

Should Sri Lanka Reboot Foreign Policy and the Economy for COVID-19 Recovery?

Chulanee Attanayake and Ganeshan Wignaraja

Summary

President Gotabaya Rajapaksa's government celebrated its first-year anniversary after winning a two-thirds majority in the parliamentary elections held on 5 August 2020. The initial months showed the government moving towards delivering ambitious promises but one year later, some fault lines are emerging. Amidst an on-going COVID-19 pandemic, the government is facing challenges on the foreign policy front and the economy. A reboot to a neutral foreign policy and an economic reform programme while continuing vaccinations could help Sri Lanka's COVID-19 recovery. This paper discusses these key aspects.

Introduction

President Gotabaya Rajapaksa's government celebrated its first-year anniversary after winning a two-thirds majority in the parliamentary elections in Sri Lanka on 5 August 2020. This victory for his party, the Sri Lanka Podujana Peramuna (SLPP), followed a landmark win in the presidential elections in November 2019.

The president's election manifesto, the 'Vistas of Prosperity and Splendour', has guided the government's ambitious national security and economic development goals. The SLPP benefited from the anti-incumbency feelings of the electorate due to the failings of Maithripala Sirisena-Ranil Wickremesinghe government which left a slowing economy, a rising external debt burden and compromised national security resulting in a terrorist attack in April 2019.

Further, the SLPP banked on the reputation of the Rajapaksa family to deliver what was promised. Having ended a costly three-decade civil conflict, which was believed to be impossible, Mahinda Rajapaksa has earned the admiration and respect among the country's Sinhala Buddhist majority electorate. Rapid post-conflict growth convinced voters of his ability to usher in economic development. President Gotabaya, despite little political experience, had developed a reputation as a doer with strong leadership.

One Year after the Parliamentary Election Victory

Following the 2019 election, the new president's task was to deliver his ambitious promises first with a minority government and later amidst a global pandemic. The initial months showed that President Gotabaya was receptive to the voters' concerns in policy making. Moreover, the government proactively responded to the COVID-19 pandemic through imposing restrictions, repatriating migrant workers, rapid contract tracing and surveillance of affected patients and creating COVID-19 treatment hospitals.

On the economy, a shift occurred from past outward-oriented policies to inward-oriented policies emphasising on state intervention in the economy. The stated aim was a people-centric and production-oriented economy through such measures as developing agriculture using advanced technology, diversifying into value added exports, strengthening local business and state-owned enterprises, and a new tax policy for domestic production. An ambitious five-year target of average growth of 6.5 per cent and per capita income of US\$6,500 (S\$8,797) were set for Sri Lanka's economic transformation.

On the foreign policy front, in an attempt to reinvigorate bilateral relations, the government emphasised on a friendly approach towards India, prioritising its security sensitivities and hinted at a new era of relations. Sri Lanka withdrew from the co-sponsored United Nations Human Rights Council (UNHRC) resolution in February 2020, which was believed to undermine Sri Lanka's sovereignty. These policy measures, along with timely and proactive decisions taken to contain the initial wave of the COVID-19, earned his party a two-thirds majority victory at the parliamentary election.

However, these developments appeared short-lived as a second wave of the pandemic soon engulfed Sri Lanka and stretched the capacity of the public health system. The number of cases grew rapidly, disrupting livelihoods and the economy. The delay in commencing a comprehensive island-wide vaccination programme and misaligned policies to mitigate community transmission during a festive season partly caused an on-going third wave. The Rajapaksa administration presently faces pressures internationally and at home as well as challenges in continuing its policy agenda.

Foreign Policy Challenge

During the election campaign, President Gotabaya signalled the commitment of developing a self-assured foreign policy that is not vulnerable to foreign pressure. His election manifesto read that his government would maintain foreign relations based on "equality" and be mindful of national sovereignty.¹ His foreign policy targetted maintaining "an equidistant and yet, cordial relations and remain neutral in the power struggle amongst nations."² The initial months showed a consistent approach. Challenging the speculation of his opponents and the international community of him being a pro-China president like his brother, his first official visit was to India. While appealing the others to respect the sovereignty and unitary status of Sri Lanka³ he also emphasised not doing anything to harm the interests of other countries.⁴ The foreign secretary reaffirmed that the government is committed to follow an India-first policy on a strategic level.⁵

¹ "GOTABAYA Presents to You a Reconstructed Country with a Future Vistas of Prosperity and Splendour", n.d., <https://gota.lk/sri-lanka-podujana-peramuna-manifesto-english.pdf>.

² Gotabaya Rajapaksa, Twitter, 19 November 2019, <https://twitter.com/GotabayaR/status/1196463705887657984?s=20>. Accessed 20 September 2021

³ [Ibid.](#)

⁴ Bharat Shakti, "We Won't Do Anything That Will Harm India's Interests: Gotabaya", YouTube, 25 November 2019, https://www.youtube.com/watch?v=P9aymd_6V2k. Accessed 20 September 2021.

⁵ Rudroneel Ghosh, "As Far as Strategic Security Considerations Go, Sri Lanka Has an 'India First' Approach", *The Times of India*, 14 August 2020, <https://timesofindia.indiatimes.com/blogs/talkingturkey/as-far-as-strategic-security-considerations-go-sri-lanka-has-an-india-first-approach/>.

However, maintaining this stance has been difficult in view of political differences within the government and Sri Lanka appears to be moving away from a neutral foreign policy stance. Although India responded to Sri Lanka's shift at the onset of the pandemic by providing essential medicines and medical supplies, and the AstraZeneca vaccine through grant-in-aid,⁶ bilateral relations have regressed with New Delhi insisting on the full implementation of the 13th Amendment of Sri Lanka's Constitution as means to resolving the long-standing ethnic issues. Colombo's breaking off the agreement with India and Japan to develop the East Container Terminal in the Colombo Port due to mounting domestic protests and India abstaining from voting in favour of Sri Lanka during the UNHRC resolution process despite intense lobbying from Sri Lanka further affected bilateral relations.

Similarly, relations with the United States (US) continue to deteriorate,⁷ mirroring relations between President Mahinda's government and the US following the end of 30-year civil conflict in May 2009. President Gotabaya's election, a former US citizen, held out the possibility of a less-tense, more business-like working relationship with the US. However, a lacklustre and disinterested response to a Millennium Challenge Corporation (MCC) Compact grant worth US\$480 million (S\$650 million) to reduce bottlenecks in transport and commercial land administration led the MCC Board to withdraw the grant in December 2020. Furthermore, the US' support for a new human rights resolution against Sri Lanka and occasional criticism of Sri Lanka's domestic and foreign policies have intensified bilateral tensions. These issues overshadow the progress which was made in the growing ties in maritime security domain over the years where bilateral maritime engagement between the two countries had grown by leaps and bounds.⁸ During the pandemic in 2020, the US provided over US\$5 million (S\$7.77 million) in assistance to Sri Lanka.⁹ It is also provided emergency medical supplies¹⁰ and donated vaccines.¹¹

Yet, the growing tensions with India and the West have further pushed Sri Lanka into China's embrace. President Gotabaya's government increasingly sees a friend in China which can bring much needed foreign exchange and other aid to Colombo. Since the pandemic struck in 2020, Beijing has provided crucial economic and health aid support.¹² Medical aid

⁶ Chulanee Attanayake and Zheng Haiqi, "China's Pandemic Diplomacy in South Asia", ISAS Insights No. 675, 15 June 2021, Institute of South Asian Studies, <https://www.isas.nus.edu.sg/papers/chinas-pandemic-diplomacy-in-south-asia/>.

⁷ Roshni Kapur and Chulanee Attanayake, "Human Rights, Geopolitics and National Priorities: Managing Fluctuations in US-Sri Lanka Relations." ISAS Working Paper No. 344, 2 June 2021, Institute of South Asian Studies, <https://www.isas.nus.edu.sg/papers/human-rights-geopolitics-and-national-priorities-managing-fluctuations-in-us-sri-lanka-relations/>. Accessed 21 September 2021.

⁸ Chulanee Attanayake, "The RIMPAC Exercise and Evolving United States-Sri Lanka Military Relations." ISAS Working Paper No. 305, Institute of South Asian Studies, 13 August 2018, <https://www.isas.nus.edu.sg/papers/305-the-rimpac-exercise-and-evolving-united-states-sri-lanka-military-relations/>. Accessed 21 September 2021.

⁹ Ibid.

¹⁰ "United States Airlifts Emergency Supplies to Help Sri Lanka Combat COVID-19 Surge - Sri Lanka," *ReliefWeb*, 15 June 15, 2021, <https://reliefweb.int/report/sri-lanka/united-states-airlifts-emergency-supplies-help-sri-lanka-combat-covid-19-surge>.

¹¹ "U.S. Donates over 1.5 Million Moderna COVID-19 Vaccines to Sri Lanka," U.S. Indo-Pacific Command, 20 July 2021, <https://www.pacom.mil/Media/News/News-Article-View/Article/2701307/us-donates-over-15-million-moderna-covid-19-vaccines-to-sri-lanka/>.

¹² Attanayake and Zheng, "China's Pandemic Diplomacy in South Asia".

aside, China provided over US\$2 billion (S\$2.71 billion) in loans¹³ and currency swaps¹⁴ to help Sri Lanka to mitigate economic distress. In addition to providing emergency anti-epidemic medical supplies, China provided over a million Sinopharm vaccines as donations and about six million as procurements. With the visit of Chinese Defense Minister General Wei Fenghe on 27 April 2021, there is talk of strengthening bilateral military ties. Moreover, China supported Sri Lanka at the UNHRC resolution. Against this backdrop, Sri Lanka appears to prioritise its relations with Beijing.¹⁵ This seems a departure from the Gotabaya government's early pledge of implementing a neutral foreign policy.

Colombo's heavy reliance on China may hinder diversifying development finance from multiple countries and aid agencies to realise its economic development. Dependence on a single powerful partner may also run counter to Sri Lanka's economic interest to increase inward investment and exports from the Colombo Port City Special Economic Zone and Hambantota Industrial Zone.¹⁶ Furthermore, it will give China additional influence, but Sri Lanka will be caught in the crossfire between the major powers in the geopolitical power struggle in the Indian Ocean.

Economic Challenge

Managing the economy during a pandemic induced economic shock which caused a contraction is another challenge.¹⁷ A downturn in garments and tourism meant the economy contracted from 3.1 per cent per year in 2017-2019 to -3.6 per cent in 2020. Poverty also rose particularly in urban areas and among informal sector workers.

To some extent, an unconventional policy mix adopted by the government in 2020 helped to support the economy. Although the limited fiscal space ruled out a significant fiscal stimulus like India and Bangladesh, about 0.8 per cent of gross domestic product was allocated to health measures and cash transfers along with postponed tax payments. The Central Bank of Sri Lanka conducted significant monetary policy easing to increase liquidity and to support business. Furthermore, import controls on non-essential items were imposed to conserve scarce foreign exchange and support proposals in the 2021 national budget for a domestic production-oriented economy. Currency swaps with China, India and Bangladesh aimed to increase foreign exchange reserves.

¹³ Press Trust India, "China Development Bank to Extend USD 500 Million Loan to Sri Lanka", *The New Indian Express*, 12 April 2021, <https://www.newindianexpress.com/world/2021/apr/12/china-development-bank-to-extend-usd-500-million-loan-to-sri-lanka-2289185.html>.

¹⁴ Press Trust India, "Sri Lanka Signs 3-Year USD 1.5 Billion Currency Swap Deal with China", *The Economic Times*, 23 March 2021, <https://economictimes.indiatimes.com/news/international/world-news/sri-lanka-signs-3-year-usd-1-5-billion-currency-swap-deal-with-china/articleshow/81647836.cms>.

¹⁵ Meera Srinivasan, "Sri Lanka Has Prioritised Relations with China, Gotabaya Tells General Wei", *The Hindu*, 29 April 2021, <https://www.thehindu.com/news/international/sri-lanka-has-prioritised-relations-with-china-gotabaya-tells-general-wei/article34442051.ece>.

¹⁶ Ganeshan Wignaraja "Post COVID-19: Positioning Sri Lanka as South Asia's Dubai", ISAS Brief No 819, 25 January 2021. <https://www.isas.nus.edu.sg/wp-content/uploads/2021/01/819-1.pdf>.

¹⁷ "Sri Lanka Declares Worst Economic Downturn in 73 Years", *France 24*, 30 April 2021, <https://www.france24.com/en/live-news/20210430-sri-lanka-declares-worst-economic-downturn-in-73-years>.

The economy picked up eight per cent in the first half of 2021 underpinned by strong growth in agriculture and industrial activities which were broadly kept working. The pick-up reflects a low base effect, cheap credit to business and pent-up consumer demand. However, prolonged import substitution could misallocate resource allocation, encourage rent-seeking behaviour and invite retaliation from trading partners. Risks are also emerging relating to the duration of the pandemic, hesitant tourism arrivals and foreign investment inflows, macroeconomic policy inconsistencies and tightening global financial conditions. Thus, Sri Lanka's economic outlook is clouded by a high degree of uncertainty. Unfavourable external debt dynamics have compounded economic uncertainty. In December 2020, Sri Lanka's external debt reached US\$49.2 billion (S\$66.6 billion) with substantial debt repayments of US\$4-5 billion (S\$5.4-6.8 billion) a year required between 2022 and 2026. Sri Lanka's high levels of external debt, which rose during the pandemic, reflects persistent fiscal and current account deficits, notable currency depreciation, the costs of a 30-year civil conflict, lacklustre post-conflict growth and falling tax revenue. Increasing concerns about debt servicing capability against low foreign exchange reserves have led to international credit rating agencies downgrading Sri Lanka's ratings, foreign capital outflows and pressures on the currency. In an interesting geopolitical twist, Sri Lanka is not engulfed in a Chinese debt trap¹⁸ as external debt owed to China amounted to about 10 per cent of the external debt stock in August 2020. International capital markets make up 47 per cent, and multilateral developments, Japan and India make up the remainder. If Chinese commercial lending were to rise, however, the probability of Sri Lanka falling into a Chinese debt trap may increase.

A Need for a Reboot?

The first anniversary of the SLPP election victory has not turned out as expected. Sri Lanka appears to be facing simmering crises in its foreign policy and economy. In its increasing closeness to China, Sri Lanka's relations with the rest of the world mirror the situation of the previous Rajapaksa administration. The economy is confronting high uncertainty, a stop-go business cycle, a high external debt overhang and rising poverty. There is scope for a refined strategy in both areas. In public, the government have ruled out seeking an International Monetary Fund (IMF) programme, which would provide assurance to international financial markets and enable Sri Lanka to borrow again. But an IMF programme would come with conditionalities like fiscal consolidation which limit domestic policy space. Policy makers have said that they will honour all foreign debt obligations and are focussing on increasing non-debt foreign inflows through sale of state assets, increasing exports and import restrictions. IMF or no IMF, a programme of homegrown structural reforms to tackle economic problems and reassure the markets as well as a strictly neutral foreign policy towards great powers are essential for Sri Lanka to progress in pandemic times.

Sri Lanka's geopolitical positioning in the Indian Ocean and its growing strategic prominence have opened new doors and opportunities for the country. Regional and extra regional powers see Sri Lanka as an indispensable partner in realising their strategic and geopolitical interests in the region. With the emergence of the Quad and the US' growing eagerness to

¹⁸ Ganeshan Wignaraja, Dinusha Panditaratne, Pabasara Kannangara and Diviya Hundlani, "The Chinese Investment and BRI in Sri Lanka", Research Paper, Chatham House, March 2020, <https://www.chathamhouse.org/2020/03/chinese-investment-and-bri-sri-lanka>.

limit China's influence in the Indo Pacific space, Sri Lanka has an opportunity to leverage its relationship with all interested major powers. Against this backdrop, Sri Lanka has the ability to hedge between major powers to support its foreign and economic interests. Hence, Sri Lanka should tread the path carefully, without tilting to one power, yet maintaining its neutrality. Only returning to this policy would allow Sri Lanka to use its foreign relations for economic advancement.

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Dr Chulanee Attanayake is a Research Fellow at the Institute of South Asian Studies, National University of Singapore. She can be contacted at chulanee@nus.edu.sg. Dr Ganeshan Wignaraja is a Non-Resident Senior Fellow at the Institute. He can be contacted on gwnignaraja@gmail.com. The authors bear full responsibility for the facts cited and opinions expressed in this paper.