The BLUE PRINT

OUT OF THE DEBT TRAP & TOWARDS SUSTAINABLE INCLUSIVE DEVELOPMENT

VERSION 2.0: EXTENDED TEN-POINT PROGRAM

SJB ECONOMIC POLICY UNIT

BLUEPRINT 2.0: OUT OF THE DEBT TRAP & TOWARDS SUSTAINABLE INCLUSIVE DEVELOPMENT

A Ten-Point Program for Sri Lanka's Economic Stabilisation and Equitable Growth

The original 'Blueprint', published and tabled in Parliament on 12 August 2022, spelled out how to stabilize the economy. 'Blueprint 2.0' has been updated to reflect subsequent events and provides a more detailed plan to move Sri Lanka beyond stabilisation towards sustainable and inclusive growth. [1] [2]

EXECUTIVE SUMMARY

Sri Lanka's economic crisis is not unexpected. Decades of short-sighted policies and half-hearted reforms weakened our foundation. Sudden global crises pushed us to the brink. Appalling mismanagement took us over the edge. Today, the state is bankrupt, inflation is rampant, the economy is faltering, and our socio-political order is in crisis. Yet we can still recover: we can regain our ground, reform our economy, and rebuild our country. Blueprint 2.0 tells us how.[3]

Anti-corruption and transparency laws are the bedrock of true, lasting change; and their rigorous implementation is essential to building a society that is just, equitable, and free from corruption.

We must obtain bridge financing for our debt crisis and productively engage with the International Monetary Fund while restructuring our debt. We must maintain financial system stability as we do so. Carefully floating the exchange rate to market levels and raising interest rates will control inflation and restore the economy's international competitiveness. Monetary policy reform will ensure that we do not backslide into crisis. Fiscal reform, including sustainable tax revenue increase, expenditure rationalisation, and reform of state-owned enterprises, is also critical.

As we stabilise, we must also grow. It is essential that we promote trade, industry, agriculture, and services by unshackling markets, increasing competitiveness and productivity, promoting exports and investment, and integrating with global production networks. Transforming the public sector into a productive, efficient, digitally enabled workforce that serves the needs of Sri Lanka's citizens, is also vital for growth. Reforms in the energy and utilities sectors are particularly important. Land and labour market reform will enable and amplify this growth.

Targeted, means-tested cash transfers within a strong, transparent, effective social safety net must safeguard those who need it most. These reforms will enable more citizens to access the opportunities stemming from growth.

This will not be an easy path, but it is our only route out of debt and towards sustainable inclusive development.

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[1] This document is prepared by Harsha de Silva, a member of the Samagi Jana Balawegaya (SJB)'s Economic Policy Unit consisting of the author, Kabir Hashim, MP and Eran Wickremeratna, MP; and is endorsed by SJB Leader Sajith Premadasa, MP. Valuable advice and commentary from Professor Premachandra Athukorala and several economists are acknowledged with gratitude.

[2] This document also incorporates, in tables, the short-medium term action plan detailed in the 'Common Minimum Program' compiled mid-2022 by the National Movement for Social Justice (NMSJ) using proposals from Advocata Institute, BASL, Elle Gunawansa Thero, independent economists' group, NMSJ, NPP, SJB, and 43 Brigade and discussed with the SLFP and business leaders. 'Timeframe' refers to timeline for completion, denoted as S: until Staff-Level Agreement with IMF; M: up to Extended Fund Facility with IMF; and L: Beyond. Changes to the original tables are tagged with '**New**' and **'Revised**' to indicate additional or modified proposals, and '***Update***' and '***Commentary***' to indicate the author's perspectives on developments since August 2022.

[3] This document focuses solely on economic stabilisation and growth: it does *not* include in-depth views of the author, the SJB, or any others on reforms in critical areas such as education, health, justice, reconciliation, environment, or any other aspects. It is not a comprehensive manifesto.

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DIAGNOSIS OF AN ECONOMIC DISASTER

In the 75 years since our independence, Sri Lanka has achieved much in terms of human development, despite lingering human rights issues and gaps in democratic governance. Yet we have been economically mediocre: our per capita income declined from USD 4077 in 2017 to USD 3815 in 2021 and will be far lower in 2022 and 2023. We have been left behind by nations that were lagging us in the 1960s. Why?

Historical local causes: Short-sighted and inward-looking policies

From 1970-1977, Sri Lanka followed statist, insular policies while other countries in the region liberalised markets and integrated globally. Our liberalisation reforms, which began in 1977 and received new impetus in the early 1990s, significantly transformed Sri Lanka's economic landscape despite incomplete implementation and the debilitating effects of the civil war and youth uprising during the late 1980s. By the mid-1990s, Sri Lanka ranked amongst the few developing countries that had made a clear policy transition from inward orientation to global economic integration. Yet subsequent governments did not allow markets to function efficiently: they postponed essential reforms, took poor decisions for political gain, and allowed crony capitalism to prosper.

Fiscal and current account deficits have been a hallmark of every government since independence, and welfare politics has been used to woo voters. The 2003 attempt to bring fiscal discipline was thwarted by weakening the Fiscal Management (Responsibility) Act. The backlash against reforms gained impetus after the end of the thirty-year civil war in May 2009. The government emphasised the role of the state and embarked on massive debt-fuelled infrastructure projects. Sri Lanka's total external debt reached over 54% of GDP by 2014. The composition of debt shifted dramatically from conventional concessionary bilateral development aid and multilateral loans, to borrowing from costly market sources and issuing international sovereign bonds (ISBs). In 2004, just 2.5% of the Sri Lankan government's foreign loans were commercial, but by end 2014 this figure had reached 52% of accumulated foreign loans. By the time of political regime shift in early 2015, the dark clouds of the impending economic storm were already gathering on the horizon.

In 2016, the coalition government attempted to reverse this trend with the support of the International Monetary Fund (IMF), under a four-year Extended Fund Facility (EFF). It entered a revenue-enhancing fiscal consolidation program and registered a primary account surplus for the first time in decades. However, due to ideological clashes between the coalition parties, key reform items (such as rationalising border tariffs, unbundling utilities, revamping foreign direct investment (FDI) policies, and entering into regional trade agreements) were abandoned, which contributed to external debt increasing. By 2019, debt repayments and interest payments accounted for over a third of total earnings from goods and services exports; external debt servicing absorbed nearly 70% of total government revenue. By the end of 2019, Sri Lanka's annual estimated debt service commitment (repayment of debt and interest payment) for the next two years reached USD 5 billion.

Contributing global factors: Major external shocks

Our debt distress was compounded by the onset of the Covid-19 pandemic in March 2020. The complete closure of national borders caused a major external shock to the economy, demolishing forex inflows through tourism. The Russian invasion of Ukraine in 2022, and the global supply chain crisis it prompted, exacerbated Sri Lanka's crisis.

Immediate local causes: Poor policies, mismanagement, and ego

The Gotabaya Rajapaksa government subjected the economy to two major, unnecessary, policy shocks: Firstly, it implemented unprecedented tax cuts in December 2019, based on a wrong interpretation of 'Modern Monetary Theory'. This wiped off one third of government revenue (estimated LKR 600 bn in 2020) and caused a high budget deficit, which was financed with printed money. Sovereign rating agencies immediately downgraded Sri Lanka's outlook, affecting our ability to access private credit markets. Secondly, the administration implemented an overnight ban on imported chemical agricultural inputs, which resulted in the harvest falling by one third to half of usual output, depending on the crop. As a result, there was an unprecedented shortage of produce and a greater reliance on imports.

The government treated this looming crisis as a temporary liquidity shock due to the pandemic and ignored the systemic issues of solvency. They thus took short-term actions such as quantitative import restrictions and forex restrictions on current account transactions, sought short-term financial support via swaps from Bangladesh, India, and China, and financed essential imports from supplier credit and foreign exchange (forex) reserves.

Misguided exchange and monetary policy put the final nail in the coffin. The government used forex reserves to repay debt and defend the pegged exchange rate at around LKR 200/USD, thus draining Sri Lanka's reserves from USD 7.6 bn in end-2019, to less than USD 50 mn by April 2022. The Central Bank of Sri Lanka (CBSL) took the contradictory policy of artificially holding interest rates as well as exchange rates, putting further pressure on the rupee. Between January 2020 and December 2021, the CBSL printed money nonstop, resulting in a 41% increase in the broad money supply. Black-market rates for forex rose rapidly, at a 30% premium of the official rate. Exporters held dollars abroad and remittance inflows dried up to less than 40% of usual values.

After 18 months of denial, the CBSL abandoned the LKR 200/USD rate on 7 March 2022. However, the exchange rate plummeted to LKR 365/USD by July 2022 because the CBSL did not sequence this adjustment. The weak rupee meant that the price of all goods and services shot up, prompting a cost-of-living crisis.

The consequences: A predictable but terrible crisis

This economic catastrophe is therefore no surprise. But what has it resulted in?

- **Sovereign insolvency**:

  In April 2022 Sri Lanka announced unilateral suspension of all external debt repayments (apart from multilateral debt), signalling bankruptcy for the first time since independence. The government ran out of forex and businesses were unable to open letters of credit for essential imports.

- **Inflation, shortages, and a national shutdown:**

  Inflation hit an unprecedented high in 2022, and though it is now stabilising due to interest rate hikes and the reduction of money printing, price levels remain alarmingly high. In 2022, lack of forex for fuel resulted in 12-hour power cuts due to power plant closures, kilometres-long fuel queues in which more than fifteen people died, and a nation-wide shutdown of schools and government offices. The fuel quota system has helped bring order, but fuel shortages are still hampering agriculture, fishing, and other industries. Essentials such as medicine and food are also facing shortages and inflation, affecting the average person's daily subsistence. Essential government services – including health and education – are unable to operate as usual. Crime has increased and shortages may result in further breakdown of social order. There have been tragic incidents of parents unable to feed their children committing suicide. Migration to less troubled pastures is top of mind for almost all, prompting worries of extreme brain drain that will compound Sri Lanka's troubles in the future.

- **Political crisis:**

  In 2022, the public demanded leadership change, especially President Gotabaya Rajapaksa's resignation – and so the *Aragalaya's* cry, "#GotaGoHome." On 31 March, there were protests outside his private residence. Despite imposing emergency, a 36-hour curfew, and a social media ban, crowds reiterated this call across Sri Lanka on 3 April, causing the Cabinet including Basil and Namal Rajapaksa to resign. Protestors established 'Occupy'-style demonstration sites outside the Presidential Secretariat in Colombo (GotaGoGama), and around the island. On 19 April, the police killed a protester in Rambukkana. On 9 May, pro-SLPP supporters from the Prime Minister's (PM) official residence attacked GotaGoGama. This prompted counter-violence from protestors that included the killing of a ruling party Member of Parliament (MP) and his security officer, and the arson of 50 government MPs' properties. Mahinda Rajapaksa resigned as PM, and Ranil Wickremesinghe, the sole MP from the United National Party, replaced him. On 9 July, enormous crowds gathered in Colombo despite the lack of transportation and stormed the President's and PM's official residences. PM Wickremesinghe's private residence was torched. President Rajapaksa fled the country temporarily, and finally resigned on 15 July. Parliament elected PM Wickremesinghe President on 20 July despite objections that he was a proxy for the Rajapaksas. The new president immediately cracked down on protestors: GotaGoGama was broken up, and many activists were arrested.

  With local elections coming up, competing candidates are now exploiting the public's desperation for real change by diverting the conversation from critical economic priorities to superficial political tactics. Yet unrealistic, vote-seeking, populist policies are what brought Sri Lanka to this crisis: we must not be misled by them again.

BLUEPRINT 2.0: A TEN-POINT PROGRAM FOR ECONOMIC STABILISATION AND EQUITABLE GROWTH

Though our economic position is dire, there is a way out of the crisis through reforms in ten key areas, which this document outlines. **As this is not a holistic policy manifesto, it does not address important reform areas such as health, education, reconciliation, or climate protection in detail.** The Blueprint 2.0 is simply a plan for economic salvation and survival, and a strategy for equitable growth.

The ten pillars of reform:

ERASE CORRUPTION

Transparency and Accountability

STABILISE THE ECONOMY

Debt Crisis Management
Monetary and Exchange Rate Policy
Revenue Consolidation
Expenditure Control

INCENTIVISE GROWTH

Trade, Industry, Agriculture, and Services Promotion
Public Sector Management and Digitalisation
Energy and Utilities Reform
Factor Market Reform

ENSURE EQUITY

Stronger Social Safety Nets

We must destroy the cancer of corruption to get Sri Lanka back on track: this is the foundation of all other change.

1. Transparency and Accountability

Sri Lanka ranked 102 from 180 countries in Transparency International's Corruption Perception Index in 2021, and 79% of citizens believe government corruption is a major issue. This has led to both loss of revenue and wasted expenditure, contributing to this economic collapse. Therefore, it is imperative that the administration must introduce and implement strong anti-corruption legislation as one of its first actions. This should include re-enacting the Independent Commission to Investigate Bribery and Corruption and implementing the United Nations Convention Against Corruption; globally accepted rules and punishments for corrupt practices. Getting rid of corruption requires a fundamental change in how we run our government, from the very top – and is essential if we are to build a better future for this country.

Intervention	Timeframe
Empower the Independent Commission to Investigate Bribery and Corruption, which the public perceives as ineffective.	S
Strengthen the legal framework to expedite the Stolen Asset Recovery Initiative (StAR). ***Update****: The government pledged to introduce an Anti-Corruption Bill which includes StAR, but did not release a draft yet, so this remains a political promise. Assets illegally acquired and hidden locally or in foreign jurisdictions must be pursued and recovered.*	S
New: Legislate the requirement to make public, the assets and liability declarations of elected representatives and public officials.	M
New: Create an independent public prosecutor's office to legally pursue corrupt persons. The independent public prosecution office will have no conflict of interest in pursuing alleged-corrupt personnel, as opposed to the Attorney General.	M

Commentary*: Despite public demands to improve transparency and accountability, the government has made little effort on this front. It promised to introduce an Anti-Corruption Bill which includes the StAR Initiative; but has not taken sufficient action on this. Indeed, the government's actions have contradicted their promises: for example, appointing a Government MP as the chair of the Committee on Public Enterprises is a barrier to establishing accountability, as the norm dictates appointing an Opposition MP to head such committees.*

Bringing stability and order to Sri Lanka's economic and financial system is the need of the hour.

2. Debt Crisis Management

Sri Lanka's urgent priority is to manage the sovereign debt crisis by obtaining critical bridge financing, as well as continuing to engage with the IMF, and expediting the debt-restructuring process with creditor assurances. Concurrently maintaining the stability of the financial system is of utmost importance.

2.1 MANAGE IMPORTS AND OBTAIN BRIDGING FINANCE

Sovereign credit rating agencies have downgraded Sri Lanka to 'default,' signalling tough times until we enter an EFF with the IMF. As a temporary policy measure, we must manage import flows of essentials in line with current account receipts (made up of export earnings, remittances, and tourist receipts), until we secure bridge financing from friendly nations or from the IMF under its Rapid Finance Instrument (RFI) facility.

Currently, restrictive regulations are in place to increase current account receipts from exports (e.g., mandatory remittance and conversion of full value of export, less allowed deductions, within 180 days of shipment; mandatory weekly sale of 25% of forex converted by banks to the CBSL). These regulations disincentivise export repatriation, reduce bank liquidity, and make it impossible to achieve a stable equilibrium exchange rate. The rupee's depreciation has not also increased worker remittance inflows as expected, and tourism has not yet recovered fully. Suggestions to increase forex inflows (by issuing resident visas for foreign currency deposits and offering higher interest rates for long-term investments) would only marginally impact forex volumes. With increased interest rates alongside a weakened currency, import/demand compression will be significant. Yet only 20% of Sri Lanka's imports are for consumption, while 60% are intermediate and 20% capital goods. Therefore, import compression will slow down growth significantly.

The Central Bank of Sri Lanka (CBSL) has severely curtailed imports of luxury items, to ensure that sufficient foreign exchange is available to import essential goods and make multilateral debt repayments. Demand management for fuel and electricity has also contributed to a lower requirement of foreign exchange inflows, but continuing this can be harmful for the economy. Therefore, it is essential that we expedite the external debt restructuring process by strengthening diplomatic relations with our creditor nations, which is discussed below.

Parallel to the debt restructuring process, we should pursue some short-term bridge finances from friendly nations as well as from multilateral agencies to bridge the external resource financing gap. In obtaining such support, priority should be given to ensure uninterrupted fuel and electricity supply, which is currently restricted, with resulting adverse effects on the economy. Privatization of some state assets remains an option, but frantically selling assets without transparency and competition will be disastrous. The government should establish a transparent and competitive process pertaining to privatization, and this effort should be part of overall State-Owned Enterprise (SOE) restructuring and long-term economic policy as opposed to a desperate move to resolve the liquidity crisis in the short term.

2.2 ENGAGE THE IMF AND RESTRUCTURE EXTERNAL DEBT

After the debt default, confidence in Sri Lanka among international financial markets and trade partners is damaged – as can be seen by most fuel and coal suppliers' lack of interest in dealing with our government. For Sri Lanka to move towards prosperity, we should restore global confidence and trust in our economy. An IMF programme is essential to ensure that Sri Lankan businesses regain the ability to engage with international trade. 'Home-grown solutions' simply cannot restore confidence among foreign nations and players, given our track record.

Any IMF-supported stabilisation program should have four pillars: (a) exchange rate, fiscal, and monetary reforms, (b) unshackling the economy from direct government intervention, (c) export development including removal of the import restriction regime and (d) strengthening social protection programs to make reforms digestible for the people; especially at low incomes. To recover quickly from the crisis, these reforms need to be implemented in one package. Economic governance and public financial management (e.g., public procurement rules) should also be strengthened, reducing room for corruption. Successfully implementing a stabilisation program with equity would improve stakeholder confidence, create a conducive environment for positive revision of the sovereign credit rating, win back external financiers, promote inward FDI, and regain the confidence of the people.

On 1 September 2022, Sri Lanka reached a Staff Level Agreement with the IMF to support the government's economic adjustment and reform policies with a new 48-month EFF with requested access of about SDR 2.2 bn (equivalent to USD 2.9 bn). However, Sri Lanka is yet to receive the IMF Executive Board's approval due to delays in securing financing assurances from creditors. By February 2023, India and Paris Club countries had confirmed to the IMF that they are providing financing assurances to Sri Lanka. However, as of the second week of February, Sri Lanka's largest bilateral creditor, China, has yet to confirm these assurances. As a result, Sri Lanka is unable to unlock IMF funding. It is unfortunate that the government denies any access to information on discussions with the IMF on proposed reforms, even to the Parliament Committee on Public Finance. This is detrimental in obtaining broad support across the political divide and could cause politically driven public agitation.

Restructuring debt is a complex and difficult process, with different types of creditors requiring different approaches (i.e., multilateral lenders such as the IMF and World Bank, vs. official bilateral creditors, vs. private creditors and holders of ISBs, vs. China). In restructuring ISBs, the process; from consent solicitation to issuing new bonds with revised terms, is expected to take a minimum of six months if the government cooperates with negotiators. This has been complicated due to multiple reasons and in the meantime one creditor (the Hamilton Reserve Bank) is suing for immediate and full repayment of its debt in New York federal courts.

A clear strategy should be devised and coordinated by the Finance and Foreign Ministries (i.e., Economic Diplomacy). These diplomatic relationships are essential to ensure economic stability. The debt restructure of the ISBs also must be organised after the first IMF tranche is disbursed. Holders of ISBs are private creditors who will require a different restructuring plan and may have a multitude of requirements. A future government may also have to address the domestic debt position, ensuring financial system stability in the longer term.

2.3 ENSURE FINANCIAL SYSTEM STABILITY

The government has so far limited restructuring discussions to foreign debt, believing that domestic debt issued in LKR will not have to be restructured. Any haircut to domestic creditors would negatively impact liquidity and solvency of the banking system and the Employees' Provident Fund. The interconnectivity of the financial system means that stress in one institution will spread, causing systemic instability. Rating agencies have already placed all state and private banks on a negative rating and downgraded state banks to default. Non-bank financial institutions such as finance/leasing companies are more vulnerable than banks due to comparatively lax regulations. Since they attract retail depositors, this poses substantial risks. Debts related to SOEs also pose significant risks.

However, domestic creditors have already suffered losses due to inflation, and would also be impacted by forex debt restructure through their exposure to ISBs and Sri Lanka Development Bonds (SLDBs). A group of ISB holders (who account for about 70% of Sri Lanka's outstanding ISBs) have already informed the IMF that they are ready for restructuring subject to the condition that domestic debt be 'reorganised' in a manner that both ensures debt sustainability and safeguards financial stability. Therefore, a holistic plan to mitigate future losses of domestic creditors is critical for maintaining financial system stability and speedy restructuring of ISBs. In addition, the two state banks should be adequately recapitalised (estimated USD 2-3 bn) to recover from the CBSL's mismanagement since end-2019. In this environment, banks and other financial institutions will not be able to extend much patience to borrowers, despite the economic downturn and inflation. In this context, there will be opportunities for attractive risk adjusted returns for FDI into the banking system, requiring innovative financial engineering.

Intervention	Timeframe
Manage imports in line with Current Account receipts and obtain bridge financing from friendly nations in terms of (a) credit lines for imports; (b) foreign currency swaps or (c) some innovative mechanisms. ***Update****: Imports are now mostly managed in line with current account receipts, but no bridge financing has come through.*	S
Continue to engage the IMF with to obtain a Staff Level Agreement leading to IMF Board approval for an EFF. ***Update****: The government and IMF reached a Staff Level Agreement on 01 September 2022. However, the EFF is delayed due to not obtaining financing assurances from all bilateral creditors; as of February 2023, only China's assurance is pending.*	S
Revised*:* Strengthen diplomatic engagement with creditor countries and the Paris club to expedite the external debt restructure.	S
Revised: Avoid domestic currency debt restructuring. However, if domestic restructuring must take place, limit treatment to reprofiling with some regulatory forbearance (this may be under the purview of the public debt office). It is critically important to ensure financial system stability (some banks are significantly exposed to forex debt; ISB and SLDB). ***Update****: There has been no discussion on domestic debt restructure even though ISB holders have specifically stated that they expect some form of 'reorganization' of domestic debt.*	M
Create a centralized public debt office, which will require highly skilled (and well-paid) professionals. Downside to locating inside CBSL. ***Update****: There has been no visible progress on this.*	M

Commentary*: The IMF Staff Level Agreement for financing under an EFF program can only be approved by its Executive Board of Directors after the process of debt restructuring is completed or considerable progress is made towards it. Thus,* *external debt restructuring is critical for economic stability. The government has reached a Staff Level Agreement and obtained the consent and support of both the Paris club and India to restructure debt. However, it has failed to obtain IMF Board approval as of February 2023 pending Chinese commitments to financing assurances. This remains the key to enabling the release of funds and further progressing in debt restructuring. However, the government has not been proactive enough to get Chinese banks on board the debt restructuring plan. While this can be a challenging task with many complexities, this critical matter which was highlighted months earlier, has not been treated with urgency.*

3. Monetary and Exchange Rate Policy

It is essential that the government acts to stabilise the monetary environment, using measures including exchange rate and interest rate adjustment, and monetary policy reforms.

3.1 EXCHANGE RATE ADJUSTMENT

Balance of payment difficulties and the black-market premium in the official forex market will be eliminated by adjusting the exchange rate to the equilibrium (market) level. This can be done through a transitional phase of floating the currency to permit market forces to reveal the equilibrium rate, and then stabilising that rate through CBSL intervention in the forex market. There are three prerequisites for doing this: firstly, forex restrictions on current account transactions, quantitative import restrictions, and forced conversion rules must be gradually removed; secondly, debt restructuring with the IMF must begin to increase confidence in fiscal/monetary discipline and improve dollar inflows; and thirdly, there must be adequate forex reserves to support the currency. It is worth noting that none of these prerequisites were done when the CBSL floated the currency in March.

3.2 INTEREST RATE ADJUSTMENT

Policy interest rates should have been raised significantly before the currency float – this would have helped to bring export proceeds to Sri Lanka and compressed demand. With year-on-year national headline inflation (NCPI) at 54.6% and food inflation at 80.1% by mid-2022, there was no way to establish price stability without a major interest rate adjustment. Accordingly, the first action of the new CBSL Governor was to raise policy rates by 700 basis points (bp) on 8 April, and again by 100 bp on 5 July 2022. The entire term structure of interest rates shifted up. Treasury bill rates shot up to 33% (Weighted Average Yield Rate for 91 day TB) by October 2022 and since stabilized at around 30% as of mid-February 2023. This, along with the depreciated currency, has reduced aggregate demand as expected. The CBSL should not try to suppress rates by refusing to accept market determined bids, as this would lead to money printing and inflation. The CBSL must obtain its weekly bill and bond funding requirement from the market at market clearing rates. These high rates will negatively impact growth, as expected. This must be addressed, but the increase was needed to avoid hyperinflation.

3.3 MONETARY POLICY REFORMS

Sri Lanka has long allowed monetary policy to be dominated by fiscal policy: the CBSL has printed money for the Treasury's political objectives, leading to high inflation and loss of competitiveness. The existing Monetary Law Act (MLA) allows this. It is important to legislate amendments to the MLA based on the draft that the Cabinet approved in

2018 but with CBSL being fully accountable to Parliament. However, the most important revision will be to prevent the monetisation of government and public sector debt driven by political objectives

Intervention	Timeframe
Allow exchange rate to reach equilibrium market value, through transitional phasing and subsequent stabilisation. ***Update****: The exchange rate stabilized at around LKR 370/USD based on a managed float*.	S
Raise interest rates to the level required to manage inflationary pressure. ***Update****: This has been done, but the effects on the economy are mixed, as discussed below.*	S
Move towards obtaining weekly bill and bond funding requirements from the market at market clearing rates. ***Update****: Much of the weekly requirement is now being obtained from the market with the CBSL still funding a part of the requirement.*	S
Ensure the independence of the CBSL by passing a new Monetary Law Act with necessary improvements to end discretionary money printing and building the CBSL's institutional independence with accountability to Parliament. ***Update****: The Cabinet has approved the legislation, but it has not yet been presented for approval by Parliament.*	M
Gradually unwind the CBSL domestic balance sheet in a carefully sequenced manner alongside market interest rate adjustments and foreign inflows. ***Update****: CBSL holdings of government securities as of 10 February 2023 is LKR 2,551 bn. Central bank financing of government deficit through money printing slightly reduced in 2023.*	M

Commentary: *Raising policy rates and therefore the entire term structure has had the desired monetary policy effect of stabilising the currency and slowing down inflation. However, it is causing the economy to shrink, resulting in business closure and job losses on one hand, and liquidity and solvency concerns for certain banks on the other.*

4. Revenue Consolidation

Fiscal sector reform is fundamentally important: the budget deficit must be reduced by both widening the tax base and restraining spending. There is ample room to strengthen the tax base as populist polices resulted in Sri Lanka having one of the lowest revenue-to-GDP ratios in the world (8.7% in 2021; with tax at only 7.7%). The 2017 Inland Revenue Act brought this ratio to 13.5% within a year but was scrapped in December 2019. However, revenue consolidation efforts, particularly increasing taxes, should be done cautiously in a shrinking economy. In determining tax rates, tax slabs, and tax-free allowances, the government needs to account for inflationary impact over the last two years and consider the long-term social implications of tax changes. Furthermore, tax revisions must be accompanied with measures ensuring transparency and accountability regarding how money is spent. Efficiency in tax administration must also be improved via pay-as-you-earn (PAYE) and withholding mechanisms, which were recently reintroduced along with revisions to VAT, corporate and personal income tax, and turnover tax. Unjustifiable tax exemptions should be eliminated and the tax net widened to bring in millions who are supposed to pay but do not pay taxes. The Fiscal Management (Responsibility) Act of 2003 must be strictly enforced with revised targets and thresholds. Non-tax revenue should also be increased systematically.

Intervention	Timeframe
Reintroduce the 2017 Inland Revenue Act with necessary amendments to address Debt Sustainability Analysis and restructuring requirements, by (a) broadening VAT tax base and withholding taxes (including capital and service payments); (b) broadening income tax base and reverse decline in number of taxpayer files; and (c) creating a progressive corporate tax regime with a gradual rate increase. ***Update***: • *Both personal and corporate income taxes have been revised. Personal income tax threshold and slabs were reduced, and marginal tax rates revised upwards. The VAT rate was increased, and the threshold was revised downwards, helping expand the tax net.* • *However, the revised personal and corporate income tax rates are much higher than in the 2017 Inland Revenue Act. The significant increase in personal income tax via PAYE during high inflation has imposed significant burdens on most professional groups. Tax slabs should be broadened in such a way that professionals (perhaps earning up to LKR 500,000 per month) are subjected to a top marginal tax rate of around 25% with the highest marginal rate going up to around 40% for the very high income earners with a temporary surcharge).* • *It must be noted that the government's estimate of LKR 100 bn in PAYE tax collection for 2023 is highly questionable given the recent statements in Parliament by the State Minister of Finance that only 120,965 persons were liable to PAYE tax from over 1.1 mn registrations at the end of 2019. An urgent study must be conducted on this discrepancy and steps must be taken immediately to ensure those who are liable to pay taxes, pay.* • *Beyond PAY, it is essential that citizens of all walks of life who by various means avoid paying taxes are brought into the tax net. The only way to meet the objective of a genuine and stable increase in taxes is by expanding the base, not by squeezing to the bone the few who pay.*	S/M
Create a taskforce to assess government assets and identify opportunities to increase non-tax revenue. Increase revenue on government-owned assets, fees, and returns from government organisations. Ensure service quality is improved at the same time. Where agency-specific funds exist, flow through to Consolidated Fund.	S
New: Abolish the Social Security Contribution Levy (SSCL), which is a tax on tax. An announcement could be made on the date of its implementation.	S/M
Formulate long term, stable tax policy with investment credits instead of tax incentives for FDI. Halt giving out Strategic Development Projects (SDP) status for new investments, which will be subject to pay 15% minimum alternative tax. ***Update****: The SDP continues to be misused.*	M
Revised: Improve tax collection mechanisms, including: ● Fixing issues with the RAMIS system and strengthening the IRD's IT capabilities. ● Reforming the IRD's tax collection reward schemes. ● Strengthening the investigation department of the IRD to reduce tax evasion. ● Streamlining the tax appeal process. ● Improving coordination between revenue collection agencies and the Attorney General's Department.	M
New: Strengthen the tax and other levy collection by local government bodies.	M
New: Bring local government bodies and provincial councils within the scope of Fiscal Management (Responsibility) Act and make them accountable to submit quarterly reports on revenue and expenditure.	M
Become signatory to Base Erosion and Profit Shifting (BEPS) Digital Economy frameworks. Introduce 15% minimum alternative tax for multinational companies (Pillar 2).	M
Introduce customs reforms such as enhanced risk-based investigations, reform of customs officers' rewards schemes and rationalisation of penalties to address perverse incentives.	M

Revised: Streamline duty under three bands; starting with higher rates and reducing it in the medium-long term to curtain revenue impact.	M
Revised: Phase out para-tariffs gradually, aiming to eliminate them in 3-5 years. Initiate the para-tariff elimination with PAL and gradual reduction of CESS to minimize revenue loss.	M
Revised: Establish a unified revenue administration for the customs, excise, and inland revenue departments.	L
New: Establish a separate government service to recruit officers to a unified revenue administration agency, with salary levels on par with the CBSL.	L
New: Establish a tax academy/department with degree awarding status to teach taxation. Include lessons about taxation in the school curriculum.	L

Commentary*: The government has conducted tax reforms, but in implementation has imposed too high a burden on Sri Lanka's middle class, and disincentivised exporters. Decreasing the VAT threshold has helped to expand the tax net, but revised income tax rates are much higher than in the 2017 Inland Revenue Act. Higher tax rates and revised tax slabs have significantly reduced the disposable income of many tax-paying professionals. Revenue consolidation efforts, particularly upwards revision of taxes, should be carried out cautiously in a shrinking economy. When carrying out tax reforms, the government needs to account for inflationary impact during the last two years, and long-term social implications such as skilled migration. Furthermore, tax revisions must be accompanied with measures ensuring transparency and accountability regarding the ways in which tax money is spent. Almost all these integral parts of sustainable tax reforms are lacking in the government's recent actions.*

5. Expenditure Control

The other aspect of fiscal reform is rationalising public expenditure, including SOE reform. Spending restraint ensures fiscal space for social safety nets and development spending programs, to facilitate sustainable and inclusive growth.

5.1 RATIONALISE PUBLIC EXPENDITURE

Rationalisation must take place to eliminate waste and improve efficiency. While defence expenditure has long been protected, this must now be assessed critically. Exorbitant pricing on non-transparent procurements and unnecessary gigantic building projects can be addressed at once. A revised budget should be passed without delay so that at least the primary deficit in the budget can be eliminated immediately. The new budget should contain all fiscal adjustments to reflect a move towards a turn-around in the primary deficit.

5.2 STATE OWNED ENTERPRISE (SOE) REFORM

Reform of over 400 SOEs established during the era of socialism and import substitution must be a key reform item. This will radically reduce the government's fiscal burden, allowing space for social security and development. Denationalisation is one route: Sri Lankan Airlines and non-core businesses such as hotels can be released to more productive sectors. Other avenues for improving SOE efficiency, including Public-Private Partnerships, must also be explored. Holding company models such as Temasek in Singapore should be studied, to implement the most suitable mechanism to manage the state's previous shareholding. Many SOEs could bring the government significant revenue if managed correctly, instead of being burdens on the state and taxpayer.

Intervention	Timeframe
Reprioritise capital expenditure from the general budget on long-term projects such as roads and highways where possible. ***Update****: This is taking place*.	S
Stop all projects that lie outside of the National Physical Plan or are being implemented without a rigorous feasibility study, financial analysis, environment analysis and/or social analysis. ***Update:*** *There has not been sufficient action on this front.*	S
Impose hard budget constraints on SOEs. Begin to cease capital and current transfers to them. ***Update****: This matter requires much more emphasis and urgency.*	S
New: Via legislation, make it mandatory for all SOEs to submit audited financial statements within the following financial year and shift all SOEs to accrual-based accounting[4].	S/M
Tighten Fiscal Management (Responsibility) Act, to address the prevailing fiscal numbers. Clearly define escape clauses (justified deviations from rules), path to recovery, and accountability measures.	M
Privatise high profile SOEs (e.g., Sri Lankan Airlines); establish Public-Private Partnerships (PPPs) where relevant; increase efficiency and productivity of SOEs. Establish a task force to review all SOEs and prioritise those to be divested, reorganised as PPPs, or subjected to management reforms. ***Update****: Even though various committees have been established there has been no visible movement towards any restructure except for the CEB to some extent (Report prepared).*	M
Liberalise markets in which SOEs operate, where relevant. Risk weight lending to SOEs by state banks.	M
New: Introduce policies that enable private players to enter markets that are currently monopolised by the state.	M
Situate entity responsible for the National Physical Plan in an appropriate Ministry, ensuring adequate funding and empowerment to ensure compliance.	M
Reform the management of airports to make them attractive for all airlines. Price ground handling services in a manner that makes the airport attractive to low-cost carriers.	M
Liberalise up to fifth freedom rights after privatisation of Sri Lankan Airlines.	M

Commentary*: Capital expenditure on long term projects has been reprioritised to a certain degree. However, the government has failed to sufficiently rationalise other recurrent expenditure or impose budget constraints on SOEs. Examples include providing bonuses to employees of loss-making SOEs and spending exorbitant amounts of public funds on Independence Day celebrations. Such actions raise serious concerns about the government's commitment to rationalise expenditure.*

[4] Several governments moved from cash-basis accounting to accrual-basis accounting in recent decades. Research shows that pure cash accounting has many weaknesses from the point of view of government financial transparency, integrity, and accountability. See more: https://www.imf.org/external/pubs/ft/tnm/2016/tnm1606.pdf.

Looking beyond stabilisation to pro-poor growth by opening the economy is the key to a true economic revival.

6. Trade, Industry, Agriculture, and Services Promotion

While we stabilise the economy, it is critical to strengthen it by promoting trade, industry, agriculture, and services. This involves unshackling the markets from unnecessary tariffs, improving competitiveness, promoting exports and investment, integrating with Global Manufacturing Value Chains (GMVC) or Global Production Networks (GPNs), and enhancing productivity. The terms GMVC and GPN are used interchangeably in this document.

Today, Sri Lanka is much more of a 'closed economy' than an open one. Our trade openness index[5] was 40.9 in 2021, the result of a progressive decline from 88.6 in 2000. This is almost the same level at which we stood in 1977 before 'opening' the economy. In comparison, Singapore's trade openness index in 2021 was 338.3; while Malaysia's was 130.4, Thailand's was 116.7 and Vietnam's was 89.2. Our exports to GDP ratio was 16.8% in 2021, again a substantial decline from 39.0% in the 2000s. This is also substantially lower than our competitors: In 2021 Vietnam's export to GDP ratio was 93.3%, Cambodia's was 64.5%, and Thailand's was 58.2%. Sri Lanka's post-war economic growth was fuelled by domestic demand rather than growth in the tradables sector. This indicates that we have in fact become a relatively closed economy, in which international trade plays a weak role.

6.1 UNSHACKLING MARKETS

Although import duty (tariff) reform is important, immediate crisis management requires maintaining relatively high tariffs (subject to the our World Trade Organisation commitments) as a 'first-aid' measure. Total import liberalisation (removal of tariffs *and* quantitative restrictions) would add too much pressure on the CBSL's forex reserve position. Using even high tariffs in place of quantitative import restrictions (QRs) would be a much better policy option for two reasons. Firstly, unlike QRs which sever the domestic markets from import competition, tariffs assure continued availability of imported goods at the tariff inclusive price and thus address supply shortages in the domestic market. Secondly, tariff revenues relieve stress on the government budget, whereas the 'QR rent' (the price-rising effect of the domestic scarcity of imported goods) benefits the traders at the expense of the consumers.

These reforms would necessitate the implementation of a trade adjustment package to help certain industries deal with the adverse effects of unshackled markets. Such a package would focus on upgrading technology and help facilitate workers' skill enhancement to adapt to changes in the economy's structure.

6.2 COMPETITIVENESS

Beyond tariff reform, it is important to remove the multitude of unsustainable price controls, movement and allocation controls, and monopoly purchases in certain imports (e.g., import monopoly of the Food Commissioner). The competitiveness of government monopolies (e.g., in sector) can be improved by restructuring relevant government suppliers and the power of private sector-led oligopolies (e.g., in rice) can be curtailed by introducing and enforcing

[5] Trade openness is measured as the sum of a country's exports and imports as a share of that country's GDP.

anti-trust legislation. The government should only participate in domestic trading for equity reasons, and even then, should do so on a competitive basis, with private enterprises also allowed to participate. Lack of competition has bred inefficiency and corruption in government procurement and service provision. Creating new supply chains and removing impediments in existing ones will improve competitiveness, increase supply, and should ultimately reduce prices. Reducing information asymmetry among producers, better storage, and better quality of transport are important issues in most markets. The private sector should be allowed to address the bottlenecks that prevent value chain efficiency.

6.3 EXPORT PROMOTION

Reforms in exchange rate, trade, investment, and fiscal consolidation restore international competitiveness and lessen Sri Lanka's anti-export bias, setting the stage for export expansion. This must be supplemented with a strong effort to promote export-oriented FDI. Our experience in the 1970s and 1990s demonstrates how trade and investment liberalisation complements the growth of export-oriented industrialisation. Apparel and tea have long held up Sri Lanka's export sector: it is time for high tech manufacturing, and high-end services including information technology (IT) services, to come to the fore.

Box 1. Case study: Linking graphite to high-tech manufacturing of complex products

Sri Lanka has the world's purest form of graphite and is currently the only commercial producer of vein graphite with high purity levels of 97-99%. The demand for graphite as the base for graphene, now being considered a 'wonder material' is expected to increase significantly in the future. The purity of Sri Lanka's vein graphite has a substantial impact on the quality and yield of graphene, creating a large unexploited economic opportunity. Graphene is expected to create the next generation of electronics and be used to enhance the quality of construction material, paints, plastics, water purification, oil and lubrication. Graphene can also dramatically increase the lifespan of a lithium-ion battery, making charging devices much faster.

Historically, we were the world's biggest supplier of graphite, but now produce less than 1% of the global market mined from three operational mines in Kahatagaha, Bogala and Ragedara. Sri Lanka Institute of Nano Technology (SLINTEC) has embarked on a nano-tech initiative with a local start-up funded by a large conglomerate, focusing on developing innovative technologies to both convert graphite to graphene and to use graphene in end-user products. According to those in the industry, while graphite can fetch USD 1.80 per kg, graphene would command a price of USD 3,000 per kg.

Sri Lanka has a clear competitive advantage in the production of graphene due to the purity of graphite in our mines. If the process of conversion can be made cost effective, this new industry could certainly help Sri Lanka join GPNs with a substantial value addition. The government should provide every possible assistance to make this happen and bring legislation to safeguard this 'supply critical material' from being abused.

6.4 INVESTMENT PROMOTION

The Board of Investments (BOI) should be restored to its original state as the apex 'one-stop-shop' for promoting FDI, to link Sri Lanka's manufacturing to GPNs and markets. BOI reforms should rationalise the fiscal incentives offered to export-oriented investors (i.e., they should be time-bound, performance-based, and transparent) as the current practice of constantly extending tax holidays drains collectable revenue. The draconian Strategic Development Project Act of 2008 should be repealed. This transformed the BOI to just 'one more stop' for prospective investors by giving the Minister extraordinary power to approve FDI projects with tax holidays up to 25 years. This mechanism should be transparent with clear eligibility criteria that cannot be manipulated. A minimum alternate tax should be applied on enterprises enjoying complete exemptions. The tax policy on new investors must be transparent to ensure equality for foreign direct investors, simplified to make compliance more efficient, and stable without ad-hoc changes.

6.5 INTEGRATING WITH GLOBAL PRODUCTION NETWORKS (GPNS)

Complex products are no longer manufactured from beginning to end in one country: this is now often an international process in which several countries participate in various stages of the production process. GPNs or GMVCs focus on vertical integration of global industries (e.g., electronics, automobiles, surgical equipment), creating new opportunities for countries to participate in international division of labour. In the past decade, there has been a substantial shift of GPN trade away from developed countries to developing nations. World Bank research shows that GMVCs boost exports and create employment in developing countries, by making firms more productive. Yet Sri Lanka has failed to link to these networks compared to regional rivals. We must urgently integrate Sri Lanka into GPNs to move away from low-wage simple products to high-wage technologically complex products.

Sri Lanka’s path out of the economic crisis and towards prosperity depends on its ability to link with GMVCs. Given that we are a small economy, we simply cannot create enough jobs by expanding the non-tradable sector, as this will deteriorate our macroeconomic fundamentals further. Sri Lanka needs to sell to the world and that can only be done by becoming a part of GMVCs or GPNs. Through linking to such value chains, Sri Lanka can produce a component of a globally sold product and thereby increase exports. Through GPNs, the entire world becomes our market, instead of one country. As opposed to selling apparel or tea to a few markets, Sri Lanka can sell one part of a mobile phone, automobile, or computer to most of the world by entering GPNs. This will expand the export market significantly, which in turn will create new jobs, increase incomes, and drive Sri Lanka’s growth in the long term.

However, the immediate reform priority should be unilateral trade and investment policy reforms that remove obstacles for domestic manufacturing to intertrade globally.

Sri Lankan SMEs and MSMEs account for more than 75% of enterprises, 20% of exports, 45% of employment and 52% of GDP. It is essential that these businesses learn to integrate with GPNs and other global value chains, as this will both encourage global businesses to invest in GPN-related industries in Sri Lanka, and support SMEs to link with global companies and markets. Integrating SMEs into global value chains can put this sector on the path to economic recovery. This is true in the agricultural sector as well: linking farmers with global agricultural value chains lets them move beyond local markets and subsistence agriculture.

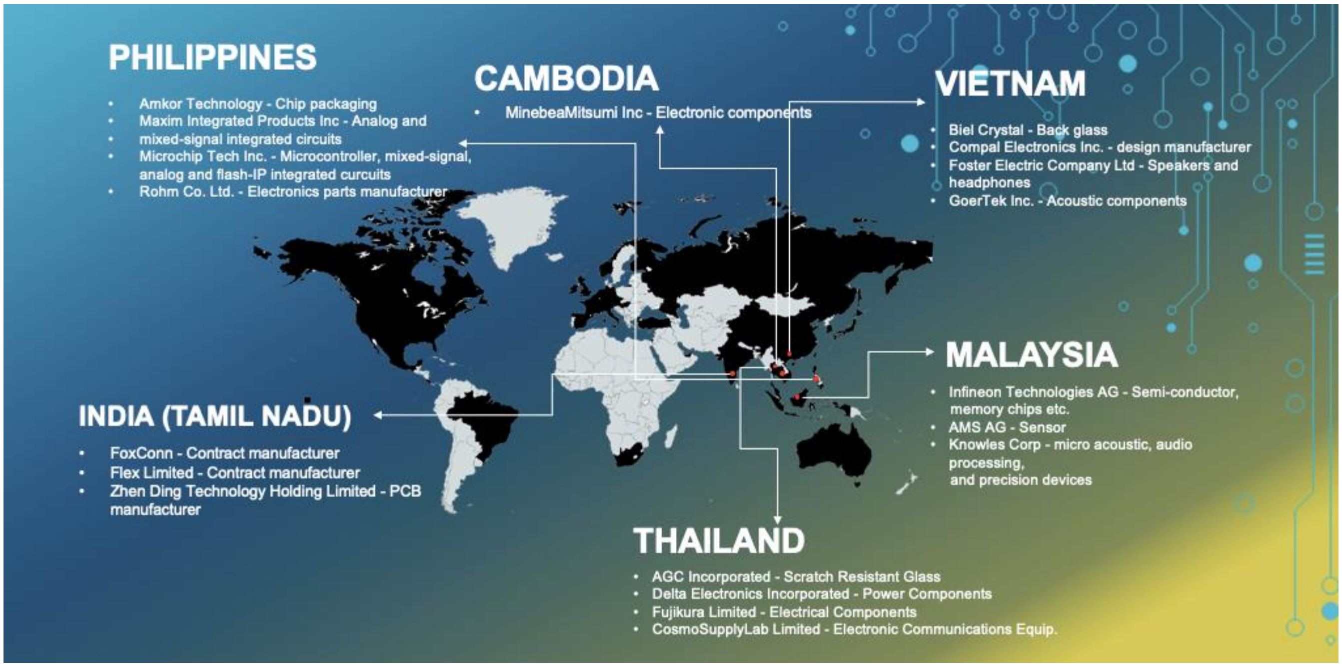

Figure 1: The components of Apple's iPhone are manufactured in 43 countries, including many in our region

6.6 ENHANCING THE SERVICES INFRASTRUCTURE FOR SUCCESS OF GPNS

Two areas of major focus to achieve this objective are logistics and IT services. Sri Lanka's integration with GMVCs is directly connected to our ability to leverage our location as the centre of the Indian Ocean, the region predicted to register the largest economic growth in the next twenty years. Sri Lanka must ensure our port services become globally competitive and enable required investments into logistics services. Liberalisation in port-related services must be undertaken to create opportunities for investors who have for a long period sustained and continued to improve our position as one of the most efficient ports in the region and beyond.

Beyond logistics, in terms of physical connectivity, integration requires communications connectivity to bring together virtual networks behind the GPN. Sri Lanka's IT services sector has seen significant and continuous growth with local software companies being recognised globally, winning projects and building products that have become best in class. The impetus for this growth came from the liberalisation of the telecom sector and the subsequent elimination of the monopoly on international connectivity. Further policy reform is needed to enhance competition while also ensuring that private operators can invest funds to build sophisticated networks to carry the data-heavy traffic that will become commonplace soon. The IT services industry continues to call for much higher numbers of skilled software engineers. However, given the current migration crisis, it is urgently required to consider short-term solutions while formulating more sustainable medium-term ones that encourage skilled personnel to remain in the country. In the short term, necessary (and even temporary) amendments can be made to immigration policy to allow software companies to operate in Sri Lanka instead of relocating overseas.

6.7 PRODUCTIVITY

Economies can expand by increasing either inputs (labour and capital) or the efficiency by which they are used (productivity), which comes from better management and technical advances. As labour and capital are inherently limited, improving productivity is necessary for self-sustained growth. Policy reforms for outward-oriented, private-sector led growth naturally set the stage for improving productivity by exposing domestic manufacturing to global competition and technology, and through the inputs of FDI.

The government can easily expedite this process. It is important to promote technical education and design training schemes in collaboration with the private sector. Another important action is to improve internet coverage on par with the region – the Digital Quality of Life Index 2020 listed Sri Lanka as a country with poorer internet quality. The state should also adopt e-governance platforms that improve government productivity and remove unnecessary 'red tape' that obstruct households and businesses. Improving public transport will also remove a major obstacle to productivity: public transport channels should be improved by building up the capacity of relevant government authorities, and investing in advanced transportation methods (e.g., LRTs, MRTs).

Sri Lanka's agricultural productivity is woefully low. Despite employing 25% of the work force, agriculture contributes only 7% of national output. Modernisation is key to improving agricultural productivity. At the farmer level this includes technologies from simple drip-irrigation techniques to more sophisticated climate controlled NFT greenhouses. At the market level, both input and output improvements, and (almost non-existent) information markets for future price discovery, weather, inputs etc. are necessary. Improving post-harvest technology in terms of packaging, logistics and climate-controlled warehousing are all essential elements in this process.

The government must also encourage research and development (R&D) and renew its focus on innovation through stronger patent management and tax incentives for innovation. Sri Lanka's current R&D expenditure is a meagre 0.18% of GDP, which is low compared to the region (Vietnam - 0.55%; India - 0.8%; Singapore - 1.92%).

Intervention	Timeframe
Fast track trade facilitation reforms by removing distortions, reconsidering import controllers' function and rolling back permit raj. ***Update**: This a low hanging fruit, but progress is too slow.*	S
Promote understanding on the necessity of imports for exports. ***Update**: The widely held view that Sri Lanka should promote exports while limiting imports continues to mislead policy. No effort has been made to explain that imports are required for most exports in Sri Lanka. This is urgently needed to make the ideological shift from a 'closed' to an 'open' economy.*	S
New: Immediately complete 'Prabashwara,' Sri Lanka's first 5,000 MT humidity and temperature controlled agricultural warehouse in Dambulla.	S/M
Revised: Minimise unnecessary and unsustainable anti-competitive regulations and controls and promote anti-trust legislation to prevent collusion in oligopoly markets.	M
Revised: Expedite implementation of regional trade agreements. Enter into trade agreements with nations with which Sri Lanka has strong trade complementarity. ***Update**: Entering into bilateral trade agreements with partial information and/or on an asymmetric basis without adequate analysis will be detrimental. The government must not rush in to bilateral FTAs unless they have been appropriately analysed for benefits accrued to both parties.*	M
Promote export oriented FDI; restore the BOI to its original one-stop-shop status.	M

Revised: Enact enabling legislation for private industrial zones and start-up facilities. Liberalise free trade zones by leasing them to investors.	M
New: Implement a comprehensive trade adjustment package to improve competitiveness of local industrialists and workers.	M

Commentary: *The government's commitment to trade facilitation reforms remains minimal. During the last six months, the government continued to revise import control regulations frequently without any medium- or long-term considerations. Research shows that import controls were implemented without any substantial analysis which created an uncertain business environment. Although trade reforms remain the key to long-term growth, government actions have taken the country in the opposite direction. Instead of beneficial reforms, the government's constant and arbitrary revision of import and customs regulations has made it even more difficult to engage in international trade.*

7. Public Sector Management and Digitalisation

For an economy to run efficiently, the public must receive health, education, social services, and civil security; and these services should be efficient, equitable, and of high quality. Sri Lanka's public sector, which is supposed to provide these services, is massive – it employs close to 1.5 mn people. Yet these roles often overlap, are redundant, and are severely underpaid. There is major political interference in recruitment, with election promises leading to mass employment. These actions create a sense of entitlement to public sector jobs, yet efficiency is depressingly low. The public sector must be reformed so that the people of Sri Lanka receive better services, and so that employees of the more productive public sector are better paid for their work. This should go hand in hand with pensions reform: unfunded public sector pensions with very high pay-out ratios are no longer sustainable and must move towards funded pension schemes at the national scale, rather than for the public sector alone. Many public sector functions must also be digitalised, to improve efficiency and reduce corruption through greater transparency.

Intervention	Timeframe
Freeze public sector recruitment. Calculate personnel requirements of the state, the armed forces, and SOEs. Any recruitment at lower levels requires green sheeting [hire from within existing state worker cadre]. Re-examine and reassess defence expenditure. ***Update****: Progress has been made.*	S
New: Use existing staff to digitise the records to increase the efficiency of service delivery (health records, land records etc.).	M
Engage in capacity building for retained public sector employees, especially for high-level staff.	M
Develop outcome-based Key Performance Indicators (KPIs) for the public sector.	M
Contract out system-wide audit process reengineering and digitalisation of the entire public sector. Start with the least resistance service (or most incentivised) and move forward. ***Update****: There has been no progress on this.*	M
Begin improving delivery of public service delivery through digitalisation.	M
New: Establish mechanisms to hire mid-career professionals to the public service.	M
New: Gradually shift the public sector from cash-basis accounting to accrual-basis accounting.	L
Convert corporations/boards/departments to companies to ringfence liabilities. Establish a formal mechanism for appointment approvals (like a fit and proper test).	L

Bring professional control and regulation to key entities. Conduct management audits for those that cannot be revamped, and restructure completely, or find alternatives. Amalgamate different institutions relevant to the same field or service under one institution.	L

8. Energy and Utilities Reform

Although this is part of SOE reform, it is critical to economic growth and so must addressed separately as well. Energy pricing must be revised urgently to avoid damage to the fiscal and banking system. While petrol and diesel prices have been increased, the transparent, automatic cost-reflective pricing mechanism must be reintroduced for fuel and implemented for LP gas. A fuel/LP gas price stabilisation fund should be created to smooth price adjustments for the consumer. Since the current energy crisis is going to be protracted, meaningful demand management is crucial. This requires some form of smart metering and pre-paid metering to be initiated by the government, as this allows more sophisticated cost-reflective pricing mechanisms. Incentives could also be provided for night-time off-peak electricity usage. Connecting Sri Lanka's grid with South India is another key to demand management. Using excess power to pump water back into reservoirs to increase hydro power using excess solar power is also an innovative option. Beyond this, accelerating renewable energy projects is critical. Private sector investment into solar and wind power is at a standstill due to legal impediments and lack of clarity on tariffs. This must be addressed.

Corruption in energy and utilities procurements (in power purchase agreements for electricity, or bulk procurement for fuel or LP gas) is a major problem that needs urgent and comprehensive attention, as is the inefficiency of these state-owned utilities. The CEB is a case in point: it faces serious concerns of corruption in power-purchase agreements and other areas. There is a compelling case for unbundling the CEB and introducing competition in generation and distribution, while also investigating and correcting corruption. Increasing electricity tariffs to the consumer for cost-reflective pricing will be unjust if the high costs are from dishonesty and inefficiency: those costs must not be shifted on to the consumer.

Intervention	Timeframe
Implement transparent, automatic market-based energy (fuel, gas, electricity) and water pricing. ***Update***: • *Even though some tariffs were revised, there is a total lack of transparency in the methodology used. Further, these revisions should not be decided by politicians: the existing regulatory mechanism must be used for its purpose and public consultations must take place as per the existing law.* • *While allowing utility providers to charge cost-reflective tariffs (free of wastage and corruption costs) from the consumer so that the utility could at least break-even, it is the government's responsibility to ensure targeted subsidies are provided to those who deserve it, as transparent line items in the budget. This policy change will immediately shift the overuse of resources and the volume of subsidies for the rich (current practice) to those who need help (socially equitable).*	S
Bring all petroleum products under Public Utilities Commission of Sri Lanka (PUCSL) regulation through legislation. Entrust price and quality regulation to PUCSL. ***Update***: *The law was amended to regulate this under a new authority. This is incorrect policy.*	M
Restructure energy and utility SOEs. Unbundle the CEB and introduce competition in generation and distribution. Separate the transmission grid to allow the necessary investments to permit the	M

absorption of wind and solar and to introduce services such as wheeling. ***Update***: *Some progress has been made on this.*	
Invest in public transport which uses renewable energy, through foreign assistance.	M

9. Factor Market Reform

Land and labour market reforms are key to improving the 'ease of doing business' in Sri Lanka, which would in turn improve FDI and growth. The bulk of Sri Lanka's land is state owned, and the private land market is inefficient. Establishing ownership is subject to lengthy delays and disputes because Sri Lanka does not have a cadastral register. This prevents land being utilised to generate capital. It is important to obtain funding to create a new digital registry.

Sri Lanka's labour market is also notoriously inefficient: public recruitment is excessive, and termination of employment in both the public and private sectors is almost impossible. This makes the cost of retrenchment one of the higher in the world, which is a major disincentive for firms to expand operations in Sri Lanka as it is very costly to downsize if required. Urgent steps must be taken to create an efficient labour market by enacting new legislation.

The labour force should be prepared through education and training to take advantage of the emerging dynamic economy, rather than being denied opportunities for growth and social mobility. The current Technical and Vocational Education and Training (TVET) framework should be drastically reformed to align the curriculum with GPN-related industry demand, keep up with technological innovation, modernise management practices, and establish private and public partnerships. English language and IT skills should be promoted at all levels of education, recognising their importance to gain quality employment. Using technology can substantially improve the coverage and cost effectiveness of skills development programmes.

Sri Lanka's female labour force participation has been very low for a long time. Female workers who can be productive members of the economy should be facilitated to enter the workforce. Flexible and female-friendly work practices should be promoted to encourage their entry to the workforce.

Finally, labour protection should take the form of unemployment insurance rather than archaic laws.

Intervention	Timeframe
Revised: Promote technical education, design apprenticeships and on-the-job training schemes in collaboration with the private sector. Incentivise industry to promote the employability of graduates.	M
New: Promote English-language based education and technology/IT-based education at all levels, particularly in rural districts.	M
New: Use technology to deliver in-demand skills training programmes.	M
Fast track unified bankruptcy laws for all enterprises.	M
Replace the Termination of Employment of Workmen Act (TEWA) with an Unemployment Insurance Fund.	M
New: Promote female labour force participation with flexible work practices and other measures.	M
Create a digital land registry, completing the ongoing Bim Saviya programme.	L

As the economy grows, so does our ability to protect our most vulnerable citizens – but we must reform our broken social security systems to let us do this effectively.

10. Stronger Social Safety Nets

The most affected by Sri Lanka's unprecedented economic crisis are the poor and the vulnerable – therefore, protecting these groups and enabling them to rise above poverty is a key priority in this plan for economic revival. The World Bank estimates that poverty levels doubled from 13.1% in 2021 to 25.6% in 2022, pushing an additional 2.7 mn people into poverty. Yet the benefits available in Sri Lanka's social welfare schemes remain inadequate, and most of those pushed into poverty are not part of the social security system.

Sri Lanka's main social welfare scheme, Samurdhi, is plagued with issues that harm its intended beneficiaries. As it is still not digitalised, special Samurdhi banks are used to disburse the cash transfers, which increases the transaction cost significantly. In fact, more than one third of Samurdhi' cost is its administration. Moreover, since Samurdhi banks are spread out over large areas, beneficiaries must travel several kilometres to visit a bank to obtain payment. Due to inefficiencies and coordination issues, they must usually spend hours in queues. The same issues affect other social welfare payments such as allowances for elderly people and people with disabilities. Samurdhi is also very poorly targeted: the current program misses an estimated 40% of Sri Lanka's poorest households, with many benefits going to families with relatively high welfare. It is also highly corrupt.

There is an urgent need to eliminate inefficiencies in the social protection system, improve its coverage and targeting, and increase the per-family benefit. Establishment of a central system under the Welfare Benefits Board (WBB) should be fast tracked to provide cash transfers directly to beneficiaries' bank accounts, and structured to eliminate selection bias and corruption. To facilitate this, a Unique ID like India's Aadhaar should be designed and implemented with technical and financial assistance. Factors such as privacy and personal data security should be considered in this implementation, and public servants should be trained in using and maintaining such a system. The financing for this transfer to the lower and lower-middle income population would be directly linked to the removal of various subsidies from the higher income population, which does not require this support.

While protecting the poor and vulnerable in a shrinking economy, social protection schemes should also provide incentives for recipients to engage in income generation. To facilitate this, the government in collaboration with the private sector should support the recipients of welfare benefits to acquire skills and qualifications that will let them obtain employment. This approach to social protection aims to support people in lifting themselves out of poverty by gaining employment in an economy that is going through organic job creation.

In the medium and long run, equitable growth should be based on the availability and access to quality public infrastructure. Therefore, while short term focus is on social safety nets, in the medium and longer term, access to quality healthcare, education and transport should be enhanced as a part of equitable growth. By enhancing access to quality public infrastructure, low-income segments of society obtain the chance to experience higher quality of life, which is a key goal of inclusive growth.

Intervention	Timeframe
New: Increase the minimum wage which is currently LKR 12,500 per month to reflect inflationary impact and strengthen the enforcement mechanisms.	S
Provide cash transfers to vulnerable sections of the population directly to bank accounts/mobile money accounts, using existing databases. This should be linked to the subsidy rationalising program, particularly in energy. ***Update:*** *Using monthly electricity usage as a metric to select deserving households for cash transfers has been proposed. Researchers have shown that such a method would yield a much more accurate list of the needy than the present Samurdhi beneficiaries list. The government has not paid any attention to this innovative and highly cost-efficient (administration costs would be negligible) proposal.*	S/M
Consolidate welfare schemes under the WBB and build a united beneficiary database, using a Unique ID model (e.g., India's Aadhar), designed and implemented with technical and financial assistance. ***Update:*** *Some progress has been made on finalizing the WBB database, but a labour dispute between the government and the Grama Niladharis and other officers who have been tasked to verify the data has prevented its completion. These officers are demanding the removal of a clause in the Act that makes those making and/or verifying false information (as true) punishable by law. The government has (rightfully) refused to agree to this demand.*	S/M
New: Digitise Samurdhi records using existing public sector staff and provide digitisation training to staff.	M
New: Conduct awareness programs for transfer recipients about their rights, benefits, and appeal processes.	M
New: Collect data regarding welfare benefit recipients' income increases/new employment and use it to review the welfare benefit list regularly. Identify why some people do not increase income or fail to find employment and provide support to be employed.	M
New: Establish linkages with GPN businesses to facilitate employment for those from low-income families, and facilitate training and education opportunities for these industries.	M
New: Improve the quality of public transportation and introduce minimum standards for buses.	L
New: Further develop rural and regional hospitals.	L
New: Provide online education opportunities for people with disabilities and support them to find 'work from home' opportunities.	L
Create funded pension schemes, expanding pensions beyond public sector to a national scheme.	L

Commentary*: The government, with the support of the World Bank, has initiated the process of setting up a consolidated welfare scheme under the WBB and building a united beneficiary database. This process needs to be expediated given the urgency of the need to provide direct cash transfers to the poor and vulnerable. However, it is important that the government focuses on long term poverty alleviation by creating an environment that encourages job creation. This will provide long-term employment opportunities for those who benefit from safety nets in the short term. Those reforms should not be left to the future – this is a mistake Sri Lanka has made many times in the past.*

CONCLUSION: LEARNING FROM OUR PAST, FOR OUR FUTURE

A Social Market Economy

Philosophically, we, the Samagi Jana Balawegaya (SJB), believe in a social market economy: a fusion of economic liberalism emphasising individual freedom and autonomy, and political freedom emphasising equity and social justice. Our core vision is to create a well-functioning, highly competitive, market-based system that works for the wellbeing of all Sri Lankans. To achieve this, we must transform our economy into an ecosystem driven by market competition and competitiveness while providing public support and social protection and ensuring dignity for all. We firmly believe that market competition is the key to the economic success of the individual and the economy; yet we know that regulation and assistance is needed to achieve equitable and inclusive growth.

Looking beyond stabilisation, to growth

Stabilising the economy will be no easy task, but we are on that journey, with steps taken to reduce expenditure through contractionary fiscal and monetary policy. This will set the stage for economic recovery, but receiving the Extended Fund Facility will not guarantee economic growth. To put the economy on a sustainable growth path, expenditure reduction policies must be combined with policies that incentivise tradable production. This is particularly important because Sri Lanka entered this crisis with a massive anti-tradable bias in the economy. From 2010 - 2019, nearly 70% of the increase in GDP came from 'non-tradable' sectors (i.e., products that are cannot be traded among countries) because of the massive reckless investment in infrastructure development and government services. Therefore, economic stabilisation without a shift in the production structure towards tradable production, in particular export-oriented production, may result in stagnation.

The experiences of the dynamic East Asian countries strongly support the view that rapid, sustained growth depends on strong performance of tradable production because growth of non-tradable production is basically constrained by domestic supply and demand.

Sri Lanka's own post-independence history proves that economic growth derived from non-tradable sectors is short-term and unsustainable. Heavy reliance on inward-oriented growth and non-tradable sectors resulted in export performance stagnating. Yet, as non-tradable growth temporarily fulfilled short-term political goals of high growth rates, trade reforms were ignored. This resulted in Sri Lanka lagging peers in the region. Countries in South and Southeast Asia which had poorer export performances surpassed Sri Lanka and became global export hubs through outward oriented growth, by becoming part of GPNs – while Sri Lanka failed miserably.

Long-term national prosperity can only be achieved by growing exports, or tradable sector products. Sri Lanka therefore needs to have outward-oriented economic policies to achieve sustainable growth. Such growth creates jobs, uplifts people from poverty, raises income levels, and improves standards of living.

Our economic revival therefore depends on our ability to integrate Sri Lanka with the world by linking our industries and people to global manufacturing value chains or global production networks.

Ensuring equitable development

To attain long-term development sustainably, opportunities should be offered to all citizens, and they should be empowered to harness these opportunities for their wellbeing. The government should actively facilitate and ensure this, by building an appropriate knowledge and information base, and maintaining proper economic policy, governance, law and order, and property rights. We believe economic growth is central to poverty alleviation. Compelling evidence from around the world shows that outward-oriented growth is more 'pro-poor' and effective at reducing poverty than statist, inward-oriented strategies. Our own economic history illustrates this well.

Yet we have also learned from the global experiences of economic development that the fruits of growth are not equitably distributed among all citizens. In any market economy, peoples' incomes differ according to their level of education, training, or skill, based on how they can contribute to production. Some degree of income inequality is unavoidable in an efficiently functioning market system, as these incentives prompt productivity which finally leads to economic growth. Therefore, the government must combine market-oriented growth-promoting policies with a well-targeted social safety mechanism.

Building a strong, transparent, and equitable social welfare system is an integral part of our development strategy: this facilitates achieving shared growth and makes difficult economic reforms palatable. That is why we believe in the total transformation of welfare politics, so that the subsidy is provided to the consumer directly rather than to the supplier of the service, which is then consumed mostly by the rich. Paraphrasing the economist Jagdish Bhagwati, although growth 'opens the doors' for everyone, some people have starting lines further back than others – their government should help them over the threshold.

Concluding Remarks

At independence, Sri Lanka was one of the most prosperous countries in Asia, with per capita income above even South Korea and Thailand. Yet over the next 75 years, we fell further and further behind, eventually ending up in a sovereign debt crisis with the stigma of being the only Asian country to default on foreign debt in half a century. Our mission is to make this unprecedented crisis the springboard for lifting Sri Lanka onto a sustainable growth path, to regain our lost paradise. We are committed to transforming the closed 'twin deficit' economy characterised by stop-start growth and periodic macroeconomic crises, into a dynamic, outward-oriented economy that delivers sustainable, shared growth for all its citizens to enjoy. This requires achieving a strong, sustainable fiscal position through government revenue and fiscal reforms; incentivising openness, exports and GPN linkages; undertaking complementary monetary, exchange rate, factor market, and competition reforms; and underpinning all of this with a coherent, well-targeted social welfare net and strong anti-corruption legislation.

This is our Blueprint out of the crisis, and towards a better Sri Lanka, for today, for the future, and for us all.

Send us your feedback!

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