# Sri Lanka: Economic crisis and household debt in the north

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> **The current economic crisis cannot be resolved by households or social institutions alone, and loans are not the solution. The Government should introduce livelihood and income stabilisation programs to help people escape the debt trap. It should also leverage cooperatives to create markets and supply chains for rural production, while expanding affordable credit for rural livelihoods and small-scale industrial growth. Additionally, a universal social security program should be implemented**

The ongoing crisis in Sri Lanka has greatly affected household debt. As the economy worsened due to inflation, higher living costs and job losses, more households are relying on debt. A significant portion of Sri Lankan households rely on microfinance companies or informal lenders and are trapped in cycles of debt. The situation mirrors what northern and eastern part of the country faced 10 years ago, which led many women to commit suicide or leave their homes.

The household debt crisis is often attributed to people taking loans for conspicuous consumption and if financial literacy was provided, the people would avoid falling into the debt trap. However, amidst the current economic crisis, people are caught in another debt crisis. This time no one can deny that people are forced to take loans to meet their livelihood needs and cover daily essentials due to the effects of this crisis. Therefore, simply giving financial literacy will not help them escape the debt trap.

### Effects on the households

Since 2022, when the economic crisis hit, inflation increased the prices of raw materials, energy, and transportation. Sectors such as Agriculture, Manufacturing, Small and Medium – size Entrepreneurs are facing difficulties in maintaining profit margins and have reduced their workforce leading to unemployment. Due to limited job opportunities many family members are migrating abroad for work.

When import tariffs and indirect taxes are imposed, and subsidies are removed, people pay higher prices for essential items, thus, medical, educational, fuel, and utility cost have increased. Our country depends on imports even for essentials goods such as rice, dhal, sugar, milk and so on. Therefore, the need for money to run a household has substantially increased.

Household incomes are inadequate to keep up with rising living costs. People have been pushed to take loans or lose their small savings or assets to manage their livelihood. The current crisis has eliminated or reduced the means of repaying loans. As a result, more loans are taken to repay the loans previously taken.

### Impact on different social groups

The ongoing crisis has impacted different social groups in varied ways, however, it reveals a pattern of how they have fallen into debt. People who do not have stable incomes, resources or assets are likely to fall into the debt trap quickly.

For the fishing community, an increase in the price of fuel impacted operational costs, making it less profitable to go out to sea. The impact differs depending on the scale. Large-scale fishers have resources such as assets and social connections with state and commercial banks, so they don't fall into the debt trap immediately. Small-scale fishers don't have such connections to meet their financial needs in an affordable way. When the cost of fishing equipment (nets, hooks, engines and boats) increases, this makes it difficult for them to maintain or replace their equipment. Many small-scale fishers rely on loans from financial institutions or informal lenders (Sammaddy) to finance their operations. Often, these loans come with high interest rates, further deepening their financial burden and difficulty to repay, and eventually leading to a cycle of debt that many fishermen struggle to escape.

Farmers face rising costs for inputs like fertilisers, pesticides, and seeds. The Government's 2021 ban on chemical fertilisers reduced agricultural productivity, while fuel price hikes, driven by the economic crisis, increased costs for machinery and transportation. These factors reduced profitability, causing farmers to cut back on labour, resulting in fewer job opportunities for agricultural wage workers. To manage these pressures, large-scale farmers turn to state and commercial bank loans or pawn jewellery, while small farmers rely on village-level institutions and microfinance companies. However, poor harvests and rising costs prevent many small farmers from repaying their loans, trapping them in a cycle of debt and eroding their economic resilience.

Daily wages have increased from Rs. 1,000 to Rs. 3,000 over the last three years, but job opportunities have decreased, leaving monthly income insufficient for basic needs. Many low-income earners and daily-wage workers have turned to borrowing to cover living expenses, taking out multiple loans from village savings groups, microfinance companies, and credit cooperatives, trapping them in a debt cycle. This crisis has depleted household savings and emergency funds. In this context, microfinance companies exploit people by offering daily, weekly, and monthly loans at high interest rates, targeting vulnerable people because credit is their only available means of survival.

**Behaviour of credit providers**

State and commercial banks provide loans only to people who have assets or guarantors – Government employees, large-scale farmers and fishermen – afer evaluating the borrower's credit worthiness. Small-scale farmers, fishermen, daily wage-workers, and low-income earners are unable to access such loans.

Microfinance companies claim to provide fast and flexible loans at the doorstep, without assessing borrower's repayment capacity. Then, they pressure borrowers to repay the loans on time. As a result, families prioritise repaying the loans from their income and are forced to take out new loans to meet their basic needs.

Local moneylenders too offer high-interest loans during emergencies in an outwardly friendly manner. However, borrowers end up paying the interest for the rest of their lives for the loan they once received.

People end up using most of their time, labour, and incomes to obtain and repay the loans. Many women have become members of multiple village-level credit groups and spend 3 to 4 days a week attending group meetings to become eligible for loans. They also make small savings to use as

collateral for the loans they borrow. To build these savings, they borrow money from friends, relatives, and microfinance companies that offer daily loans. Social groups who are directly affected by the debt crisis do not have time or agents to voice their issues or struggle against the exploitation, as all their time and labour are spent on their daily survival.

**Role of State and social institutions**

The Government has failed to provide adequate social welfare for low-income and daily wage workers. Cash transfers and food aid have limited scope and don't reach vulnerable people. The Aswesuma program offers Rs. 3,000-15,000 monthly based on family size and vulnerability, but a four-member household needs at least Rs. 3,000 daily to survive. Delays in aid disbursement and bureaucratic hurdles further prevent timely support.

Cooperatives and village groups offer affordable loans that help people maintain financial liquidity. However, they lack the capacity to provide loans for increasing credit needs and higher amounts because they circulate loans from the savings of their members. Cooperatives should enhance access to affordable credit by strengthening cooperative networks with unions and federations. In addition to offering credit services, they should focus on creating marketing opportunities for rural producers and ensuring efficient distribution of quality goods and services to consumers at fair prices.

Community-level organisations and non-governmental organisations should not limit their duties to merely providing low-interest loans as an immediate solution to this complex problem. They have a duty to reveal the depth of the issue and pressure the Government for permanent solutions.

The current economic crisis cannot be resolved by households or social institutions alone, and loans are not the solution. The Government should introduce livelihood and income stabilisation programs to help people escape the debt trap. It should also leverage cooperatives to create markets and supply chains for rural production, while expanding affordable credit for rural livelihoods and small-scale industrial growth. Additionally, a universal social security program should be implemented.

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