



AN ANALYSIS OF DEBT ISSUES IN MIDDLE-INCOME COUNTRIES: THE SRI LANKA CASE

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DEVELOPMENT ALTERNATIVES
WITH WOMEN FOR A NEW ERA

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ABSTRACT

The paper “An Analysis of Debt Issues in Middle-Income Countries: The Sri Lanka Case” examines Sri Lanka’s economic crisis through a historical, political economy lens, focusing on its sovereign debt challenges. It begins with an introduction to Sri Lanka’s unprecedented balance of payments crisis, outlining the twin crises of illiquidity and insolvency that stem from decades of fiscal mismanagement, compounded by global economic disruptions. The subsequent sections provide a detailed historical analysis of Sri Lanka’s debt trajectory, emphasising the shift towards commercial borrowing post-2008 and the role of International Sovereign Bonds (ISBs) in exacerbating the crisis.

The paper critically evaluates the political economy of debt restructuring, highlighting the influence of International Financial Institutions (IFIs), private creditors, and local elites. It assesses the socio-economic impacts of austerity measures, which have disproportionately affected vulnerable populations, particularly women, as viewed through a feminist political economy lens. The discussion extends to the systemic risks of macro-linked bonds and neoliberal economic reforms, arguing that these solutions may entrench long-term economic vulnerabilities. The paper concludes with a call for comprehensive reform of global debt governance frameworks and advocates for policies that balance debt sustainability with equitable socio-economic development.

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LIST OF ACRONYMS

AIP	Agreement in Principle
BoP	Balance of Payment
CBA	Central Bank Act
CBSL	Central Bank of Sri Lanka
CCC	Ceylon Chamber of Commerce
CEB	Ceylon Electricity Board
CDO	Collateralised Debt Obligations
DSA	Debt Sustainability Analysis
DDR	Domestic Debt Restructuring
EFF	Enhanced Fund Facility
ETB	Economic Transformation Bill
FfD4	Fourth Conference on Financing for Development
GDP	Gross Domestic Product
GNP	Gross National Product
IFA	International Financial Architecture
IFI	International Financial Institution
IMF	International Monetary Fund
ISB	International Sovereign Bond
LKR	Sri Lankan Rupees
MLB	Macro-linked Bond
MSMEs	Micro, Small and Medium Enterprises
MPS	Mont Pelerin Society
MDB	Multilateral Development Bank
NPP	National People's Power
QTM	Quantity Theory of Money
LKR	Sri Lankan Rupees
VAT	Value Added Tax

EXECUTIVE SUMMARY

This article analyses Sri Lanka's sovereign debt crisis through a historical, feminist and political economy lens. It critically examines the drivers of the country's economic crises, emphasising the interplay between global financial architecture, the socio-economic impacts of austerity measures and domestic policy mismanagement. Using Sri Lanka as a case study, the article provides insights into broader challenges faced by middle-income countries (MICs) grappling with external debt crises.

HISTORICAL DEBT TRAJECTORY AND DEFAULT

Sri Lanka's debt challenges stem from a decades-long reliance on foreign borrowing, particularly after transitioning to a middle-income country post-2008 global crisis. This shift reduced access to concessional loans and drove the country to rely on expensive commercial borrowing, notably through International Sovereign Bonds (ISBs).¹ Between 2007 and 2019, Sri Lanka's ISB issuances skyrocketed, exposing the economy to high interest rates and short repayment periods. The composition of debt shifted significantly, with ISBs comprising 4.1 per cent of total external debt in 2007 to 37.8 per cent by 2019, amplifying the risk of fiscal instability.

The sharp increase in amortisation payments in 2019 to 2021 had to be serviced in a context of severe losses in tourism, remittances and export revenue after the Easter Sunday attacks in April 2019, Covid-19 pandemic and the subsequent global economic slowdown. These put unprecedented strain on Sri Lanka's foreign reserves, eventually spiralling down to an economic crisis and debt default in April 2022.

SRI LANKA'S POST-DEFAULT REFORM AGENDA: THE PROBLEM-SOLUTION MISMATCH

The influence of International Financial Institutions (IFIs) and private creditors in shaping Sri Lanka's debt restructuring agenda was a thorny issue. The IMF-led debt sustainability analysis and the framework for debt restructuring negotiation devised by Sri Lanka's debt advisors and followed by the government prioritised international creditors and wealthy local bondholders, particularly at the expense of workers' retirement savings and equitable economic recovery. The incorporation of macro-linked bonds—tying repayments to GDP performance—risks perpetuating cycles of indebtedness and increasing the propensity to repeated debt defaults in future. Additionally, the lack of a statutory global debt governance framework creates inequities, with private creditors often extracting favourable terms at the expense of public welfare.

IMF-backed austerity measures have hit Sri Lanka's most vulnerable the hardest, amplifying economic disparities. A regressive tax overhaul—shrinking the direct tax base while hiking VAT—along with the rollback of fuel and energy subsidies, has driven up living costs and strained social safety nets. Micro, Small, and Medium Enterprises (MSMEs), which employ 75 per cent of the workforce, have been forced to shut down, triggering widespread job losses. Women, disproportionately represented in informal sectors, have borne the brunt of these disruptions, deepening gender-driven economic inequalities.

The approach to debt restructuring in Sri Lanka underscores the role of IFIs and the complicity of local finance capital and think tanks in shifting the financial burden onto working-class populations and highlights broader challenges in development financing and the quest for fair debt solutions.

A GLOBAL SOUTH AND FEMINIST PERSPECTIVE TO BUILD PATHWAYS TO EQUITABLE CRISES RECOVERY AND FAIR DEBT SOLUTIONS

Alternative approaches must prioritise sustainable financing for the global South while preserving national autonomy and most importantly, sovereignty. For Sri Lanka, this entails creating space for industrial policies focused on emerging markets and exploring self-sufficiency in food and essentials to withstand external shocks without compromising the basic needs of its people. Global priorities remain fixated on extraction rather than fostering industrialisation, with a heavy emphasis on debt repayments, land acquisitions, resource control, and takeover of strategic assets like ports and energy sources. While political regimes may come and go, the contradictions that brought them to power and the controlling influence of international finance capital are here to stay. Industrialisation, once seen as the bedrock of liberal democracy, a robust welfare state, and national sovereignty, have all but disappeared from the national discourse in Sri Lanka, regardless of class or political affiliation.

Sri Lanka's debt crisis is a wake-up call, not just for its own citizens, but for the global community to fundamentally rethink the International Financial Architecture (IFA) established in the Great Depression's aftermath as it remains ill-suited to address the pressing challenges of the twenty-first century. Exposed by the COVID-19 crisis, inequities in financing access are stark: wealthier nations secure low-cost funding, while developing countries face crippling debt burdens and escalating socio-economic vulnerabilities. The IMF and World Bank's underrepresentation of the interests of the global South exacerbates these disparities.

The ongoing debt servicing crisis in developing countries underscores the urgent need for systemic reforms. The impact of rising global interest rates and inequitable borrowing costs amplifies these challenges, forcing heavily indebted nations to prioritise creditor payments over essential development needs in health care, education, and climate action.

BEYOND ANTI-CORRUPTION NARRATIVES, TOWARDS SYSTEMIC REFORM

The dominant political narrative continues to blame widespread corruption for Sri Lanka's economic crisis. While the anti-corruption rhetoric holds merit, it oversimplifies a more complex reality. A tangle of legal frameworks and financial instruments has emerged as the new face of conditionality, tying governance reforms to debt restructuring in what increasingly looks like a testing ground for policy experimentation. Key legislative reforms underpin the IMF programme's structural benchmarks, spanning fiscal management, central banking, commercial banking, utilities, and public-private partnerships. Backed by the IMF's Governance Diagnostic Assessment, which flags "governance weaknesses and corruption vulnerabilities" as barriers to recovery, these measures aim to bolster transparency. However, they risk constraining the state's ability to adapt to budgetary pressures, leaving external borrowing as the primary fallback. Fueled by the Aragalaya movement, anti-corruption populism remains a powerful electoral force amid economic turmoil and public discontent. While echoing neoliberal ideals and the Good Governance agenda, this rhetoric often falls short of delivering meaningful reform. Instead, it exploits public frustration, stoking anger and instability that undermine both national and regional stability—turning economic recovery and growth into a distant prospect. Past international economic reform efforts have fallen short, offering piecemeal solutions rather than addressing systemic inequities. The path forward hinges on bold action to correct structural imbalances. A reimagined International Financial Architecture (IFA) that prioritises inclusivity and sustainability is not just a moral imperative but a strategic necessity to meet modern development needs and mitigate future crises in Sri Lanka and other developing countries. Whether the international community rises to this challenge or allows disparities to persist and hatred to grow will define the trajectory of global progress for decades to come.

INTRODUCTION

Sri Lanka's new brand is its economic crisis. The Indian Ocean island nation has been in the global news since 2022 for its unprecedented balance of payment (BoP) crisis, in which excessive debt overhang is a central feature. The twin crises of illiquidity and insolvency characterising the current economic paralysis in Sri Lanka are the culmination of decades-long setbacks in current account performance and domestic public finances (Montes et al., 2022; Athukorala & Wagle, 2022). The 2019 Easter Sunday attacks, the COVID-19 pandemic and the subsequent global economic slowdown had a compounded effect on the economy. They thinned out foreign currency cash flow supported by migrant workers' remittances, exports and tourism income and severely affected domestic and international trade and business continuity.

On 12 April 2022, the Sri Lankan government announced its decision to temporarily suspend the servicing of external debt owed to bilateral and commercial creditors. This decision presents an unprecedented phase in Sri Lanka's evolving macroeconomic status. The ongoing difficulties share many of the features of its previous macroeconomic crises. However, the current crises must be overcome under much harsher external conditions than in past crises. Understanding the parameters of these conditions and the political economy of Sri Lanka's sovereign debt will be important in informing the policy initiatives and political agendas that can be constructively considered. This paper will highlight inflexion points in Sri Lanka's sovereign debt trajectory and the political economy that drives and is reproduced by it. Sri Lanka's case will be critically evaluated with historical evidence (from 1980 to 2023) based on global and domestic trends seen in the country.

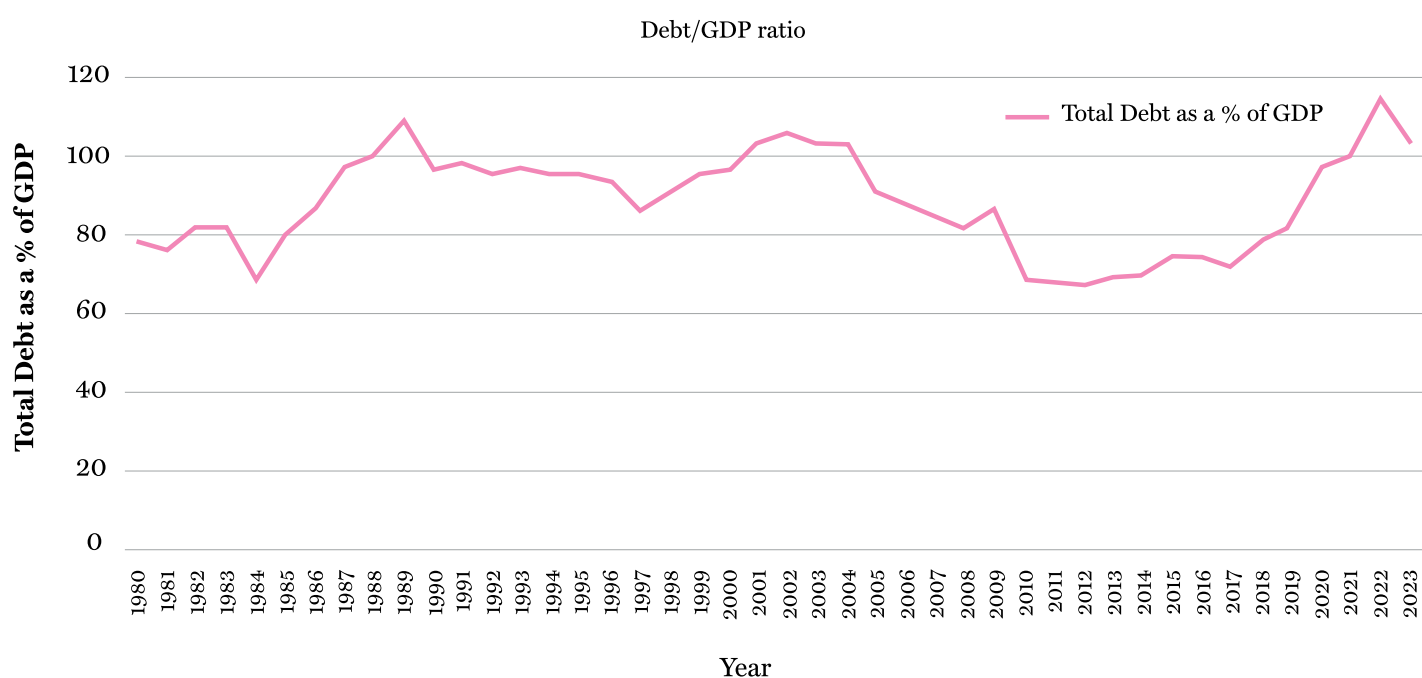
The paper is structured to comprehensively analyse Sri Lanka's sovereign debt crisis within a historical and political economy framework. The section following the introduction offers a historical overview of Sri Lanka's sovereign debt trends, highlighting shifts in borrowing patterns and the growing reliance on international sovereign bonds. This is followed by a detailed analysis of post-2008 debt dynamics, including the structural changes in debt composition and the role of external borrowing. The paper then delves into the political economy of debt restructuring, focusing on the stakeholders, the influence of international financial institutions, and the implications of recent restructuring agreements. The impact of austerity measures on social protection systems and public services is critically assessed, with particular emphasis on how these reforms exacerbate existing inequalities. Lastly, the paper adopts a feminist political economy perspective, examining the intersection of debt and gender-based vulnerabilities, and concludes with a forward-looking discussion on systemic reforms needed for equitable economic recovery.

1. A HISTORICAL SNAPSHOT OF SRI LANKA'S SOVEREIGN DEBT

Sri Lanka's current external debt ratio is not unprecedented. In the 1990s, the country faced higher external debt burdens exceeding 60 per cent of its Gross Domestic Product (GDP) but successfully avoided a total default. As a proportion of the GDP, illustrated in **Figure 1**, Sri Lanka's debt indicates three peaks – in 1989, 2002 and 2022, when the total sovereign debt exceeded 100 per cent of the GDP. These peaks followed increasing borrowing trends from 1985 to 1989, 1999 to 2002, and 2017 to 2022. In retrospect, heavy borrowing in the first two periods can be attributed to financing the fiscal and external gaps during two of the most intense episodes of Sri Lanka's civil war, which spanned thirty years. The third borrowing spell combines domestic financing needs and a global finance trend after the 2008 financial crisis – shifting the sovereign debt structure towards international commercial borrowing.

As of the end of the first quarter of 2024, Sri Lanka's total government debt was USD100 billion, consisting of 57 per cent domestic sources (in Sri Lankan Rupees (LKR)), 37 per cent foreign, and 6 per cent guaranteed debt.² Of the 37 per cent foreign debt, 22 per cent was spent on projects and programmes, and 15 per cent was commercial borrowing. Of the USD37 billion foreign debt, USD12 billion is multilateral, USD10 billion is bilateral, and USD15 billion is commercial.

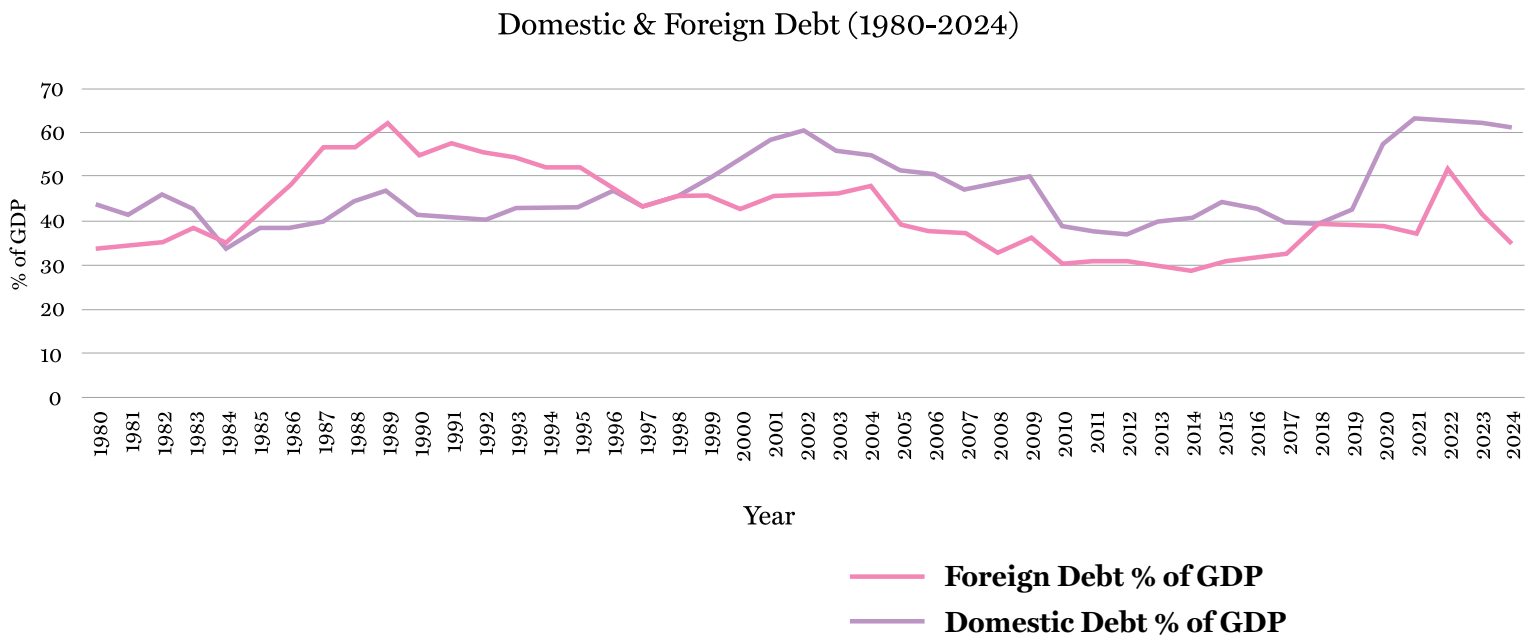
Figure 1. Sri Lanka's Debt/GDP Ratio: 1980 to 2023



Source: Central Bank of Sri Lanka

Sovereign debt comprises domestic and foreign debt.³ Sri Lanka’s foreign debt stock has surged over the past sixty years, with the foreign debt-to-GDP ratio rising from 3 per cent in 1950 to 36 per cent in 2010 (see **Figure 2**). Following the “Open Economy” reforms in the post-1977 period, the government’s reliance on foreign borrowings surged, pushing the foreign debt-to-GDP ratio above 30 per cent, compared to the 10 per cent average from 1950 to 1976. By the end of 2010, the foreign debt portfolio included 703 active loans, 44 per cent of total government debt. Notably, in 2010, 63 per cent of this foreign debt was on concessional terms,⁴ and 69 per cent originated from bilateral and multilateral donors, featuring grace periods of two to twenty years and repayment terms of five to fifty years and largely in the form of project and commodity aid from bilateral and multilateral sources. This structure, combined with an average interest rate of around 1.9 per cent per annum, had been manageable (Wijayasekera, 2010).

Figure 2. Sri Lanka’s Domestic & Foreign Debt as Percentage of GDP: 1980 to 2024

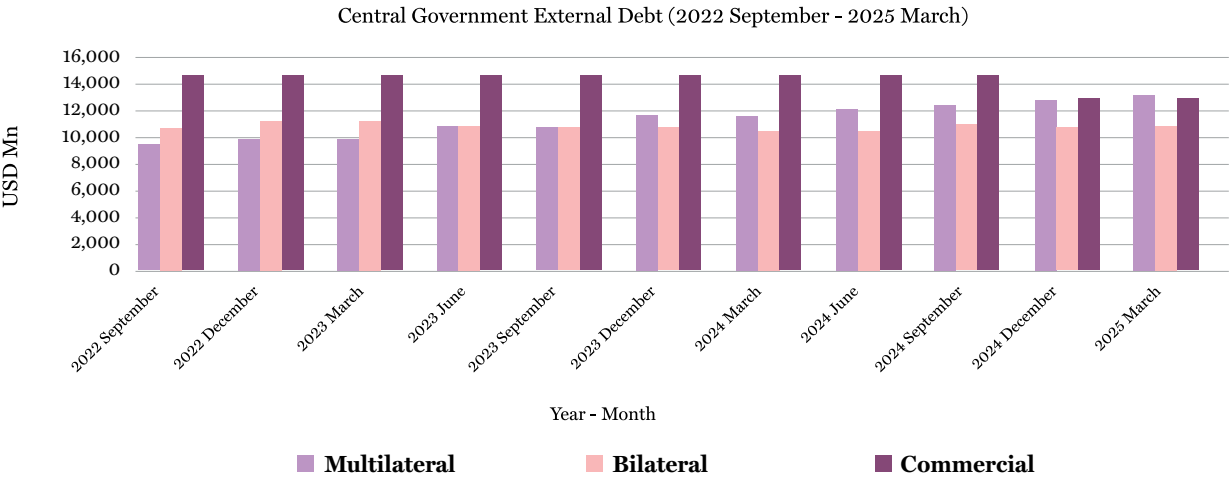


Source: Central Bank of Sri Lanka

CHANGE IN SOVEREIGN DEBT STRUCTURE POST-2008

As illustrated in **Figure 3**, the structure of Sri Lanka’s foreign debt changed after 2008. An exponential increase in foreign currency-denominated debt from international financial markets indicates a similarity between Sri Lanka and many underdeveloped countries during this period.

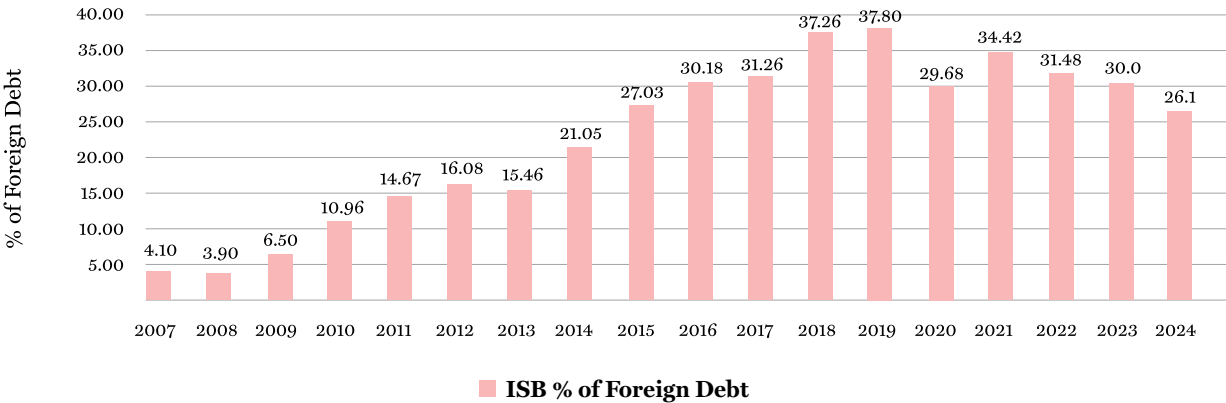
Figure 3. Sri Lanka’s Foreign Debt Structure: Sept 2022 to March 2025



Source: Central Bank of Sri Lanka

The increasing trend of international commercial borrowing in Sri Lanka is driven by its transition to a middle-income country, which has reduced access to concessional loans from multilateral agencies and bilateral donors. Borrowing from more expensive non-concessional and commercial sources represented just 7 per cent of total outstanding government external debt in 2006, but by 2012, they accounted for over 50 per cent. Sri Lanka received a sovereign credit rating in December 2005, aimed at accessing international financial markets. Consequently, the country turned to international capital markets, issuing its first International Sovereign Bond (ISB) worth USD500 million in 2007. From 2007 to 2014, the nation issued seven sovereign bonds totalling USD5.5 billion (See **Table 2** for details). Concurrently, Sri Lanka gradually opened its government securities market to foreign investors. The foreign ownership limit of 5 per cent on Treasury bonds, set in 2006, was raised to 10 per cent in 2007. In 2008, Sri Lanka further opened its Treasury bill market to foreign investors (Weerakoon, 2015). The current foreign debt structure reflects a growing reliance on ISBs (as illustrated in **Figure 4**).

Figure 4. International Sovereign Bond Trend: 2007 to 2024



Source: Central Bank of Sri Lanka

ZOOMING IN ON THE 2014 TO 2019 PERIOD

There has been an apparent shift towards a greater dependency on foreign debt financing, such as high-coupon, long-term, and USD bond issuances, from 2015 to 2019. As indicated in **Table 1**, Sri Lanka's total debt stock increased from USD22,959 million in 2014 to USD36,710 million in 2019, representing a substantial rise of USD13,751 million over the five years, leading to the most recent peak of sovereign debt. This was when the country underwent reforms under the IMF Extended Credit Facility and credit rating reviews. Debt categories experienced notable changes (see **Table 1**), with bilateral debt inching up by USD197 million.

Table 1. Sri Lanka's Foreign Debt Stock: 2014 to 2019

USD Mn							
ITEM	2014	2015	2016	2017	2018	2019	INCREASE IN DEBT (2014 to 2019)
Bilateral	5,410	5,441	5,574	5,771	5,678	5,607	197
As a % of Total Foreign Debt	23.6	21.9	20.2	18.6	16.8	15.3	1.4
Multilateral	6,880	6,911	7,199	7,856	8,011	8,152	1,272
As a % of Total Foreign Debt	30.0	27.8	26.1	25.4	23.7	22.2	9.3
Commercial	5,024	6,670	8,866	11,084	13,969	16,394	11,370
As a % of Total Foreign Debt	21.9	26.9	32.2	35.8	41.3	44.7	82.7
ISB	5,000	6,650	8,150	9,650	12,150	15,050	10,050
As a % of Commercial Debt	99.5	99.7	91.9	87.1	87.0	91.8	88.4
As a % of Total Foreign Debt	21.8	26.8	29.6	31.2	35.9	41.0	73.1
Other	24	20	716	1,434	1,819	1,344	1,320
As a % of Commercial Debt	0.5	0.3	8.1	12.9	13.0	8.2	11.6
As a % of Total Foreign Debt	0.1	0.1	2.6	4.6	5.4	3.7	9.6
Export Credit	5,646	5,801	5,891	6,261	6,179	6,558	912
As a % of Total Foreign Debt	24.6	23.4	21.4	20.2	18.3	17.9	6.6
Total	22,959	24,823	27,530	30,972	33,837	36,710	13,751

Source: Ministry of Finance and Central Bank of Sri Lanka

Multilateral debt rose significantly by USD1,272 million. The most substantial surge occurred in commercial debt, which soared by USD11,370 million, largely driven by International Sovereign Bonds. Between 2015 and 2019, the government issued an additional eleven ISBs (see **Table 2**), contributing USD10,050 million to the total increase, amounting to nearly 12 per cent of GDP. Export credit also saw a significant uptick, climbing by USD912 million. Currently, Sri Lanka has USD12.5 billion in ISB debt.

Table 2. Sri Lanka's ISB Issuances: 2007 to Date

DATE OF ISSUANCE	AMOUNT (USD MN)	INTEREST RATE (%)	TENURE (YEARS)	MATURITY DATE	BORROWING REPAYMENT (-) (USD MN)	OUTSTANDING	RESERVES AT THE END OF THE YEAR (USD MN)
17/10/07	500	8.25	5	17/10/12	0	500	3,508.2
22/01/09	500	7.40	6	22/01/15	0	1	5,357.4
30/10/10	1	6.25	10	30/10/20	1	2	7,196.5
27/07/11	1	6.25	10	27/07/21	1	3	6,749.3
25/07/12	1	5.88	10	25/07/22	1	4	7,105.9
01/06/14	1	6.00	5	01/06/19	0	4,5	8,208.4
04/07/14	500	5.13	5	04/07/19	0	5	8,208.4
06/03/15	650	6.13	10	06/03/25	650	5,15	7,303.6
11/03/15	1,5	6.85	10	11/03/25	1,5	6,65	7,303.6
18/07/16	1	6.83	10	18/07/26	1	7,65	6,019.1
18/07/16	500	5.75	5	18/01/22	500	8,15	6,019.1
05/11/17	1,5	6.20	10	05/11/27	1,5	9,65	7,958.7
18/04/18	1,25	5.75	5	18/04/23	1,25	10,9	6,919.2
18/04/18	1,25	6.75	10	18/04/28	1,25	12,15	6,919.2
14/03/19	1	6.85	5	14/03/24	1	12,15	7,642.4
14/03/19	1,4	7.85	10	14/03/29	1,4	13,55	7,642.4
28/06/19	500	6.35	5	28/06/24	500	13,55	7,642.4
28/06/19	1,5	7.55	10	28/03/30	1500	15,05	7,642.4
31/12/20	NIL				-1	14,05	5,664.3
31/12/21	NIL				-1	13,05	3,139.2
31/01/22	NIL				-500	12,55	2,362.0

Source: Ministry of Finance, Sri Lanka

As indicated in **Table 3**, total debt inflows amounted to USD22,933 million, with commercial loans and ISBs being the primary sources. Outflows totalled USD13,928 million, resulting in a net inflow of USD9,005 million over the period.

Table 3. Sovereign Debt Inflow Vs. Outflow: 2014 to 2019

ITEM	2014	2015	2016	2017	2018	2019	2015 - 2019
INFLOW							
Commercial	1500	2150	2200	2500	3500	4400	14,750
ISBs	1500	2150	1500	1500	2500	4400	12,050
Foreign Currency Term Financing		700	1000	1000			2,700
Multilateral	576	526	719	631	646	547	3,069
Bilateral	625	464	404	367	316	329	1,880
Export Credit	790	553	527	739	502	912	3,233
Total	3,491.4	3,693	3,849.2	4,237.1	4,964.7	6,188.6	22,933
Bilateral (20%)	500	371	323	294	253	263	1,504
Export Credit (10%)	711	498	474	665	452	821	2,910
Total (20%,10%)	3,287	3,545	3,716	4,090	4,851	6,032	22,234
OUTFLOW							
Commercial	267	812	418	842	1339	2876	6,287
ISBs	264	808	412	524	680	2321	4,745
Principal Payments		500				1500	2,000
Interest Payments	264	308	412	524	680	821	2,745
Foreign Currency Term Financing			2	316	657	501	1,476
Other	4	4	4	2	2	55	67
Multilateral	323	317	345	384	467	530	2,043
Bilateral	471	447	509	526	553	548	2,583
Export Credit	349	466	526	651	683	689	3,015
Total	1,410.5	2,041.2	1797,5	2,402.9	3,043.2	4,642.7	13,928
Net Inflow (2015-2019)	9,005						
Net Inflow (2015-2019) (20%, 10%)	8,306						
ISBs payments as a % of total Debt Service	19	40	23	22	22	50	34
Commercial debt ser. as a % of total debt service	19	40	23	35	44	62	45

Source: Ministry of Finance, Sri Lanka

It is important to examine the absorption and the supply of foreign exchange by the Central Bank⁵ during the period in question, as Sri Lanka's reserve position is directly related to the debt crisis. As indicated in **Table 4**, in 2015, the net absorption of foreign exchange was negative at USD3,249.53 million, indicating a significant supply to the market. The trend of negative net absorption continued in 2016 with USD768.16 million. However, 2017 saw a reversal, with a positive net absorption of USD1,664.36 million, reflecting a build-up in reserves. In 2018, net absorption turned negative again at USD1,119.67 million. By 2019, net absorption was slightly positive at USD387 million.

The significant supply of foreign exchange in 2015 and 2018 necessitated increased foreign borrowing by the government to replenish reserves and maintain financial stability. This need to borrow more to accumulate reserves, especially through high-interest commercial debt and ISBs, directly contributed to the rise in government debt stock during this period.

Table 4. Absorption and Supply of Foreign Exchange by the Central Bank of Sri Lanka

PERIODO	USD Mn			
	ABSORPTION	SUPPLY	NET ABSORPTION	RESERVE POSITION
2014	1,407.2	862.25	544.95	8,208.4
2015	179.4	3,428.93	-3,249.53	7,303.6
2016	1,132.22	1,900.38	-768.16	6,019.1
2017	2,214.11	549.75	1,664.36	7,958.7
2018	556.96	1,676.63	-1,119.67	6,919.2
2019	593.9	206.9	387	7,642.4

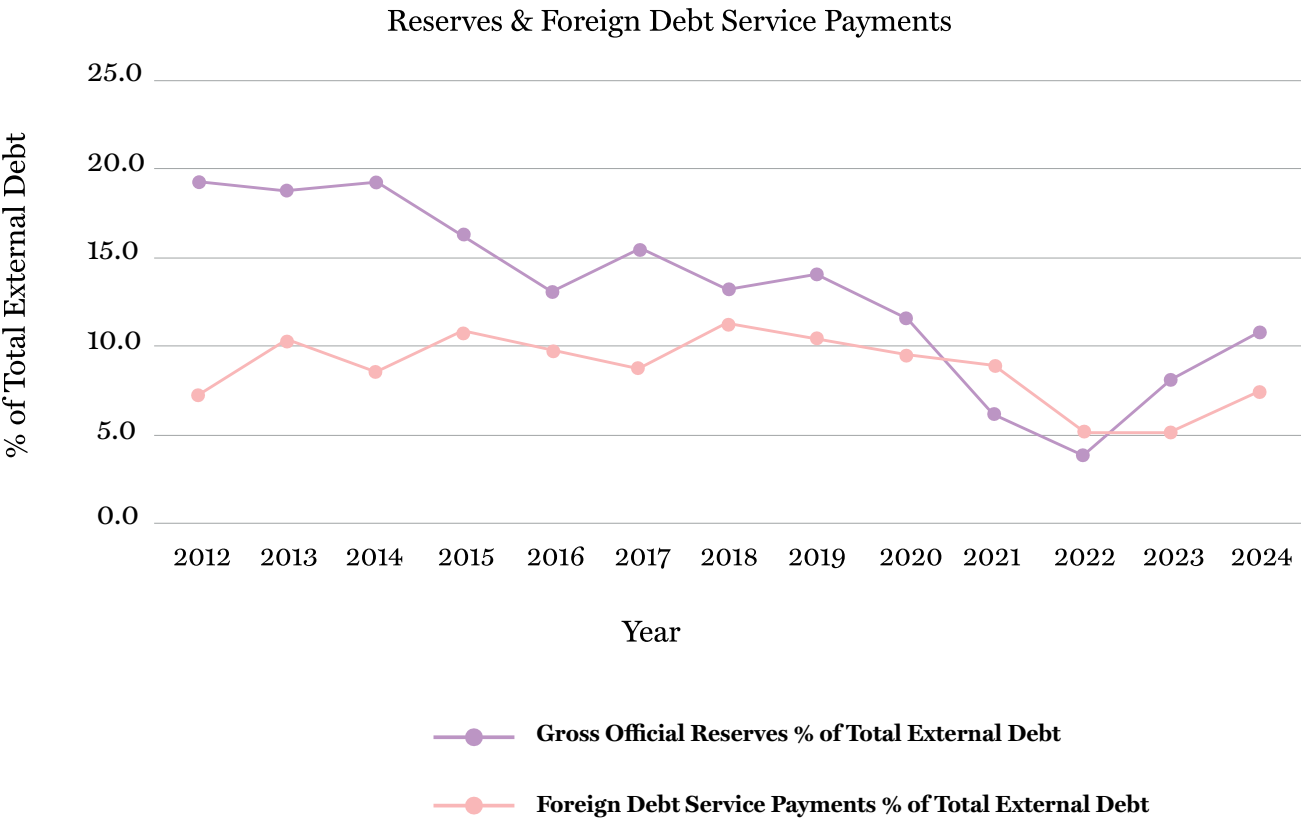
Source: Ministry of Finance

Figure 5 illustrates Sri Lanka's reserve position against foreign debt service payments. Between 2012 and 2022, the declining trend in reserves began in 2015 and continued to 2022. This trend was a function of two issues: Sri Lanka's current account performance and increased debt service burden.

In the first half of 2015, Sri Lanka faced a significant slowdown in foreign capital inflows and a deteriorating trade balance. Foreign investment in Treasury bills, bonds, and long-term government loans declined sharply. The trade deficit widened by over

15 per cent, with export earnings contracting by 0.6 per cent. Worker remittances growth also decelerated to 2.2 per cent, down from 10.5 per cent in the first half of 2014. Consequently, Sri Lanka’s current account was under severe pressure (Weerakoon, 2015).

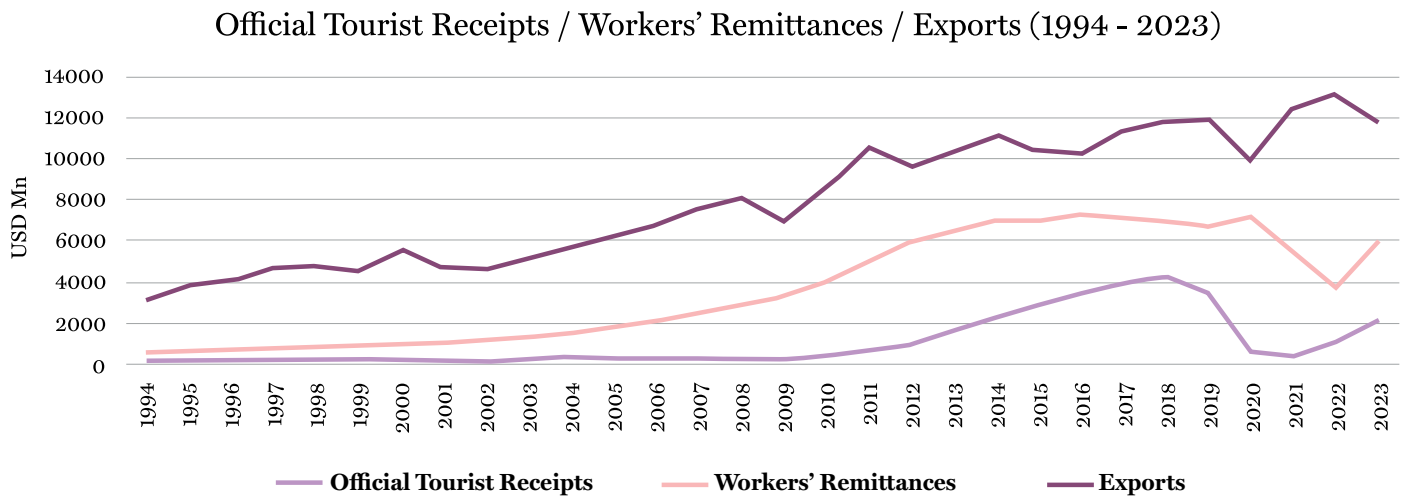
Figure 5. Sri Lanka’s Reserve Position and Foreign Debt Payments: 2012 to 2024



Source: Central Bank of Sri Lanka

Sri Lanka’s declining reserve position since 2015 was further exacerbated in the aftermath of the 2019 Easter Sunday bombings, followed by the spread of the COVID-19 pandemic in 2019 and 2020. These shocks led to a virtual halt in foreign exchange earnings from tourism and remittances and severely impacted exports due to global supply chain disruptions and decreased demand. **Figure 6** illustrates the dip in the top three sources of foreign exchange inflow to the country in the years leading up to the peak of the economic crisis in 2022.

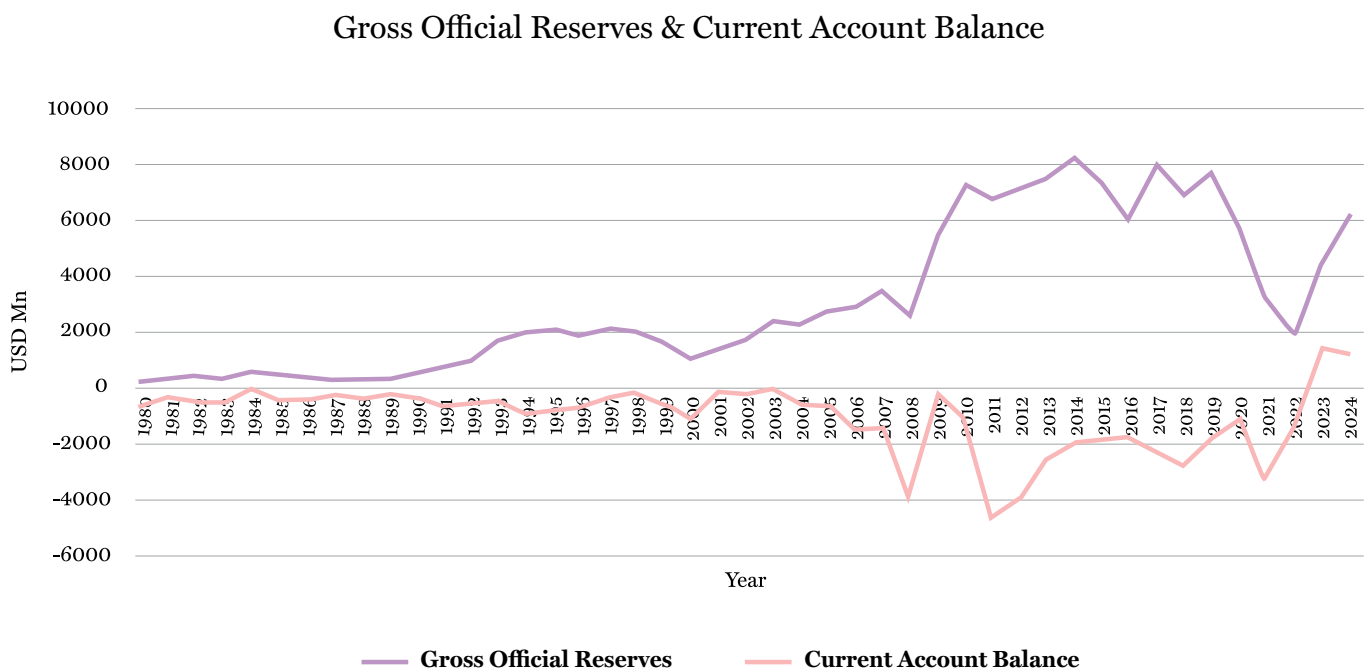
Figure 6. Trend in Foreign Exchange Inflows from Tourism, Remittances and Exports: 1994 to 2023



Source: Central Bank of Sri Lanka

Figure 7 illustrates the corresponding results for Sri Lanka's current account and gross official reserves. The sudden drop in the current account in 2021 due to the drastic decline in exports, tourism income, and remittances and the adverse effect on gross official reserves are evident here.

Figure 7. Gross Official Reserves & Current Account Balance Trend: 1980 to 2024



Source: Central Bank of Sri Lanka

What made matters worse, leading to a severe BoP crisis, was the maturing of four ISBs from 2019 to 2021, amounting to USD3.5 billion (see **Table 2**). **Table 5** presents the amortisation and interest payments adding up to the total debt service payment of the country. The sharp increase in amortisation payments from 2019 to 2021 had to be serviced in the context of severe losses in tourism, remittances and export revenue, which put unprecedented strain on Sri Lanka's foreign reserves, eventually spiralling down to an economic crisis and debt default.

Table 5. Breakdown of Foreign Debt Service Payments and Gross Official Reserves: 2012 to 2022

YEAR	GROSS OFFICIAL RESERVES	FOREIGN DEBT SERVICE PAYMENTS		
		DEBT SERVICE PAYMENTS	AMORTISATION PAYMENTS	INTEREST PAYMENTS
2012	903,590	284,368	193,529	90,839
2013	980,028	312,152	203,993	108,159
2014	1,075.701	298,769	183,109	115,660
2015	1,052.179	399,679	284,293	115,386
2016	901,656	295,820	169,107	126,713
2017	1,216.518	389,551	224,609	164,942
2018	1,264.486	527,188	314,480	212,708
2019	1,388.118	808,809	574,839	233,970
2020	1,055.866	771,851	505,172	266,679
2021	629,207	786,780	532,521	254,259
2022	689,041	487,854	358,743	129,111

Source: Central Bank of Sri Lanka

The preceding evidence points to the structural composition of Sri Lanka's external debt as the primary cause of the debt crisis that led to default in 2022. As illustrated above, historical data clearly indicates that Sri Lanka's current external debt ratio is not unprecedented, as the country faced higher external debt levels in the 1990s. Today's key difference is that a larger portion of this debt comes from international capital markets with high interest rates and short maturity periods (Nicholas and Illanperuma, 2023).

Borrowing from international capital markets is particularly risky for developing countries like Sri Lanka. ISBs have high interest rates ranging from 5.5 to 8.5 per cent, requiring repayment within five to ten years. Unless a country can maintain a sound current account with consistency in foreign exchange earnings from exports and other sources, this type of debt becomes untenable very quickly. Unlike project-linked loans, ISBs do not generate assets or economic growth. Given that funds are fungible⁶ once they reach a country's treasury, there is little transparency around government spending from these bonds.

In addition to the excessive reliance on ISBs noted in the 2015 to 2019 period, the key economic decisions that significantly weakened the economy were:

Missed Opportunities with Low Oil Prices: The government failed to capitalise on low international oil prices from 2015 to 2019, which could have bolstered foreign exchange reserves and reduced the Ceylon Petroleum Corporation's debt. Instead, reserves eroded, and debt increased.

Liberalisation of Vehicle Imports: Reducing taxes on motor vehicle imports in 2015 led to a surge in vehicle imports, further depleting foreign reserves. Such decisions masked underlying structural issues in the economy (Subramaniam, 2017) and exacerbated the reserve position in subsequent years.

Reserve Management Failures: Despite significant foreign currency inflows from ISBs, IMF funding, and the Hambantota Port lease (to China Merchant Ports), reserves declined, leaving the economy vulnerable to external shocks like the COVID-19 pandemic. Sri Lanka faced a financial market sell-off and capital flight amid economic slowdown fears, mirroring trends in other emerging markets. Within two months, 70 per cent of foreign-held Treasury bills and bonds—valued at USD372 million (0.42 per cent of GDP)—exited the market, while the Sri Lankan Rupee depreciated 5.3 per cent over the same period (Central Bank of Sri Lanka, 2020a; Central Bank of Sri Lanka, 2020b).

The Central Bank's reserve management strategy, which focused on making imports cheaper, notably for the comprador merchant class⁷ (further discussed in later sections), failed to build a sufficient buffer to withstand future economic shocks, leading to a weakened reserve position by the end of 2019.

It is also important to note that Sri Lanka's exchange control regime underwent a major shift with the acceptance of IMF Article VIII in March 1994, removing restrictions on current international transactions and initiating capital account

liberalisation. In 1995, capital account relaxation allowed commercial banks to secure foreign loans up to 5 per cent of their capital, later increased to 15 per cent in 1997. Foreign currency loans for exporters and private-sector overseas investments were also introduced. From 2000 onwards, restrictions on foreign investment were eased further in sectors like banking (60 per cent), insurance (90 per cent), and stockbroking (100 per cent). Flexibility was granted for residents and non-residents to hold earnings abroad and invest in government securities and overseas equities. In 2020, the Central Bank directed licensed commercial banks and the National Savings Bank to halt purchases of ISBs for three months. The measure, aimed at easing exchange rate pressure and financial market stress caused by the COVID-19 outbreak, permitted ISB purchases only if funded through new foreign currency inflows (Central Bank of Sri Lanka, 2020c). In 2021, local companies were permitted by the Central Bank to purchase ISBs issued by the Government of Sri Lanka in the secondary market (Central Bank of Sri Lanka, 2021). These developments indicated premature liberalisation of the capital account. They provided entry points for the local private sector to have a stake in the dollar-denominated commercial debt of the sovereign. Reversals of short-term capital inflows facilitated by such liberalisation exacerbated economic volatility, while weak financial regulation heightened the likelihood of systemic crises. Allowing the local private sector to invest in government-issued ISBs on the secondary market has steadily increased its influence over public debt management. (See the following discussion on the ISB ecosystem and macro-linked bonds.)

2. THE GLOBAL ISB TREND AND KEY PLAYERS IN THE DEBT ECOSYSTEM

The trend among “frontier economies” like Sri Lanka and emerging economies in the developing world toward borrowing high-cost debt from international capital markets has global dimensions. After the global crisis of 2008, emerging market corporations significantly ramped up US dollar-denominated bond issuance (Williams et al., 2022). Historic US interest rate lows and developed economies’ institutional investors’ “search for yield” fueled the surge in emerging market dollar debt. This boom mirrors past periods, such as the 1970s’ petrodollar recycling and the early 1990s’ expansion of developing country bonds due to falling dollar rates.

The creation of emerging market corporate debt benchmarks, like JPMorgan’s CEMBI Narrow Index, reshaped the landscape for bond issuance. The index’s inclusion criteria—requiring bonds to have a minimum principal of USD500

million— incentivised issuers to upsize offerings to meet eligibility. This shift, coupled with heightened interest from developed market institutional investors since 2008, drove a surge in large-scale bond issuances in emerging markets. Corporations that traditionally issued smaller bonds started meeting the USD500 million threshold to tap into the visibility and rewards offered by index inclusion. These bonds had lower yields than lower face-value bonds issued by otherwise identical issuers. The lower interest rates enticed developing countries to address balance-of-payments issues linked to poor trade terms (ibid.).

In the case of Sri Lanka, the bondholders represent a diverse and challenging group to coordinate, with some, like Hamilton Reserve, holding out and even suing the government (Newton 2024). As such, the ISB landscape is a highly litigious ecosystem creating perverse incentives for a constellation of actors consisting of bondholders, legal advisory firms, credit rating agencies and layers of intermediaries that are in and out of the revolving doors of this speculative political economy. Sri Lanka's ISB holders have formed two groups to negotiate the debt restructuring. The larger group, known as the Ad-Hoc Group, controls about 50 per cent of the outstanding ISBs and includes global investment giants like Amundi Asset Management, BlackRock, HBK Capital Management, and T. Rowe Price Associates (Do Rosario & Campos, 2023). This group is represented by a steering committee with Rothschild & Co. as financial advisors and White & Case as legal advisors. Notably, BlackRock has a longstanding relationship with White & Case.

The second group, consisting of Sri Lankan domestic financial market holders, controls around 12 per cent of the outstanding ISBs and is advised by Newstate Partners and Baker McKenzie (Ministry of Finance, Economic Stabilization and National Policies, 2024c). Following the global sovereign debt restructuring architecture norms, Sri Lanka hired globally renowned financial advisors Lazard Frères and legal advisor Clifford Chance to support the debt restructuring process (ibid.).

With 41 per cent tied to commercial borrowing, Sri Lanka's external debt stock is a point of tension between private bondholders and government policies. Some external creditors demand parity between domestic and external debt treatments, leveraging domestic opposition to haircuts (concessions) on local debt to push for softer terms on their holdings. However, external bondholders have enjoyed higher returns for greater risk, are already adequately compensated and should not expect equal treatment to domestic creditors. Despite this, the government moved to appease both external creditors and the IMF, aiming to regain access to international capital markets—a

move seen as prioritising global finance capital over domestic interests. Sri Lanka's ISB ecosystem is further complicated by the vested interests of local parties that pressure the government to restructure ISBs. The Ceylon Chamber of Commerce (CCC), whose members hold around USD1.8 billion of Sri Lanka's outstanding ISBs, is a case in point. During the COVID-19 crisis, CCC members purchased these bonds at steep discounts, as low as 40-50 per cent of their original value (Pathirana, 2024). Their interests mirror those of foreign ISB holders who want to maximise their profits by lowering the haircuts given to the Sri Lankan government in debt repayment. A group of politically influential elites, the CCC has inroads into any political regime. It is capable of putting significant pressure on government decisions around debt restructuring, as evident from the most recent restructuring "Agreement in Principle" (AIP) (See later section on macro-linked bonds).

Globally, the absence of a statutory framework for managing distressed sovereign debt complicates crisis resolution, leading to inefficiencies and inequities (Guzman & Stiglitz, 2016). Particularly in middle-income countries like Sri Lanka, the current ad hoc system relies on decentralised, non-binding market instruments like collective action clauses and competing codes of conduct. These legal gaps create incentives for arbitrage, undermining cooperation and giving rise to vulture funds—hedge funds that exploit the legal loopholes they helped create.⁸

These funds specialise in targeting countries in debt crises, buying distressed debt at steep discounts, often issued under New York law, and then suing for full repayment, including punitive interest and compensation for risks they never assumed. If a country refuses to comply with favourable rulings, these funds resort to aggressive tactics. Over the past decade, this approach has become more prevalent; while only 5 per cent of debt restructurings involved legal disputes in the 1980s, this figure soared to nearly 50 per cent by 2010 (Schumacher et al., 2021). The outcomes are concerning. Vulture funds are reaping exorbitant returns, creating significant inequities among creditors and exacerbating moral hazard⁹ issues. This undermines the chances of successfully completing sovereign debt restructuring, as seen in Argentina's recent case. The message to creditors: holding out can be highly profitable (Guzman & Stiglitz, 2016).

ISBs are tradable, and credit rating agencies influence their prices. When a country's credit rating is downgraded, bond prices fall, and yields rise, driving up future borrowing costs. This can trigger a snowball effect, where a country is forced to take on more debt at higher interest rates to repay existing obligations borrowed at lower rates. On 23 November 2018, Moody's downgraded Sri Lanka's sovereign credit rating

from B1 to B2, reflecting increased concerns over the country's ability to meet external debt obligations. Sri Lanka had already been classified as a high-speculative B1 credit since July 2013, with its outlook shifting from stable to negative in June 2016. The country's external financial deterioration significantly impacted its ability to raise funds, as evidenced by the sell-off of the 2025 USD bond, with its yield rising to 9.04 per cent amid market concerns. This negative sentiment hindered Sri Lanka's ability to tap Eurobond markets for refinancing, creating short-term financial stress. It also presented an opportunity for risk-takers to purchase Sri Lankan debt at a discount, potentially benefiting from high yields in their investment portfolios (de Zilwa, 2019).

In 2021, Moody's again downgraded Sri Lanka's credit rating, a decision the Government of Sri Lanka criticised as irrational and poorly timed. The downgrade came just before the 2022 Government Budget announcement, which was anticipated to be crucial for the country's economic outlook. Moody's assessment overlooked key measures Sri Lanka had taken to enhance its external position, such as medium to long-term funding from bilateral sources, credit lines for petroleum, a major forex loan, and bilateral currency swaps. These steps, announced in October 2021, had already shown positive results, raising questions about the fairness of Moody's evaluation.

The agency's concerns about governance and political stability, which seemed misplaced at the time, now appear prophetic as they were articulated six months before the protests that led to a regime change in Sri Lanka. Interestingly, Moody's prophecies coincided with critical financial milestones like signing a Foreign Currency Term Financing Facility with China Development Bank and currency swaps with India and Bangladesh. Although this turn of events precedes the Sanctions Evasion Prevention & Mitigation Act (2024) of the U.S. government,¹⁰ it can be considered yet another dynamic of the weaponisation of the dollar, as credit rating agencies such as Moody's are important actors in this ecosystem (Krikke, 2024). Despite Moody's negative outlook, Sri Lanka's economy demonstrated resilience in early 2021, with an 8.0 per cent GDP growth rate supported by a strong vaccination campaign and recovering tourism. The government's strategies to boost foreign exchange through exports and remittances were effective. Moody's failure to acknowledge these positive trends reflects a potentially flawed, biased, or compromised assessment methodology.

Credit rating agencies have come under fire globally, particularly after Standard & Poor's, one of the "big three" alongside Moody's and Fitch, downgraded the United States from its AAA rating. These agencies face criticism for a fundamental conflict of interest: they are paid by the banks and companies they are supposed to

evaluate impartially (Neate, 2011). In a filing with the U.S. Securities and Exchange Commission, Moody's culture of "intimidation and harassment" to pressure analysts into assigning ratings that align with client expectations, compliance department targeting "troublesome" analysts and management incentivising lenient ratings to maximise corporate earnings is documented as testimony (ibid.). Moody's and other credit rating agencies were central to the U.S. subprime mortgage crisis by overrating complex financial products backed by questionable mortgages. The agencies' favourable ratings of Collateralised Debt Obligations (CDOs)¹¹ led banks to invest in risky debts they would typically avoid. Nobel laureate economist Joseph Stiglitz has called rating agencies "key culprits" in the financial crisis, accusing them of turning low-rated securities into top-rated investments, enabling the banks' risky behaviours (ibid.).

Sri Lanka's plight is emblematic of a broader global issue and a political economy affecting many developing countries which have fallen into the ISB debt trap. Following the 2008 financial crisis, these nations were drawn to ISBs to address the chronic balance of payments problems exacerbated by deteriorating trade terms and limited industrialisation. Concurrently, Western institutional investors, seeking higher returns, turned to stocks, CDOs, and emerging market debt. The shift in debt structure has had severe consequences for citizens, who bear the brunt of ongoing debt crises.

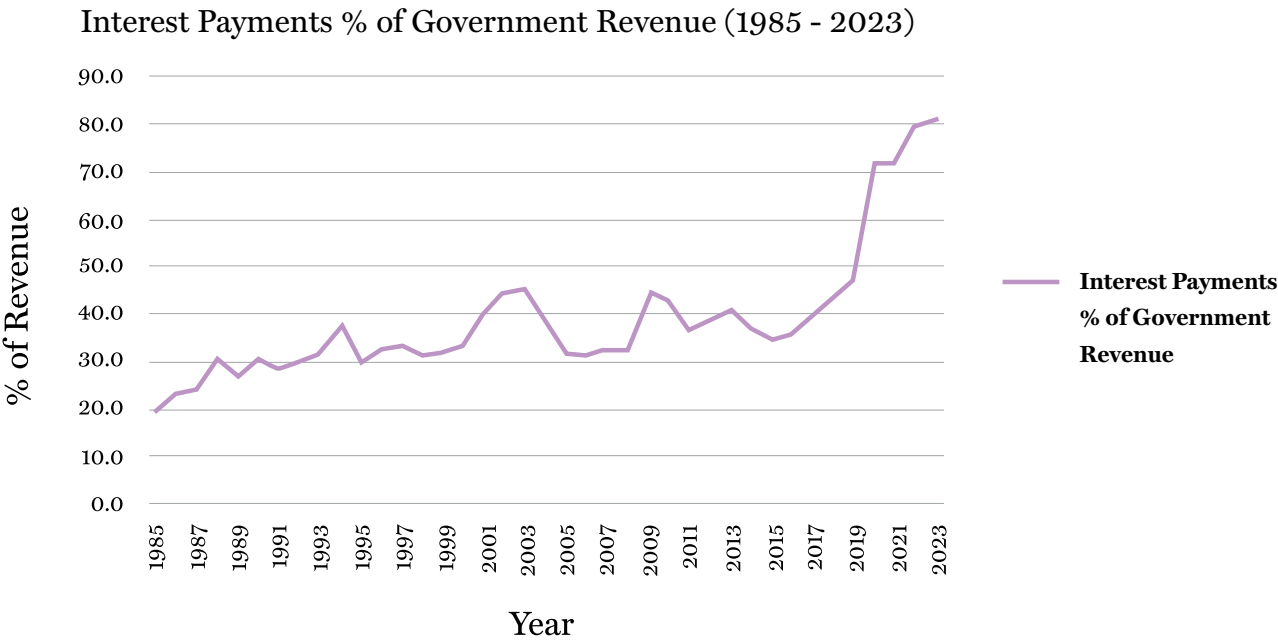
An analysis of debt composition and servicing shows a clear trend: higher proportions of ISBs in a country's debt lead to increased annual interest payments. Many of the most debt-distressed countries, including Argentina, Lebanon, Ecuador, and Ghana—each having defaulted post-2019—share a high exposure to bond markets. Elevated ISB interest payments heighten exposure to external and cyclical shocks, compounding fiscal vulnerabilities. The COVID-19 pandemic, for instance, decimated global tourism in 2020 and 2021, slashing Sri Lanka's annual export revenue by 24 per cent. This was followed by a global oil and commodity price surge driven by the Ukraine war. Such shocks leave developing nations grappling with a harsh trade-off: servicing high ISB debt at the expense of critical public welfare programmes and investment priorities.

3. LION'S SHARE OF EXPENDITURE ON INTEREST PAYMENTS ON DEBT

The 2024 Report by the United Nations Trade and Development (UNCTAD), *A World of Debt: A Growing Burden to Global Prosperity*, notes that over half of developing countries allocate at least 8 per cent of government revenues to interest payments.

This figure has doubled in the past decade. The pressure is especially significant in Africa, Latin America, and the Caribbean (United Nations Trade and Development, 2024). The case of Sri Lanka is particularly worrying as interest payments on debt reached nearly 80 per cent of government revenues by 2023. **Figure 8** illustrates the exponential increase in interest payments as a percentage of government revenue after 2015, the period characterised by high ISB exposure.

Figure 8. Interest Payments as a Percentage of Government Revenue: 1980 to 2023



Source: Central Bank of Sri Lanka

Interest costs reached 8.9 per cent of the GDP, driven by elevated interest payments as rates rose to combat record inflation since 2022. In 2023, domestic debt interest premiums remained high due to market uncertainty surrounding the domestic debt optimisation operation and the government’s absorption of guaranteed State-Owned Enterprise debt (Ministry of Finance, Economic Stabilization and National Policies, Sri Lanka, 2023). Rising interest payments were projected to consume significant government revenues, averaging 14.3 per cent of GDP in 2024.

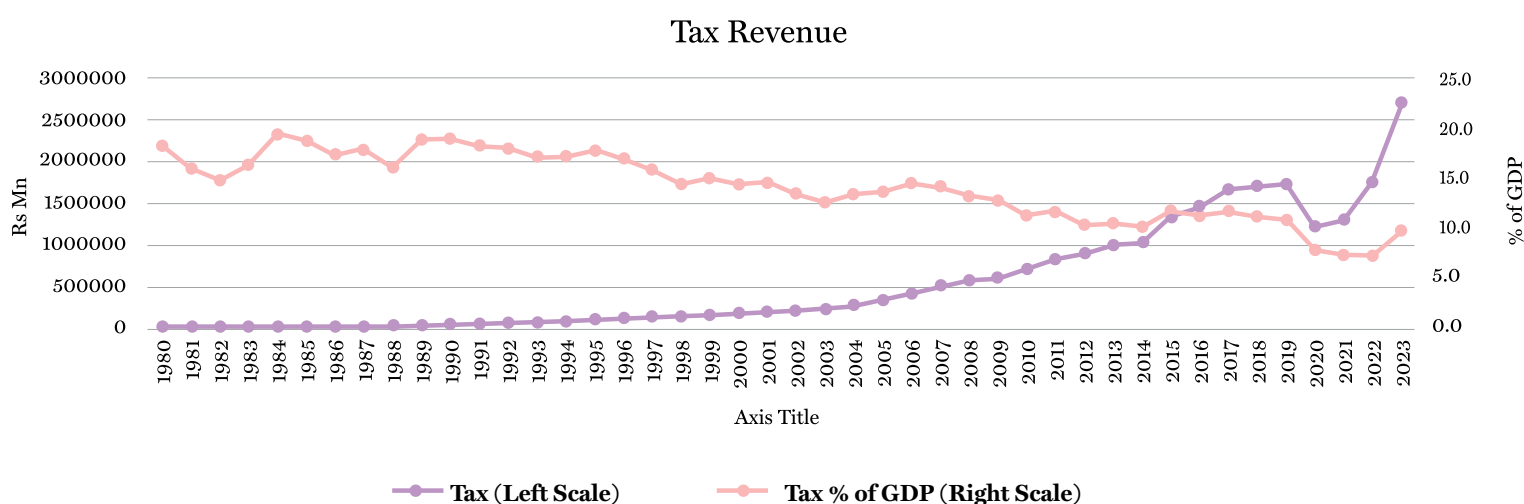
In 2023, interest payments amounted to LKR2,455.6 billion, accounting for 52.3 per cent of total recurrent expenditure, far outpacing other expenditure categories. Transfers to households, including pensions, social safety net payments, free medical supplies, fertiliser subsidies, in-kind subsidies to school students, and nutritional programmes, totalled LKR912.4 billion, or 19.4 per cent of recurrent expenditure. Salaries and wages expenditure reached LKR939.5 billion, representing 20.0 per cent of recurrent expenditure. The expenditures on school education and free health care

as a percentage of total expenditure were 5.9 per cent and 7.9 per cent, respectively. Education and health spending as a percentage of GDP stands at 1.2 per cent and 3.8 per cent, respectively, dwarfed by staggering interest payments on debt. The impact on social expenditure is further explored in the section on *Reading Sri Lanka through a Feminist Political Economy Lens*

SRI LANKA'S LONG-TERM REVENUE DECLINE

The analysis of expenditure invariably draws attention to Sri Lanka's fiscal gap. Over the long run, the economy's fiscal gap arises from a reduction in the tax effort from around 20 per cent of GDP to the present 10 per cent (Moore, 2017). The tax performance began to fall in the mid-1990s and continued for the next three decades (see **Figure 9** below). From 1990 to 1995, the tax-to-GDP ratio averaged 18.5 per cent, dropping to 11.9 per cent between 2010 and 2015. The most recent impulses have come from the extensive tax reductions at the end of 2019, with the onset of a new government and the demands for public spending arising from the response to the COVID-19 pandemic.

Figure 9. Trend in Sri Lanka's Tax Revenue: 1980 to 2023



Source: Ministry of Finance, Sri Lanka

Sri Lanka's tax revenue decline stems from multiple factors. The principal factor is that despite significant shifts in the economic structure, the government has not modernised its revenue systems, leading to a drop in revenue collection as a proportion of Gross National Product (GNP). Among other factors are unplanned, ad hoc tax incentives—exemptions, holidays, reliefs, duty waivers—that have eroded the tax base, causing an estimated annual GDP loss of over 1 per cent. Cumulatively, Sri Lanka's tax expenditures account for nearly 4 per cent of the GDP (Ministry of

Finance, Economic Stabilization, and National Policies, 2024a). Additional factors include periodic increases in allowable expenses and allowances, ad hoc tax rate cuts, a narrow tax base and coverage, a tax system lacking elasticity and buoyancy, a large informal economy fostering tax evasion and avoidance, ineffective tax amnesties,¹² low compliance, a complicated tax system, and weaknesses in tax administration (Kalegama, 2010). What underpins the declining trend in government revenue are the political and institutional dynamics favoured by the wealthy and powerful (Moore, 2017) that affect tax administration. Key factors include the waning influence of popular movements such as political parties and trade unions, the rise of foreign aid and loans as alternatives to domestic revenue generation, and the institutional push to exempt the private sector from taxes. Additionally, powerful executive presidents often sidelined finance ministers, and there was a political and institutional entrenchment in relying heavily on import taxes collected by the Customs Department from a shrinking economic sector.

The political economy explanation for declining tax revenue is more persuasive when considering the tax mix. The direct taxes comprise, on average, less than 20 per cent of tax revenue or 2 per cent of GDP, while the indirect taxes comprise around 80 per cent of tax revenue or 8 per cent of GDP. There has been a significant decline in direct tax revenue over the years. For instance, property taxes (financial tax, wealth tax, gift tax, estate duty, etc.) averaged 2 per cent of tax revenue before 1977 and at present is almost negligible (Kalegama, 2010).

A detailed analysis shows that the indirect tax system in Sri Lanka is regressive, i.e., taxes as a percentage of income decline successively for higher-income earners (ibid.). The highest-income group bears the lowest tax burden, while the lowest-income group bears the highest burden. Indirect taxes impose a relatively high tax burden on lower-income groups, where women are over-represented; however, periodic revisions, including the most recent tax efforts, have focused more on increasing revenues at large rather than addressing the tax policy mix. Indirect taxes are administratively easier to implement than direct taxes. Embedded in commodity prices, they are harder to evade and incur relatively low collection costs. As such, they provide quick wins for the government's revenue targets.

4. POLITICAL ECONOMY OF SRI LANKA'S DEBT STORY

A bird's-eye view of the political economy, including popular political discourses, is useful in anticipating how future scenarios of Sri Lanka's debt story will unfold and its implications for the population, particularly disadvantaged communities and women. Jogging our collective memory back to 2022 is important for this purpose.

The zenith of Sri Lanka's economic crisis was popularly characterised by a series of mass protests that began in March 2022 against the government of Sri Lanka, commonly known as the *Aragalaya*. Facing unprecedented price hikes and thirteen-hour power cuts, the capital Colombo's middle class, consisting of white-collar workers, IT professionals, artists, and tuk-tuk drivers, chanted "Gota go home!" against President Gotabaya Rajapaksa. Those who initially condemned protests later joined the street protests as feelings of helplessness swept through the country in the face of daily struggles to buy petrol, food, medical supplies and other necessities. The deprivation during early 2022 certainly cut across all classes, as farmers, fishers, labourers, self-employed people, manufacturing workers, white-collar employees, and small-business owners were all hit by inflation. However, the popular discourse was dominated by middle-class anxieties, reflected on protest slogans, placards and social media hashtags (Illanperuma, 2022).

The salient political narrative was and remains that widespread political corruption caused the economic crisis in Sri Lanka. Social media memes called for ousting Members of Parliament, reflecting deep political mistrust, which has been brewing in middle-class consciousness for over a decade (ibid.). It is important to note that this very consciousness and the associated narratives that denounced politicians, state and politics as 'dirty' had led to former President Gotabaya Rajapaksa's landslide victory in the 2019 Presidential election. Gotabaya garnered the massive middle-class swing vote as the latter perceived him as not a politician, but a technocrat with an iron-fist style leadership quality and a track record of delivering results. However, as his central-left coalition government struggled to manage the BoP crisis in the face of COVID-19 and global stagflation, the salient narrative focused on allegations of corruption as the root cause of the crisis. In association with the corruption narrative was the mismanagement of the economy with an underlying ideological critique of heterodox economics. Unlike Africans and Latin Americans opposing IMF austerity, Sri Lanka's middle class demanded the President resign for not approaching the IMF sooner, sharing slogans like "Call the IMF" and "Follow the IMF you stupid" (ibid.).

These narratives of political corruption and mismanagement with an underlying critique of heterodox economics create a powerful trope evident in many recent “colour revolutions” leading to regime change. The potent narrative of economic mismanagement effectively demonises state intervention in the economy in the name of corruption, inefficiency, and nepotism, all of which pander to middle-class consciousness while externalising the crisis to the realm of politics, politicians and the establishment. This creates the perfect milieu to cleverly usher in a rebranded neoliberal policy agenda as the only solution to stabilise the country in an almost Trojan horse-like manner.

A key component of this milieu is the country’s intellectual authorities. For decades, Western-funded think tanks, advocacy groups, and major media houses have groomed economists, social scientists, researchers, and journalists to rebrand neoliberalism in Sri Lanka. These actors, together with young and old aspiring middle-class women and men, were at the forefront of protests advancing socially progressive causes like feminism, LGBTQ+ rights, and minority advocacy (ibid.). Herein lies our observation that feminist and most other socially progressive groups in Sri Lanka have been subjected to decades of subversion by the neoliberal agenda. Their resistance tends to be driven by human rights, identity politics, and good governance agendas, and less by an awareness of the political economy. The intellectual vacuum created by the dilution of the Left movement was replaced by the neoliberal agenda and its flanking political projects – human rights and good governance.

The 2022 protests in Sri Lanka were fueled by raw outrage but lacked a concrete policy or plan. Aside from the corruption and economic mismanagement narratives, there was no concrete vision for course correction to set Sri Lanka’s economy on the right track. The protestors’ articulations of economic reforms reflected their grievances of not being represented in decision-making as opposed to a critique of the neoliberal political economic order. They were vulnerable to being co-opted by neoliberal forces and international finance, represented on the ground by comprador merchant capital and other local business elites. This co-option is evident in the aftermath of the 150 days of protests, which catalysed regime change and ushered in sweeping neoliberal reforms supported by the protestors. In other words, the protests were leveraged to neutralise public resistance to the aggressive reinforcement of neoliberal economic policy in Sri Lanka.

THE PRESSURE TO DEFAULT

On 12 April 2022, Sri Lanka's Finance Minister Ali Sabry and Central Bank Governor Nandalal Weerasinghe declared a preemptive negotiated default on the country's external public debt, totaling USD51 billion (Ministry of Finance, Economic Stabilization and National Policies, 2022). The move came amid a severe balance-of-payments crisis and critically low foreign reserves of about USD20 million. The announcement effectively suspended foreign debt payments to international bondholders and bilateral creditors, signaling that repayments would be halted pending an IMF bailout and a comprehensive debt restructuring programme.

The debt standstill was executed without prior consultation, disregarding the implications of bilateral debt agreements forged over years of goodwill (Objection statement to SC/FRA/212/2022 and SC/FR/195/2022, 2024). According to public information, the announcement of the debt standstill occurred before the appointment of legal and financial advisors, without the prior approval of the Cabinet of Ministers, and without informing Parliament, which holds complete authority over public finance. This decision also overlooked the provisions of the Appropriation Act 30 of 2021, which had allocated funds in the annual budget for debt repayments. The decision to default can be further questioned, given that by April 2022, nearly 50 per cent of the year's debt obligations had already been met.

From the last two quarters of 2021, pressure was building from various constituencies of the country's civil society, think tanks, credit rating agencies and intermediaries representing bondholder and vulture fund interests in Sri Lanka. Credit rating companies such as Fitch were pioneers in predicting sovereign debt default (Bandara, 2021), and global financial media rang alarm bells about investors bracing themselves for the government's decision to do so (Financial Times, 2022). Intellectuals that either advocated for or signposted to sovereign debt default ranged from those representing liberal views to old Left/Trotskyite ideologies bordering on utopianism (Liyanage, 2022; Jayaratne, 2021). Sri Lanka's corporate-backed think tanks linked to Mont Pelerin Society's (MPS)¹³ vast network (Kunanayakam, 2018) and inroads to powerful economic and political elites such as Verite and Advocata Institute (Daily Mirror Online, 2022; The Morning, 2021) advocated default in the name of public welfare, and urged the government to prepare for the "inevitable" and "imminent" eventuality. Foreign and local representatives of vulture funds strategically mobilised their media engagement vis-à-vis a coterie of journalists/writers (Vizcaino, 2022). They prepared for the lawsuits that would take place in the aftermath of the default (Dolmetsch, 2022). This constellation of actors, interests, and tropes represent an

intricate network connecting think tanks (including the Mont Pelerin Society), global finance capital and transnational elite, advancing the neoliberal agenda in Sri Lanka.

As noted by Kunanayakam (2018), these entities and individuals profess “independence” and “impartiality,” with think tanks often labeling themselves as “non-profit.” However, this narrative holds only when seen through the lens of transnational capital. In a manner reminiscent of Orwellian doublespeak, their independence translates to corporate dependence, impartiality to a bias toward the “single model,” and non-profit to profit maximisation for the Western oligarchy (Kunanayakam, 2018). The “imminent” eventuality of sovereign debt default that they predicted and advocated for appears factually questionable in the face of historical data and alternative analyses. In the aftermath of Sri Lanka’s debt default, many in the same constellation advocated for and emerged as gurus of regressive and unnecessary measures like Domestic Debt Restructuring (DDR), which has a devastating impact on pension funds (Verite Research, 2022) (discussed in detail later).

SRI LANKA’S POST-DEFAULT REFORM AGENDA: THE PROBLEM-SOLUTION MISMATCH

The sophisticated web of relations re-engineering the Sri Lankan state with the neoliberal agenda (discussed in the previous section) provided proximate and fundamental causes for the debt and economic crises, reflecting an oversimplification of the complexities of policymaking and assuming that the government’s decisions are a one-way street. They attributed the country’s challenges in 2022—hyperinflation, fuel shortages, and foreign currency scarcity—to economic mismanagement over twenty-seven months, focusing primarily on the following:

- An unwise tax policy implemented in 2019 to reduce certain taxes.
- The foreign exchange policy and reserve management.
- Money printing and inflation.
- Continuous servicing of debt (particularly foreign debt) and the non-implementation of a debt default.

The debate extends to whether Sri Lanka’s debt woes are primarily due to fiscal deficits or the monetary financing of these deficits. Those who blame monetary financing argue that successive governments relied too heavily on the Central Bank of Sri Lanka (CBSL) to finance deficits due to the limited capacity of domestic financial markets. To restore debt sustainability, the fundamental policies recommended include reducing the budget deficit, halting the practice of printing money to cover deficits, and allowing greater flexibility in the exchange rate.

Narratives reflecting these causes, combined with the potent corruption and mismanagement tropes (discussed above), continue to dominate the media and have been successfully internalised and socialised. The internalisation and acceptance of these narratives have created a conducive, almost resistance-free social environment for the austerity measures and governance reforms of Sri Lanka's Seventeenth International Monetary Fund (IMF) programme. In preparation for the IMF programme, the government implemented a series of orthodox austerity measures, rebranded as macroeconomic stabilisation, in collaboration with the IMF and Multilateral Development Banks (MDBs).

Key measures included a sharp tightening of monetary policy to curb inflation and avert hyperinflation. Between 2021 and 2022, the central bank raised its Standing Deposit Facility Rate from 5 per cent to 14.5 per cent and the Standing Lending Facility Rate from 6 per cent to 15.5 per cent. Additionally, the government removed fuel price subsidies. It implemented a pricing formula that aligned domestic fuel costs with international market fluctuations, ending the practice of state-fixed, below-market prices (Central Bank of Sri Lanka, 2022).

Other steps included stabilising the exchange rate with central bank guidance, enhancing foreign exchange management, maintaining rigorous financial sector oversight, signaling intent to pass legislation to bolster central bank independence, raising taxes, and launching a privatisation programme for state-owned enterprises. Simultaneously, the government ramped up economic diplomacy, engaging in intensive negotiations with the IMF for an Enhanced Fund Facility (EFF),¹⁴ conducting foreign debt restructuring discussions with bilateral creditors and private bondholders, and seeking further financial assistance from India.

The IMF bailout for Sri Lanka was finalised eleven months after the country's default in April 2022, underscoring India's crucial interim support. It took six months to secure an IMF staff-level agreement under the EFF on 1 September 2022, amounting to USD2.9 billion over 48 months. However, the actual disbursement was delayed until 20 March 2023 due to the need for assurances from Sri Lanka's creditors on restoring debt sustainability (IMF, 2023a). China's reluctance to restructure high-interest infrastructure loans contributed to the delay, but it eventually provided the necessary assurances, clearing the way for IMF Board approval.

AUSTERITY REFORMS AND THEIR IMPACTS

Following its sovereign debt default, Sri Lanka's Seventeenth IMF programme is seen as imposing the toughest policy conditions yet. The programme targets austerity, renamed "revenue-based fiscal consolidation" by increasing tax revenue and utility prices. It aims to control inflation by raising interest rates, eliminating monetary financing, and enacting legislation to establish an independent central bank. Additionally, the programme seeks to rebuild foreign exchange reserves through a flexible exchange rate and other measures, ensure financial stability with adequately capitalised banks and a new banking act, and sweeping governance reforms to reduce corruption risks through improved fiscal transparency and public financial management.

The measures imposed on Sri Lanka's economy have been severe, triggering a sudden devaluation of the rupee and causing input costs for production and essential consumer goods to skyrocket. The Central Bank's sharp interest rate hikes have made credit inaccessible for small businesses. Market pricing of energy has led to a tripling of fuel and electricity costs, curbing overall demand, while government capital expenditure has come to a standstill. These actions resulted in the economy contracting by 7.8 per cent in 2022 and 3.6 per cent in 2023—marking the steepest economic downturn since the Great Depression of the 1930s. The fallout has been devastating: many businesses have collapsed, formal sector jobs have vanished, and informal livelihoods have been severely disrupted. For example, when kerosene prices quadrupled, fisherfolk were forced to reduce their trips to sea, slashing their income opportunities (Ravindran, 2022).

Micro, Small and Medium Enterprises (MSMEs) comprising 99 per cent of Sri Lankan businesses (20 per cent of them led by women) and employing 75 per cent of the workforce, bear the brunt of compounded impacts of COVID-19 and the ongoing economic reforms. A study by the Department of Census and Statistics reports that 20 per cent of MSMEs either permanently (15 per cent) or temporarily (5 per cent) closed in 2022 (Department of Census & Statistics, 2024). This amounts to a closure of 108,100 MSMEs, causing job losses estimated between 119,100 and 475,800.

MSMEs are crucial in reducing socioeconomic disparities in Sri Lanka, contributing over 50 per cent of the country's GDP. However, the report highlights that foreign exchange shortages and rising exchange rates adversely affect these businesses. Difficulties importing raw materials, equipment, and software impede production and growth, while increased operational costs are shrinking profits. The study underscores

the need for the Sri Lankan government to address these foreign exchange issues and exchange rate hikes comprehensively. The findings indicate that financial assistance is the most anticipated form of support for MSMEs in navigating the crisis. It stresses the necessity for government-backed financial aid and other forms of assistance to help MSMEs endure and survive.

The report identifies key challenges faced by businesses of all sizes. The most pressing issue is the surge in interest rates, which has significantly impacted nine out of ten enterprises surveyed. Additionally, 70 per cent of businesses report a decrease in repayment capacity due to reduced income, while over 50 per cent are struggling with restricted credit facilities from banks and financial institutions. The inability to secure assets or guarantors for collateral affects roughly one-third of micro and small enterprises and one-fifth of medium-sized enterprises (ibid.).

FIXATION ON THE PRIMARY SURPLUS

With the implementation of the IMF programme in March 2023, achieving a primary budget surplus became a central conditionality—demanding that Sri Lanka’s revenues surpass its expenditures. The country was required to hit this benchmark by 2024, shifting from a primary budget deficit of 5.7 per cent in 2021. This target necessitates slashing government spending to the bare minimum, a daunting task when revenue streams are dwindling. Where revenue adjustments are being made, they are done in a highly regressive manner.

Tax rate revisions are a case in point. The Value Added Tax (VAT) rate was revised three times between 2022 and 2024, from 12 per cent to 15 per cent to 18 per cent. This upward revision compensated for lost tax revenue given the reduction in VAT to 8 per cent from 2020 to 2022 (from the previous 15 per cent). Inflation during the period 2018 to 2022 hovered between 6 per cent and 8 per cent but surged to around 50 per cent in 2023. To assess VAT payment adequacy, the VAT base was adjusted for inflation and growth (see **Table 6**).

Table 6. Analysis of VAT collection during the first Quarters of 2018 to 2023

BASE	APPLICABLE VAT RATE (%) (A)	INFLATION RATE - QUARTER 1 (%) (B)	GDP GROWTH RATE - Q1 (%) (C)	ACTUAL REVENUE RS.MN (D)	NOMINAL BASE RS.MN (E) = D / A	ADJUSTED BASE RS.MN (F) = D IN THE PREVIOUS YEAR*B*C	REVENUE ADJUSTED RS.MN (G) = F*A	DIFFERENCE BETWEEN THE ACTUAL - ADJUSTED REVENUE RS.MN (H)=D-G	% OF REVENUE COLLECTED AS A PROPORTION OF ADJUSTED REVENUE (I)=D/G (%)	GROWTH IN NOMINAL BASE (%) (J)
2018	15%	7.5%	3.7%	116,469	776,460					
2019	15%	1.7%	-0.1%	117,404	782,693	788,870	118,331	-927	99	1
2020	8%	4.5%	-0.9%	64,009	800,113	810,553	64,844	-835	99	2
2021	8%	5.5%	4.5%	72,005	900,063	882,105	70,568	1,437	102	12
2022	8%	9.3%	-0.5%	96,316	1,203,950	978,850	78,308	18,008	123	34
2023	15%	52%	-8.5%	113,232	754,880	1,674,454	251,168	-137,936	45	-37

Source: Ministry of Finance, Sri Lanka

The **Table 6** illustrates that the VAT rate was increased, and it has not resulted in widening the tax base. Despite nominal expansion of the VAT base and a peak rate between 2021 and 2022, it contracted by approximately LKR450 billion, or 37 per cent, in 2023 compared to 2022. A comparison between 2023 and 2020 indicates that despite the VAT rate cut to 8 per cent from 15 per cent and the economic challenges of the COVID-19 pandemic, VAT collections in Q1 2020 were 89 per cent, nearly matching Q1 2019 levels, which were unaffected by the first shock to the economy, the Easter attacks in April 2019. VAT collections rose to 95 per cent in 2021 and surpassed expectations at 121 per cent in Q1 2022. Nonetheless, VAT collections in 2023, while up 17 per cent from 2022, only reached about 45 per cent of the expected amount, suggesting the VAT rate increase did not achieve the anticipated benefits. Instead, the nominal VAT base contracted by nearly 37 per cent in Q1 2023. This contraction indicates a significant slowdown in economic growth, which has undermined the effectiveness of higher tax rates in boosting revenue collection.

The current focus on austerity measures continues to erode already low public spending, even though the IMF and the government consistently emphasise enhancing revenue instead of curtailing expenditure. However, government expenditure declined by 4 per cent in the first four months of 2024 compared to the same period in 2023. This reflects the government's sustained expenditure controls to enforce fiscal discipline to tackle budget deficits and unsustainable debt levels (Ministry of Finance, Economic Stabilization and National Policies, 2024b). The IMF programme sets a benchmark for the cost of social safety nets for those impacted by austerity measures,

revealing a stark prioritisation. As noted previously, while up to 4.5 per cent of GDP (and nearly 80 per cent of the revenue) is allocated annually for foreign currency debt servicing, only 0.6 per cent of GDP is designated for social safety nets via targeted cash transfers. This allocation remains static despite a doubling in poverty levels (Kadirgamar, 2023). Historically, 0.6 per cent is consistent with past cash transfer expenditures, but the urgent need has escalated due to increased regressive taxes and price hikes.

IMPACT ON PUBLIC SERVICES AND SOCIAL SAFETY NETS

Simultaneously, universal social services remain underfunded. This is evident in practices requiring patients to purchase their own medicines at government clinics (ibid.). Public hospitals struggle with medicine shortages, severely impacting outpatient services and leading to postponed surgeries. Critics have pointed out that cash transfer benefits in the previous system, Samurdhi, are poorly targeted, with the neediest individuals excluded and insufficient amounts provided to address food security concerns amid high food price inflation. This has led to establishing a targeted cash transfer system, Aswesuma, supported through a World Bank loan. Once known for its high Human Development Indicators due to robust social welfare policies, Sri Lanka's shift towards targeted social protection marks a significant erosion of its welfare state, which previously relied on universal services.

This shift is particularly concerning given that nearly two-thirds of the population works in the informal sector, making it almost impossible to effectively target social protection. Livelihoods are often seasonal and vary by sector, complicating efforts to provide adequate support. The targeted approach reflects a broader neoliberal agenda aimed at dismantling universal social benefits, with Sri Lanka being one of the last strongholds of such policies (ibid.).

Workers in the formal sector, including those in low-wage jobs like the garment industry and tea plantations, are mandated to contribute to pension funds. This group faces an additional setback as international bondholders demanded domestic debt restructuring as a precondition for further negotiations, despite the crisis being primarily external. The IMF has praised Sri Lanka's DDR, yet this process has led to a 47 per cent reduction in the value of retirement funds. At the same time, financial institutions and wealthy local bondholders remain unaffected. This approach to debt restructuring underscores a broader trend of shifting the financial burden onto working people.

Sri Lanka's austerity programme is being implemented in a context of reduced household incomes, increased expenditures, and widespread adoption of coping strategies. A 2023 Department of Census and Statistics survey revealed that 60.5 per cent of households experienced decreased average monthly income, while 91.1 per cent faced increased expenditures. To manage these financial strains, 93.5 per cent of affected individuals aged three to twenty-one adopted at least one strategy to mitigate educational disruptions. Additionally, 22 per cent of households incurred debt due to the crisis, and 7 per cent of the population altered their health treatment procedures. These statistics underscore Sri Lankan households' extensive challenges amid the ongoing economic downturn (Department of Census and Statistics, 2023). The Citizens' Survey conducted by the United Nations Development Programme (UNDP) in Sri Lanka reveals that household debt, adaptive capacity, and educational attainment are key drivers of multidimensional vulnerability in Sri Lanka, with debt emerging as the most significant factor. About 33.4 per cent of the population faces multidimensional vulnerability, compounded by debt-related challenges. And 38.5 per cent of surveyed households report debt as a top issue, with many of them resorting to pawning jewelry or selling assets to meet essential needs such as food, healthcare, and education (United Nations Development Programme, 2023, 2024). Both surveys draw attention to the need for high-quality public services and increased coverage for a growing vulnerable population.

SALE OF PUBLIC ASSETS

Amid this crisis and the onslaught of reforms, the elite class is seizing the opportunity to push through a "fire sale" of Sri Lanka's public assets under the guise of austerity. Privatisation involving foreign actors is seen as a quick fix to bolster foreign reserves and government revenues. However, this could make utilities, fuel, and other public services unaffordable for the working class. The 2024 budget includes plans to sell strategic lands and privatise sectors like energy, fuel, transport, banking, and telecom infrastructure, including the profitable Sri Lanka Telecom. Perhaps the most significant public asset at risk is electricity (Budget Speech 2024). The Ceylon Electricity Board (CEB), the island's main public electricity provider, is set to be split into multiple entities for generation, transmission, and distribution, paving the way for eventual privatisation. However, since the election of a new government led by National People's Power (NPP), previous decisions to privatise Sri Lanka's national airline carrier – Sri Lankan Airlines – and the CEB have been halted primarily because the ruling party leads the CEB union (ETV Bharat, 2024).

There are also proposals to lease 300,000 acres of state land for large-scale commercial agriculture aimed at exports, sidelining small-scale farmers. A new draft

Fisheries Act could open the door for foreign fishing vessels and commercialised fisheries, undermining local small-scale fishing communities. Additionally, while the government plans to recapitalise state banks, it is also moving to divest nearly 20 per cent of their shares, raising concerns about the availability of affordable credit during future crises when shareholder interests could take precedence. The government's recent reversals on asset sales appear less about public welfare and more about appeasing key political constituencies. Privatisation under austerity may still advance in sectors where ruling party interests are not at stake.

A COMPLEX WEB OF LEGAL FRAMEWORKS AND FINANCIAL INSTRUMENTS: THE NEW FACE OF CONDITIONALITY

As stated in the 2024 national budget, the government planned to enact or amend sixty new laws under the current parliament, despite elections planned for the third quarter of 2024. Many of these legislative changes, covering fiscal management, central banking, commercial banking, utilities, and public-private partnerships, are integral to the IMF programme's structural benchmarks. The World Bank is also involved in supporting both the development and implementation of these reforms. These sweeping legal reforms are backed by the IMF's Governance Diagnostic Assessment, highlighting "governance weaknesses and corruption vulnerabilities" that hinder economic recovery (International Monetary Fund, 2023b). Sri Lanka's situation marks one of the IMF's experimental instances of making governance reforms a condition for debt restructuring.

Among the most controversial new laws is the latest Central Bank Act (CBA), which replaced the previous Monetary Law Act. The CBA claims to ensure the Central Bank's independence and prevent it from buying government debt in primary or secondary markets. This measure is viewed as crucial for the Central Bank to implement policies that meet its inflation targets. The Central Bank has also committed to removing its exchange rate guidance and transitioning to a flexible exchange rate strategy. This shift is expected to help restore the equilibrium real exchange rate and improve the trade and current account balances.

Critics argue that the prohibition on purchasing government securities under CBA, alongside the CBA's emphasis on inflation control and central bank independence, is fundamentally flawed and could harm Sri Lankan economic growth and employment (Nicholas & Nicholas, 2023a; Nicholas & Nicholas, 2023b). The CBA's focus on controlling inflation and increasing central bank autonomy is rooted in the Quantity Theory of Money (QTM), which separates monetary phenomena from real economic

factors like growth and employment. This theory justifies the central bank's narrow focus on inflation control, ignoring the broader impacts of monetary policy. However, this view is problematic as it overlooks how interest rate policies influence aggregate demand, affecting both inflation and real economic outcomes.¹⁵

In Sri Lanka's context, the CBA's assumptions and limitations are seen as outdated and detrimental. The CBA perpetuates the flawed premise that monetary policy impacts inflation and real economic conditions separately. Consequently, the Central Bank of Sri Lanka's (CBSL) focus on inflation fails to address the adverse effects on growth and employment without considering its broader economic impacts. Additionally, the CBA's restriction on government debt purchases prevents the CBSL from effectively managing interest rates and implementing countercyclical fiscal policies (*ibid.*).

The most recent of these controversial pieces of legislation has been the Economic Transformation Bill (ETB), which clearly reflected the debates about how to structure the economy. ETB set ambitious national economic targets mirroring the IMF programme targets: a GDP growth rate of 5 per cent annually until 2027, followed by a mandated 8 per cent growth rate for at least fifteen years. Additional targets included reducing unemployment to 5 per cent by 2025, achieving a highly competitive, export-driven economy by 2040, and maintaining the central government's annual gross financing needs below 13 per cent of GDP by 2032. The bill also aimed to lower the central government's annual foreign currency debt service to under 4.5 per cent of GDP by 2027 and to increase female labour force participation to 40 per cent by 2030 and 50 per cent by 2040 (The Gazette of the Democratic Socialist Republic of Sri Lanka, 2024). How these targets were to be achieved based on currently very low baselines remained unaddressed.

The Economic Transformation Bill, which sought to replace the Board of Investment with the newly established Economic Commission of Sri Lanka, sparked concerns among legal and investment experts (Fernando, 2024b). The bill aimed to introduce a comprehensive National Policy on Economic Transformation and create several new institutions, including the Economic Commission, Investment Zones Sri Lanka, and the Office for International Trade.

Critics argued that the bill lacked clarity on the investment concessions, potentially creating uncertainty for foreign investors. Investors typically require clear, fixed terms, and the bill's open-ended nature could have deterred investment. Furthermore, legal luminaries warned that the bill could exacerbate corruption and inefficiency, as it leaves considerable discretion to the Minister and relies on potentially problematic ad-

hoc regulations. The bill's flexibility in adjusting concessions based on IMF demands and external debt restructuring could have undermined long-term investor confidence. Blending external debt management with foreign investment policies in a single framework might create more difficulties, arguing that separate, well-defined policies would be more effective.

Other critics viewed the proposed Bill, likened to a 21st-century version of the colonial-era Waste Lands Ordinance,¹⁶ as a move towards economic re-colonisation, given that the legislation aimed to eliminate state support for domestic investors, instead favoring foreign investors, thereby aligning with neoliberal economic models rather than the successful East Asian development approach (Jayatileka, 2024). Their criticism was leveled against the economic power shifting in favour of foreign interests, undermining national economic sovereignty and local competition. It challenged the core democratic principle of popular sovereignty by restricting the ability of elected governments to adapt economic policies based on changing needs and priorities.

The Bill proposed an "Economic Constitution" that would lock in specific economic policies, making it difficult for future governments to adjust strategies in response to domestic needs. For instance, if a future government wanted to balance agricultural production between exports and domestic food security, it would be constrained by the Bill's export-oriented mandates. Furthermore, the Bill established an unelected Economic Commission, which would dictate economic policies to the elected Cabinet of Ministers. This Commission, appointed by the President, would have the authority to set national policies on investment, trade, and investment zones, centralising economic decision-making away from democratic oversight. Despite the criticisms based on the Bill's practicality and concerns about its undemocratic edicts, it passed in Parliament on 2 August 2024.

There are at least three key pieces of legislation tied to the IMF programme that have already passed or are pending parliamentary approval: the Public Financial Management Act (passed on 8 August 2024), the Public Debt Management Act (passed on 18 June 2024) and the State-Owned Enterprise Bill (in draft). The previous government pushed to rapidly enact most of these laws before the September and October 2024 elections. The swift implementation of a neoliberal and restrictive legal framework may lead to legal challenges as current and future governments, elected with fresh mandates, assume power. The ongoing economic experimentation of the IMF and MDBs in Sri Lanka vis-à-vis the IMF programme and debt restructuring is already severely impacting its working population. It offers crucial lessons for other global South countries facing external debt defaults. The composite programme is

not only an unapologetic austerity programme but also tied to sweeping legal reforms that may severely restrict how institutions such as the General Treasury, Central Bank and the Parliament navigate future economic downturns and crises. These laws will limit the flexibility and agility with which the state can respond to budgetary demands, thereby leaving external borrowing as the only option.

ENTRY OF PROBLEMATIC FINANCIAL INSTRUMENTS: MACRO-LINKED BOND (MLB)

Following proposals made by neoliberal think tanks that advocated for sovereign debt default and domestic debt restructuring, Sri Lankan authorities are exploring incorporating macro-linked and governance-linked bonds into their debt restructuring plan. These complex financial instruments are designed to link repayments to the country's GDP performance or governance reforms during the IMF programme, which extends to 2027 (Fernando, 2024a; Ranasinghe, 2024; Verite Research, 2024; Panduwawala & Damsinghe, 2024). Macro-linked bonds (MLBs) feature a standard haircut and coupon rate based on Sri Lanka meeting the IMF's baseline growth targets. However, if the economy performs better than the IMF's projections, the bonds offer reduced haircuts and higher coupon rates.

Critics note that Sri Lanka's MLBs may not fully live up to their name (Setser, 2024). Sri Lanka reached an agreement with bondholders encompassing an MLB in September 2024 and more recently in November, after the new government's election. Pathirana (2024) argues that restructuring Sri Lanka's International Sovereign Bonds through the Agreement in Principle (AIP)¹⁷ risks entrenching the nation in a perpetual cycle of indebtedness, undermining long-term debt sustainability (Pathirana, 2024). Despite short-term relief appearances, the restructuring terms exacerbate vulnerabilities due to rising costs, predatory lending practices, and systemic mismanagement of debt obligations (ibid.).

Careful analysis of the AIP indicates rising debt service costs under the restructured terms. While the agreement extends ISB maturities to 2038, it masks significant cost escalations:

- Weighted interest rates will rise to 6.8 per cent after 2028 and surge to 9.75 per cent after 2032. These levels far exceed Sri Lanka's projected real GDP growth rates, widening the gap between income growth and debt service obligations.
- The purported nominal haircut of 14.9 per cent becomes ineffective within two years due to escalating interest payments, resulting in a net increase in total repayment obligations.

- Payments tied to nominal GDP thresholds—such as USD107 billion or USD99 billion between 2025 and 2027—drive an additional USD2-2.3 billion in debt repayments. Such scenarios worsen the real burden for a nation with limited economic recovery prospects.

The Sri Lankan President's initial plan to renegotiate Sri Lanka's ISB deal has shifted with the sudden announcement of the Agreement in Principle, raising alarm among economists. It can be inferred that the Ceylon Chamber of Commerce (CCC), representing holders of USD1.8 billion in ISBs, played a pivotal role in shaping the deal. As previously discussed, CCC members who acquired bonds at steep discounts during the COVID-19 crisis have reportedly pushed for swift implementation of the AIP following its 19 September disclosure. CCC President Duminda Hulangamuwa, a recent addition to the ruling party's (NPP) Economic Council, may have influenced President Dissanayake to expedite the deal. Although the proposed restructuring arrangement masks rising interest costs, prompting further scrutiny of its economic viability, CCC's investors in the ISBs stand to gain if the current deal goes through. Sri Lanka's experience underscores the risks of capital account liberalisation, allowing private sector players—often tied to global counterparts—to shape public debt management. The influence of vested interests now entrenched in the political economy of the country's debt is increasingly apparent. The Ceylon Chamber of Commerce's role in the NPP Economic Council exemplifies how financial capital interests drive government policy, often diverging from official political rhetoric.

Sri Lanka's latest ISB restructuring deal illustrates predatory lending practices by creditors. Creditors extended debt well beyond sustainable thresholds, violating norms that govern lending prudence. Sri Lanka's debt exceeded government revenue by a factor of ten, a clear indicator of creditor opportunism. The agreement allows creditors to alter the governing laws of ISBs from New York to Delaware, effectively waiving Sri Lanka's legal leverage for higher debt cancellation. This concession undermines potential avenues to challenge exploitative debt.

The AIP is based on the IMF's Debt Sustainability Analysis (DSA), which sets an unsustainable 95 per cent debt-to-GDP target and further entrenches long-term dependence. Although the IMF's framework has been criticised for not adequately incorporating external debt variables and balance-of-payments issues, it remains a key part of the debt restructuring process. The GDP thresholds exclude interest payments, distorting the nation's true repayment capacity and limiting its bargaining power. The use of the IMF framework is not by default but by design. The political economy of the global debt architecture necessarily places the IMF DSA framework as the only

credible basis for negotiating ISBs (Rehbein, 2023), implicating IMF complicity in compromising economic sovereignty and stability of developing countries like Sri Lanka.

Instead of mitigating risk, the MLBs may create more volatility as Sri Lanka exits the IMF programme, potentially leading to future default risks. As such, rather than reducing the risk of future debt trouble, Sri Lanka's MLBs set up the risk that Sri Lanka will fall back into debt trouble in 2029 or 2030 (Setser, 2024). The restructuring agreement's macro-linked design locks Sri Lanka into unsustainable financial commitments, prioritising creditor interests over national welfare. Sri Lanka risks perpetuating its debt trap without renegotiating terms to include significant haircuts and realistic repayment structures. To avoid further erosion of sovereignty and ensure equitable economic recovery, the government must pursue transparent, accountable debt management practices, distancing itself from creditor-dominated frameworks.

5. READING SRI LANKA THROUGH A FEMINIST POLITICAL ECONOMY LENS

Public debt, historically tied to systems of domination, reflects structural inequalities, including gender-based economic violence inherent in capitalist systems.

Anthropologist David Graeber links debt to historical violence (Graeber, 2011), while feminist scholars argue that the economic, social, and political processes shaping financial capitalism perpetuate gender inequities (Federici, 2010).

Women, particularly in diverse and marginalised groups, bear disproportionate burdens of public debt through fiscal policies and austerity measures. These policies are often decided without inclusive, democratic participation, allowing power elites to impose debt under the guise of collective responsibility, redistributing wealth regressively and eroding rights (Eusepi & Wagner, 2017). Feminism has consistently integrated economic issues into its agenda, from early analyses of gender dynamics in development debates to critiques from global South scholars on the risks of market-driven governance (Taylor, 2000). Current discourse now focuses on the challenges posed by global financial capitalism to achieving equality and justice, reflecting a broadening intersection of economic and gender advocacy (Benería et al., 2016; Sibeko, 2019; Simeoni, 2021). While feminist economics and orthodox perspectives agree that fiscal policies and debt management must align with macroeconomic and social equity goals, this alignment remains absent in practice (Kolovich, 2018; Davoodi

et al., 2022). What does it mean to embed gender considerations into sovereign debt practices and reform processes? In the political economy of debt in Sri Lanka, a feminist political economy lens can be applied at several points: 1) implications of debt stock and repayment on the national budget, 2) the impact of austerity, and 3) implications of economic reforms.

IMPLICATIONS ON THE NATIONAL BUDGET

Sri Lanka's government spending as a percentage of GDP remained stable before 2020, but its composition shifted significantly. Capital expenditures dropped sharply from 5.4 per cent of GDP in 2015 to 3.3 per cent in 2020, while recurrent expenditures held steady despite fluctuations in subcomponents. Spending on goods and services declined from 6.8 per cent of GDP in 2015 to 5.6 per cent in 2019, while interest payments surged from 4.4 per cent to 6.0 per cent, straining fiscal space amid rising public debt. The fiscal pressure was compounded by delayed payments in 2019, carried into the 2020 budget, further limiting financial flexibility. As previously discussed, Sri Lanka currently spends 80 per cent of government revenue on interest payments (nearly half of government expenditure). The second biggest budget category is the salary bill of government workers, which amounts to roughly 20 per cent of expenditure. While recurrent expenditure takes up 90 per cent of the national budget, the allocation for public investment is only 10 per cent (Ministry of Finance, Economic Stabilization and National Policies, 2024b).

Sri Lanka's social protection framework relies on universal healthcare and education, tax-funded retirement benefits, and over twenty-five poverty alleviation programmes. Employers must provide injury compensation and maternity benefits, but the country lacks formal social insurance systems, reflecting institutional foundations established in the 1930s. Government spending on social assistance is modest, at 0.63 per cent of GDP (UNICEF, 2022). Nutrition spending is minimal, and resources for children's education needs have diminished over time. Overall, social protection expenditures fall well below international benchmarks.

Since independence, Sri Lanka has upheld a free healthcare policy, providing public health services at no cost, while the private sector offers a wide range of services on a fee-based model. Public healthcare and education spending have declined in recent years, collectively accounting for less than 5 per cent of the GDP and a fifth of government expenditure. Healthcare spending in Sri Lanka, at 3.8 per cent of GDP, falls short of the 4.1 per cent average for lower-middle-income countries (UNICEF, 2021b). Private healthcare's share of total expenditure has risen from 45 per cent in

2000 to 57 per cent in 2018. Household data from 2016 shows that monthly spending on private healthcare averages LKR1,695, with the largest portions allocated to private medical fees (33 per cent) and pharmacy products (26.6 per cent). Sri Lanka's central government education budget has shrunk by 2.3 per cent since 2019, likely reflecting revenue pressures from the COVID-19 pandemic. The country's education spending as a percentage of GDP remains below regional benchmarks, peaking at just 2.7 per cent in 2017—still significantly lagging behind its peers (UNICEF, 2021a).

Decades of feminist economic research and activism have highlighted the importance of public spending on services such as health, education and social protection, which cushion women's disproportionate unpaid care work burden. Greater public investment in direct care services and sectors that support care work (i.e. public transport) can address gender inequities. However, Sri Lanka's trajectory signals a regressive trend in public spending for health, education, and social protection. With the lion's share of government revenue channeled towards interest payments on the country's debt, Sri Lanka has limited fiscal space to spend on public services, which has implications for gender inequality.

IMPACT OF AUSTERITY

Austerity-driven fiscal consolidation measures, including labour market flexibilisation, cuts to public sector jobs, and privatisation of services, disproportionately impact women. These policies erode social protection benefits and services, leaving vulnerable groups—where women are overrepresented—at greater risk. Sri Lankans have been grappling with a sharp rise in living costs over the past two years, leaving many in financial distress. Notably, the country now has the highest electricity prices in South Asia, adding to the economic strain on households. Sri Lanka lacks gender-disaggregated data on austerity's impact, but household surveys (discussed previously) highlight widespread financial strain. Declining monthly incomes and rising expenses have forced many households to adopt coping strategies, including incurring debt, prioritising education over other needs, and forgoing healthcare due to cost constraints.

IMPLICATIONS OF ECONOMIC REFORMS

Given that the implications of Sri Lanka's economic reforms have been discussed in previous sections, the emphasis here will exclusively be on the implications of Domestic Debt Restructuring (DDR). The IMF has praised Sri Lanka's DDR. Yet, this process has led to a 47 per cent reduction in the value of retirement funds (on

top of the losses incurred by inflation and currency depreciation). At the same time, financial institutions and wealthy local bondholders remain unaffected. This approach to debt restructuring underscores a broader trend of shifting the financial burden onto working class populations.

Restructuring domestic debt in Sri Lanka's already struggling economy is painful and contentious. The burden falls disproportionately on pension funds, a critical component of retirement savings for workers battered by soaring living costs. The government plans to cut interest rates on sovereign bonds held by the largest pension funds, reducing them from over 20 per cent to 12 per cent and eventually to 9 per cent by 2025. It aims to trim its annual interest burden by 0.5 percentage points of GDP.

This adjustment will significantly erode retirement savings, with an estimated 30 per cent decline in their value over the next decade. Adding to the strain, returns on these funds are subjected to a 30 per cent tax rate—steeper than the rate for many corporate entities—affecting workers whose wages often fall below the minimum taxable income. This policy, which disproportionately targets the limited financial assets of low-income workers, threatens to exacerbate poverty and deepen class and gender inequalities. At the same time, unpaid care labour—predominantly provided by women—bears the brunt of the austerity measures, highlighting the gendered toll of Sri Lanka's debt crisis and the government's response. Even the IMF, in its March 2025 review, acknowledged the social cost of reforms, noting that “all quantitative targets for end-December 2024 were met, except the indicative target on social spending.” While the report affirms that “reform efforts are bearing fruit with the recovery gaining momentum,” it also underscores the fragility of the economy and the need to sustain reforms to achieve lasting recovery and debt sustainability (International Monetary Fund, Asia and Pacific Dept, 2025).

6. CONCLUDING QUESTIONS

Sri Lanka's debt crisis underscores broader challenges in development financing and the quest for fair debt solutions. Despite the IMF programme's promises, Sri Lanka received little bridging concessional finance from donors and multilateral actors after defaulting, leaving its import bill largely funded by its own foreign revenues.

The crisis raises questions about the reliance on commercial borrowing for development, which has led countries like Sri Lanka into unsustainable debt. As the architecture of international finance is reimagined, finding alternative sources of sustainable development financing for the global South will be crucial.

Moreover, the IMF's role as an "arbiter" in debt restructuring should be reconsidered. The IMF's approach, as seen in Sri Lanka, has often exacerbated crises rather than resolved them. The need to structure development financing to preserve a country's autonomy is becoming increasingly evident. For Sri Lanka, this means creating space for industrial policies focused on local markets and exploring self-sufficiency in food and essentials to withstand external shocks without compromising the basic needs of its people.

Sri Lanka's debt crisis is a wake-up call, not just for its own citizens grappling with the worst economic downturn since the Great Depression but for the global community to fundamentally rethink the international financial system established in the Depression's aftermath. The current international financial architecture (IFA) is ill-suited to address the pressing challenges of the 21st century. Exposed by the COVID-19 crisis, global inequities have become starkly evident, with wealthier nations accessing unlimited, low-cost financing. At the same time, developing countries face crippling debt burdens, limited financial resources, and escalating socio-economic vulnerabilities. The persistent underrepresentation of global South nations in decision-making processes within institutions like the IMF and World Bank further exacerbates these disparities.

The ongoing debt servicing crisis in developing countries underscores the urgent need for systemic reforms. With 3.3 billion people living in countries that spend more on interest payments than on healthcare and 2.1 billion living where more is spent on debt servicing than on education, the diversion of critical resources undermines progress on health, education, and climate action. Rising global interest rates and inequitable borrowing costs amplify these challenges, as heavily indebted nations are forced to prioritise creditor payments over essential development needs.

Historical reform efforts have fallen short, offering piecemeal solutions rather than addressing systemic inequities. However, initiatives like the Bridgetown Initiative¹⁸ and the Fourth International Conference on Financing for Development (FfD4)¹⁹ in 2025 present pivotal opportunities to reshape the global financial system. Comprehensive reform must prioritise equitable representation, robust regulation, and accessible financing mechanisms, ensuring that the IFA evolves to meet modern development needs.

The path forward hinges on bold action to correct structural imbalances. A reimagined IFA prioritising inclusivity and sustainability is not just a moral imperative but a strategic necessity to achieve global development goals and mitigate future crises.

Whether the international community rises to this challenge or allows disparities to persist will define the trajectory of global progress for decades.

At the time of writing, a ‘honeymoon period’ after the election of a new ‘Marxist’ government, Sri Lanka’s middle class yearns to return to their habits of conspicuous consumption. In contrast, the working class struggles to secure the basics to feed their families. The merchant elite craves the easy profits of buying cheap, selling dear, and betting against a depreciating currency. Yet, global finance capital keeps Sri Lanka—and other developing nations—trapped as captive markets, stifling any hopes of industrialisation. Notably, the ‘Marxist’ government ultimately acquiesced to debt restructuring terms that risk locking Sri Lanka into a prolonged cycle of indebtedness and fiscal subordination. Any attempts at conscious industrial policy are swiftly quashed, with neoliberal advocates misleadingly labeling them as failures. Global priorities remain fixated on extraction rather than fostering industrialisation, with a heavy emphasis on debt repayments, land acquisitions, resource control, and strategic assets like ports and utilities.

Industrialisation, once seen as the bedrock of liberal democracy, a robust welfare state, and national sovereignty, has all but disappeared from the national discourse in Sri Lanka, regardless of class or political affiliation. In its place is a shallow, socially engineered focus on identity politics, welfarism, and anti-corruption—a narrative that raises many questions but offers few solutions. While political regimes may come and go, the contradictions that brought them to power and the controlling influence of international finance capital are here to stay.

The anti-corruption rhetoric, despite its factual accuracy, needs to be problematised. Its deployment as a populist trope, set against the backdrop of Sri Lanka’s political history and the global surge in populism, is not a coincidence. Strengthened during the Aragalaya, this trope holds electoral appeal in the current context of a fractured economy and widespread social disenfranchisement, as it promises liberation from these systemic issues. Like other developing countries, anti-corruption populism in Sri Lanka aligns with neoliberal principles like transparency, openness, and the rule of law, resonating with the Good Governance agenda. However, this populism is ultimately superficial, serving more to legitimise regime change, boost electoral prospects and reinforce neoliberal economic policies rather than drive meaningful transformation.

At the current juncture, Sri Lanka remains an experiment, much like a rat or a guinea pig in the Washington laboratory. Subjected to decades of subversion and conditioning

vis-à-vis hybrid warfare tactics, its intelligentsia is unimaginative and complicit in the unfolding economic violence and destruction. Sri Lanka's economists, in particular, exhibit a strange monolithic thought process that does not reflect that of a pragmatic economist that "thinks with both hands". Their view on the economy is through a corporate lens, not a developmental one. Increasingly, the thought leaders' reading of society is through the lens of identity politics. The deficit in political leadership makes some feel safe and secure with the old guard, while others want a 'system change'. The populace at large appears numb, lacking political and cultural literacy, and vulnerable to populist tropes and narratives that externalise economic, political and social problems. Their vulnerability is leveraged to spew hatred, anger and despondency. This combination can be effectively manipulated to create a recurring state of instability in the country and the region, making any prospects of recovery and growth a mere dream.

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NOTES

- 1- International Sovereign Bonds are debt securities issued by national governments to raise money for public spending and to manage debt. They can be denominated in the issuing country's currency or in a foreign currency
- 2- This refers to the assurance provided by a government to investors, guaranteeing that debt repayment will be fulfilled without fail.
- 3- Domestic debt includes issuance of Treasury bills and Treasury bonds to secure short-term financing and Rupee securities and loans to secure medium- and long-term financing. These debt instruments, denominated in Sri Lankan Rupees (LKR), carry fixed interest rates
- 4- Concessions were based on low average interest rate of about 1.9 per cent per annum which eased the burden of the foreign debt service payments of the country
- 5- The Central Bank of Sri Lanka (CBSL) intervenes in the foreign exchange market to maintain a stable exchange rate and to ensure that the country has adequate external reserves. The CBSL's intervention is usually done by buying or selling foreign exchange at market rates.
- 6- To optimize cash flow management, treasuries practice resource fungibility for maximum efficiency. Book-entry accounts enable the treasury to use Consolidated Funds flexibly, regardless of budget earmarks or appropriations. This allows earmarked funds to remain accessible to beneficiaries without the need for separate bank accounts, streamlining cash flow tracking and control.
- 7- A term used in theories of economic globalisation to designate groups in developing countries who align themselves with multinational capital and promote its interests, sometimes (although not necessarily) in the belief that such development will benefit their society (Oxford Reference, no date)
- 8- A vulture fund is an investment fund that targets distressed assets, like bonds or stocks near default or bankruptcy. Its strategy involves purchasing undervalued securities with the aim of profiting from potential recovery, making high-risk but potentially high-return investments (Hayes, 2022)
- 9- Moral hazard refers to the situation where an individual or entity can take risks without facing consequences if things go wrong. This can occur at various levels—employee, division, or corporate. When an agent can take risks without penalty, it encourages them to pursue greater gains, disregarding potential negative outcomes. This creates an environment where misconduct and financial offenses are likely to occur (Frunza, 2016)
- 10- Senator Marco Rubio introduced the Sanctions Evasion Prevention and Mitigation Act (2024), a measure that would mandate U.S. presidents to impose sanctions on financial institutions utilising China's CIPS payment system, Russia's SPFS messaging platform, or other alternatives to the dollar-dominated SWIFT network.
- 11- A Collateralized Debt Obligation (CDO) is a complex financial product made up of loans and other assets, which act as collateral if borrowers default. CDOs are divided into tranches, each with different risk levels—senior tranches being the safest. While CDOs tied to risky subprime mortgages played a key role in the 2007-2009 financial crisis, they remain a tool for diversifying risk and generating liquidity for investment banks, though they are not suitable for all investors.
- 12- Sri Lanka has provided over 12 tax amnesties from 1964 to date. Few quantitative studies have assessed the effectiveness of tax amnesties in Sri Lanka, with R.M. Jayasinghe's 2010 analysis concluding that despite increased declarations in 2003 and 2009, these amnesties failed to boost income tax revenue or expand the tax base (Jayasinghe, 2010)
- 13- The Mont Pelerin Society (MPS) is a group of economists, philosophers, and historians who advocate for classical liberalism. Founded in 1947 by economist Friedrich Hayek, its members share concerns about government expansion, state welfare, trade unions, business monopolies, and inflation. The Society meets annually or biennially to discuss and promote the principles of free markets, individual rights, and an open society through academia and think tanks. MPS's aim is to preserve, develop, and disseminate these classical liberal ideals (Investopedia Team, 2021).
- 14- The Extended Fund Facility offers financial support to countries dealing with medium-term balance of payments issues caused by structural weaknesses. It provides extended programme engagement and a longer repayment period to assist in implementing necessary structural reforms (International Monetary Fund, no date)
- 15- Critical perspectives of the QTM are included in F.R. Clow's 1903 article (Clow, 1903)
- 16- The Waste Lands Ordinance No. 1 of 1897 was a colonial law in Sri Lanka that declared uncultivated lands to be state lands under the British crown. The ordinance was implemented by British Government Agents, and the Land Settlement Department was established in 1903 to assist with this work (Hansard, 1899).
- 17- The agreement-in-principle (AIP) was announced in a press release by the Ministry of Finance on November 26th, 2024 (Ministry of Finance, Planning and Economic Development, 2024)
- 18- The Bridgetown Initiative is a call for urgent reform of the international financial architecture (IFA). It was launched in July 2022 by Prime Minister Mottley, following a high-level retreat in Bridgetown, Barbados. Initially a set of ideas for change, it evolved into the Bridgetown Agenda, later renamed the Bridgetown Initiative. The initiative has been updated several times, with the first update, Bridgetown Initiative 2.0, released in April 2023, and a third update, Bridgetown Initiative 3.0, currently in progress. (Bridgetown Initiative, no date)
- 19- The International Conferences on Financing for Development bring together leaders from governments, international organisations, financial institutions, businesses, civil society, and the UN System. These conferences are key forums for addressing global development finance. The Fourth Conference (FFD4), scheduled for 30 June to 3 July 2025, was to focus on financing the remaining years of the Sustainable Development Goals (SDGs) through 2030. The third conference was held in Addis Ababa in 2015 (United Nations Department of Economic and Social Affairs, no date)

AUTHORS



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