris Club, Bilateral, regional and global groupings and agreements involving India and/or affecting India's interests.

Why in News?

Recently, Sri Lanka has reached a preliminary debt restructuring deal with India and the Paris Club Group, paving the way for it to revive a stalled IMF (International Monetary Fund) loan programme. It will help Sri Lanka, which defaulted on its debts in 2022, to **secure the next tranche of a USD 3 billion IMF lending package** agreed in March 2023.

- When a country defaults on its debt, it means that the **government is unable to meet its financial obligations** to its creditors. This failure can manifest in various ways and has significant implications.

What is Sri Lanka's Debt Scenario?

- Sri Lanka has foreign debts of about USD 46 bn, the largest share of which is owed to Chinese lenders, with Japan, India and commercial bondholders also large creditors.

- Sri Lanka has yet to reach a deal with the commercial bondholders, which could yet slow down progress on the country's economic recovery.
- Sri Lanka in May 2022 became the first country in the Asia-Pacific **to default on its debts in two decades**, the result of domestic economic mismanagement and a surge in global inflation following the coronavirus pandemic and **Russia's invasion of Ukraine**.
- A sharp drop in foreign currency reserves led to **shortages of imported food, fuel and medicine**, devastating living standards on the island and triggering mass protests in 2022.

What is the Paris Club?

- **About:**
 - The Paris Club is a group of **mostly western creditor countries that grew from a 1956 meeting** in which Argentina agreed to meet its public creditors in Paris.
 - It describes itself as a forum where official creditors meet to solve payment difficulties faced by debtor countries.
 - Their objective is to find sustainable debt-relief solutions for countries that are unable to repay their bilateral loans.
- **Members:**
 - The members are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Japan, Netherlands, Norway, Russia, South Korea, Spain, Sweden, Switzerland, the United Kingdom and the United States.
 - All 22 are members of the group called Organisation for Economic Co-operation and Development (OECD).
- **Involved in Debt Agreements:**

- According to its official website, Paris Club has reached **478 agreements with 102 different debtor countries**.
- Since 1956, the debt treated in the framework of Paris Club agreements amounts to USD 614 billion.
- **Recent Developments:**
 - The Paris group countries dominated bilateral lending in the last century, but their **importance has receded over the last two decades** or so with the emergence of China as the world's biggest bilateral lender.
 - In Sri Lanka's case, for instance, India, China, and Japan are the **largest bilateral creditors**.
 - **Sri Lanka's debt to China is 52% of its bilateral debt**, 19.5% to Japan, and 12% to India.

How is India Helping Sri Lanka with Debt Management and Economic Development?

- **Role in Debt Restructuring:**
 - India has played a role in collaborating with the International Monetary Fund (IMF) and creditors to help Sri Lanka in restructuring its debt.
 - India became the first country to hand over its letter of support for financing and debt restructuring of Sri Lanka.
- **Connectivity and Renewable Energy:**
 - Both countries have agreed on a joint vision that emphasises comprehensive connectivity, including People to People connectivity, renewable energy.
 - Indian companies are developing renewable energy projects in the northeast of Sri Lanka, indicating growing collaboration in the energy sector.

- **Economic and Technology Cooperation Agreement (ETCA):**
 - Both countries are exploring the possibility of an ETCA to integrate their economies and foster development.
- **Agreement on a Multi-Project Petroleum Pipeline:**
 - Both India and Sri Lanka have agreed to establish a multi-product petroleum pipeline from the southern part of India to Sri Lanka.
 - This pipeline aims to ensure an affordable and reliable supply of energy resources to Sri Lanka. Recognition of energy's critical role in economic development and progress is driving the focus on establishing the petroleum pipeline.
- **Adoption of India's UPI:**
 - Sri Lanka has also adopted India's UPI service, which is a significant step towards enhancing fintech connectivity between the two countries.
 - The use of rupee for trade settlement is further helping Sri Lanka's economy. These are concrete steps to help Sri Lanka's economic recovery and growth.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims

Q1. "Rapid Financing Instrument" and "Rapid Credit Facility" are related to the provisions of lending by which one of the following? (2022)

- (a) Asian Development Bank
- (b) International Monetary Fund
- (c) United Nations Environment Programme Finance Initiative
- (d) World Bank

Ans: (b)

Exp:

❑ Rapid Financing Instrument (RFI) provides quick financial assistance, which is available to all member countries facing urgent balance of payments requirements. The RFI

was created as part of a broader reform to make IMF financial support more flexible to meet the diverse needs of member states. The RFI replaces the IMF's previous emergency assistance policy and can be used in a wide variety of circumstances.

☐ The Rapid Credit Facility (RCF) provides immediate balance of payments (BoP) requirements to low-income countries (LICs) with no ex-post condition, where a full economic program is neither necessary nor feasible. RCF was set up as part of a comprehensive reform to make the fund's financial support more flexible and better suited to suit the diverse needs of LIC including times of crisis.

☐ There are three areas under the RCF: (i) a "regular window" for immediate BoP needs due to a wide range of sources such as household instability, emergencies and fragility (ii) for immediate BoP needs due to sudden, exogenous shocks. an "exogenous shock window" and (iii) a "large natural disaster window" for immediate BoP needs due to natural disasters where the damage is estimated to be equal to or greater than 20% of the member's GDP.

Q2. "Gold Tranche" (Reserve Tranche) refers to (2020)

- (a) a loan system of the World Bank
- (b) one of the operations of a Central Bank
- (c) a credit system granted by WTO to its members
- (d) a credit system granted by IMF to its members

Ans: (d)

Mains

Q1. In respect of India-Sri Lanka relations, discuss how domestic factors influence foreign policy. (2013)

Q2. 'India is an age-old friend of Sri Lanka.' Discuss India's role in the recent crisis in Sri Lanka in the light of the preceding statement. (2022)