Speech by Mr. K. M. Mahinda Siriwardana, Secretary to the Treasury and the Ministry of Finance, Economic Development, Policy Formulation, Planning and Tourism at the Farewell Ceremony for Deputy Secretary to the Treasury Mr. Priyantha Rathnayake, held at the General Treasury on 05th November 2024

Today is a day of mixed emotions for all of us at the General Treasury/Ministry of Finance. It is a sad day since we bid farewell to a longstanding colleague, leader, and friend, DST Priyantha Rathnayake. But it is also a joyous occasion as we reflect on a long and successful career that has provided tremendous value to the General Treasury and to the country as a whole.

I will not go into details of DST Rathnayake's outstanding career at the Ministry of Finance as my colleagues will talk about it. We all know of the strong contributions he made to the External Resources Department and prior to that at the Department of National Planning. DST Rathnayake has also made an excellent contribution as the Treasury representative on the Boards of Directors of a number of state owned enterprises, including all three major state banks, most recently on the Board of Directors of the Bank of Ceylon during a tumultuous period for the institution. He also served Sri Lanka with distinction as Alternate Director at the AIIB.

I would like to take a bit more time reflecting on DST Rathnayake's contribution during the last 2 and a half years in helping navigate the country out of its deepest and most complex economic crisis in the post-independence period. To be very frank, it was an extremely difficult task at the time of my acceptance of the Secretary to the Treasury position in April 2022, as the entire country was going through a highly uncertain period with chaos, and the Treasury was not having both Rupees and dollars even for its day-to-day operations. In fact, DST Rathnayake has been a pillar of strength from my first day of taking office here at the Treasury.

As we began the process of resurrecting the economy from the most difficult days of the crisis, we had two major parallel and inter-linked initiatives. The first was securing the support of the IMF by designing a robust and comprehensive macroeconomic reform programme. The second was commencing the process of debt restructuring, which in turn was a pre-requisite for the IMF programme to proceed.

Whilst the ongoing IMF supported EFF programme is by far the most complex macroeconomic reform programme the country has undertaken, we as institutions and individuals, have had experience of dealing with the IMF. We were aware of what needs to be done and the overall framework that needs to be adhered to when it comes to IMF programmes.

However, with regard to debt restructuring, this was an entirely new realm for everyone in Sri Lanka. In fact, even globally, the Sri Lankan case is largely unprecedented. Sri Lanka was the first middle income country going through a large post-COVID 19 debt restructuring process outside of the Common Framework for Debt Treatments. It would be a test case for numerous areas, including the IMF's revised debt sustainability framework for middle income countries, the MAC-SRDSF. The world was watching how Sri Lanka would deal with a range of creditors, including China, India, sovereign bondholders, and other commercial creditors, whilst managing geo-politics, Comparability of Treatment (CoT) obligations, all while meeting time sensitive deadlines for financing assurances required for each IMF Executive Board Review.

Considering DST Rathnayake's long standing prior experience as DG/ERD, he was appointed the head of the External Debt Restructuring Committee (EDRC), tasked with coordinating the debt restructuring process under my overall supervision with the support of debt advisors Lazard and Clifford Chance. This was an extremely challenging task given the complexity of the problem at hand. I recall the challenging negotiations we had with the IMF on the contours of the Debt Sustainability Analysis (DSA), particularly considering the urgency of reaching consensus in order to unlock the Staff Level Agreement (SLA) with the IMF by September 2022. It is interesting to note the public debate on the DSA two years later, whereas **at the time negotiations were taking place, the country was on the brink of complete collapse with no funds available to even to pay for a shipment of fuel.**

Following Staff Level Agreement, the next step was to obtain financing assurances from our main official creditors. Without these financing assurances, the IMF Executive Board would not be able to approve the programme and Sri Lanka would continue to struggle without access to any kind of external financing. At the time, Sri Lanka was a battleground for various issues relating to the global sovereign debt restructuring architecture. There were various unresolved issues at a global level, such as the participation of multilateral creditors in the debt restructuring process, defining cut-off dates and debt treatment perimeters, distinguishing commercial and official debt, among many others.

The inability to agree on some of these matters at a global level contributed to a long process for creditors to provide Sri Lanka with the required financing assurances. We had to draw upon all of the levers of diplomatic and professional relationships with our creditors, and interventions at the highest levels, including the IMF, US Treasury, and national leadership of our key creditors. It took almost 6 months to obtain financing assurances from India, the Paris Club, and Exim Bank of China. Today, many of these issues in the debt restructuring architecture have been resolved through the Global Sovereign Debt Roundtable (GSDR), and Sri Lanka's experience provided valuable lessons for this process. Eventually, by March 2023, the IMF Executive Board approved the EFF programme, which marked a crucial turning point in the battle to restore economic stability in Sri Lanka.

Immediately thereafter, we had to set about engaging our creditors for restructuring agreements at a technical level. The next target was to obtain Agreements in Principle (AIP) for the financial terms of debt restructuring by the first review of the EFF programme which was due by the end of 2023. Lazard and Clifford Chance provided excellent support in the design of various restructuring proposals for the official creditors, who had by now formed into the Official Creditor Committee (OCC) which included 16 members of the Paris Club and India. Exim Bank of China remained outside of the OCC and Sri Lanka conducted negotiations with them separately.

At this stage as well, beyond the technical financial terms, there was a great deal of care needed in navigating geopolitics. It was necessary to carefully balance the preferences of all creditors in terms of restructuring perimeters, grace periods, maturity extensions, and coupon treatment, whilst ensuring that the resultant solution would be compliant with the IMF debt targets whilst ensuring comparability of treatment with other creditors. It was also a major challenge to manage the sharing of information between creditors, where at times, there was a trust deficit that Sri Lanka had to carefully bridge.

Eventually by October 2023, Exim Bank of China was the first creditor to announce agreement in Principle, followed by the OCC in November. This paved the way for the IMF Executive Board to approve the first review of the IMF-EFF programme in December 2023, enabling the continuity of the reform process. By this time, we were beginning to experience the initial benefits of stabilisation as the currency appreciated, inflation had declined rapidly, interest rates were beginning to normalise, fiscal situation was improving and the first signs of growth were emerging.

During this time, Sri Lanka was also finalising its Domestic Debt Optimisation (DDO) process. The cooperation of the state banks was of crucial importance in this process, and DST Rathnayake played an important role as a Director of the Bank of Ceylon in this regard. Contrary to popular belief, the bulk of the debt relief provided in the DDO was by the banking sector, particularly the state banks, in the restructuring of FCBU loans, SLDBs, and SOE borrowings, such as the CPC loans, along with the Central Bank of Sri Lanka (CBSL). The DDO provided Gross Financing Needs (GFN) relief of about 1.5% of GDP, out of which 1% of GDP was from the banking sector. The debt treatment of the provident funds, including the Employees Provident Fund (EPF) was limited to maturity extension, with a cap on coupons in line with historical real returns and the expected interest rate path. Accordingly, the DDO was implemented in a manner that provided the required debt relief to the country, whilst ensuring that financial sector stability was maintained.

As we moved into 2024, the attention shifted to debt restructuring negotiations with the bondholders, where progress was very limited compared to the official sector where AIPs were already secured. Sri Lanka proactively engaged with the bondholders through their respective advisors from the time the Ad-hoc Group of bondholders was formed in June 2022. Indicative debt treatment terms were shared with bondholders by May 2023 after the IMF DSA was made public, following IMF Executive Board approval in March 2023.

However, the bondholders from the outset were not willing to engage on plain vanilla based solutions since they took the position that the IMF macroeconomic baseline is too conservative. They believed that a debt treatment based on a conservative nominal GDP path would excessively penalise them since they expected Sri Lanka to significantly out-perform the IMF baseline. Nonetheless, Sri Lanka also had a strong preference to restructure debt on plain vanilla terms and to avoid complex state contingent instruments.

The proposed solution was the now famous Macro-linked Bonds (MLBs). Whilst it may not be a perfect outcome, the MLBs provide a practical solution whereby if Sri Lanka outperforms the IMF baseline, there would be a sharing of benefits between Sri Lanka and creditors, in a manner that still ensures Sri Lanka's debt targets are met. Whereas if Sri Lanka faces some adversity resulting in an under-performance compared to the IMF baseline, creditors would provide additional debt relief. This enabled negotiations to continue, and the second review of the EFF programme was approved by June 2024, unlocking further financing and positive macroeconomic outcomes for Sri Lanka. Over the next several rounds of negotiations with bondholders, Sri Lanka built in additional measures to ensure a balance of risks and ensure that the final outcome would comply with Sri Lanka's debt sustainability requirements, as confirmed by the IMF last month.

The next major step was the completion of restructuring agreements with official creditors. This was yet another process of carefully managing and balancing the interests of various different official creditors. DST Rathnayake played a crucial role in securing the agreements of Chinese creditors during talks in Beijing in March 2024. The process was carefully coordinated and managed such that both the OCC and Exim of China signed debt treatment agreements on the 26th of June 2024. This paved the way for countries like Japan to resume financing for crucial projects such as the Bandaranaike International Airport (BIA) expansion, which helps set the foundation for Sri Lanka's economic recovery and growth.

We are now in the final stages of the debt restructuring process, where DST Rathnayake played an instrumental role from the outset. Whilst we have come a long way in the last 2 and a half years, **there is still a lot of work to be done.** We are now in the crucial stage leading up to the bond exchange, and we must still navigate a lot of complexities in terms of documentation and legal challenges in order to ensure a successful conclusion. Whilst DST Rathnayake leaves us having made a tremendous contribution, his guidance and experience has enriched an excellent set of officers who will carry on his good work. **The new DSTs Ajith Abeysekara and Dilip Silva will have big shoes to fill** as we navigate the complexities of the final stages of the debt restructuring process. I have no doubt that they will do an excellent job that will do justice to the efforts of DST Rathnayake over the last 2 and a half years.

However, the new DSTs will also soon have to demonstrate leadership beyond their specific domains of expertise. Successful DSTs like Mr. Rathnayake have been able to demonstrate a broad spectrum of knowledge covering many aspects of macroeconomic management. Macroeconomic management covers a number of important areas. *"….From the point of view of long-term policy, **macroeconomic management could be seen as method of efficiently steering the economy through troubled economic waters.** In this sense, it could be accepted as a comprehensive set of policy measures designed by a national government to attain the basic economic goals –for example the best possible utilization of a country's resources and production potential for a stable and long-term rate of growth, remedying the existing structural imbalances, ensuring an equitable distribution of incomes and wealth, and maintaining balance in the external payment position of the country…."*[1]. **This involves taking decisions to deal with long standing issues in the economy, dismantle bottlenecks and facilitate economic activities to foster higher economic growth and ensure better living standards to the people.**

In macroeconomic management, it is important to understand that achievement of medium term targets needs carefully planned, diligent policy implementation. In this regard, the identification of inter-linkages of other sectors and policies is very important**.** Hence, a multi-dimensional approach to policymaking and implementation is essential with regard to macroeconomic management.

[1] Soumitra Sharma, *"The Evolution of Macroeconomic Management"*
https://link.springer.com/chapter/10.1007/978-1-349-24280-1_1

In a democratic governance system, economic policy decisions are closely inter-linked with political reality. In an authoritarian political system, it is possible for decision makers to conduct economic policy without direct or indirect accountability for economic outcomes. However, in a democratic political structure, economic decisions and outcomes of those decisions will be judged through the ballot box. Therefore, any claim that economic management can or should be fully independent from political administration in a democracy, is a myth. In this regard, I wish to quote from the literature. *"…. Adam Smith, David Ricardo, and John Stuart Mill are widely regarded as the originators of modern economics. But they called themselves political economists, and Mill's Principles of Political Economy was the fundamental text of the discipline from its publication in 1848 until the end of the century. These early theorists could not conceive of the economic and political worlds as separate….Subsequent trends divided the political from the economic analysis. ….By the 1970s, however, it was clear that the separation between the economic and political spheres was misleading. That decade saw the collapse of the Bretton Woods monetary order, two oil price shocks, and stagflation – all highlighting the fact that economic and political matters are intertwined.* ***The economy was now high politics, and much of politics was about the economy…."[2].***

I wish to reiterate that macroeconomic management requires a great deal of responsibility that should be undertaken with utmost care and professionalism. This is because the decisions that you take affect the entire population of 22 million. Economic administrators should be honest, intelligent and disciplined. They should have integrity and humility to listen to others, to be willing to learn without letting ego or ideology obstruct the path to the best decisions in the interest of the country. The true benefits of such balanced behavior of economic administrators will no doubt contribute to the welfare of all Sri Lankans, sooner or later.

The **stability being experienced in the Sri Lankan economy at present is due to effective macroeconomic management under the stewardship of leaders,** including DST Rathnayake and the teamwork of all involved. In achieving these successes, we had to clear many obstacles while addressing various deep routed legacy issues in the General Treasury while making efforts to ensure responsible and disciplined fiscal management. In this process, we had to work to implement reforms which were well-known but neglected for years if not decades due to political and other reasons. The result of these efforts and teamwork is clearly evident when comparing the situation during the worst of the crisis and the present.

[2] https://www.imf.org/en/Publications/fandd/issues/2020/06/political-economy-of-economic-policy-jeff-frieden

- A **primary budget deficit** of 5.7% of GDP in 2021 was converted to a primary surplus of 0.6% of GDP in 2023. In the first 8 months of 2024 the primary surplus reached Rs. 649 billion.
- **Inflation** declined from 70% in 2022 to register deflation of -0.8% in October 2024.
- **Food inflation** which was 95% in 2022 declined to 1% by October 2024.
- **Registered taxpayers** increased from 437,547 in 2022 to over 1 million at present.
- Usable **foreign exchange reserves** were around USD 20 million in April 2022, by end September 2024, gross official reserves, including the PBOC swap was USD 6 billion.
- **Losses in 52 key SOEs** in 2022 amounted to Rs. 775 billion, which was converted to a profit of Rs. 456 billion in 2023 and a profit of Rs. 281 billion during the first six months of 2024[3].
- **Interest rates** declined from around 30% in 2022 to under 10% (Treasury bill yields) at present.
- The **currency** appreciated from Rs. 363/USD to under Rs. 300/USD at present
- The **Treasury cash balance** was converted from an overdraft of Rs. 832 billion by end 2021 to a positive cash balance of Rs. 647 billion by end June this year.
- The **monetary financing** from the Central Bank of Sri Lanka (or loosely called as money printing) **was terminated** since mid- September 2023.

I wish to emphasize that whilst Sri Lanka has achieved a degree of economic stability in the current context, the country is far from a stable equilibrium. There is a long way to go to address the deep-seated structural imbalances in the economy. Economic reforms to establish stability have been front loaded and required legislation such as the Public Financial Management Act, Public Debt Management Act, and Central Bank Act has already been enacted.

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[3]Mid-Year Fiscal Position Report 2024, Ministry of Finance, Economic Development, Policy Formulation, Planning and Tourism, 31st October 2024
https://www.treasury.gov.lk/api/file/d709d704-874b-4ec2-8a5d-64308482f01b

The second generation of reforms to unlock economic growth now need to be implemented. This includes trade reforms, investment reforms, measures to improve the ease of doing business and to unlock the full potential of economic infrastructure such as the telecom sector and energy sector reforms. Trade and investment reforms are critical to ensure the required non-debt creating inflows to support long term external debt sustainability. Unless the required reforms are crystalized, fiscal discipline becomes entrenched, and the structural imbalances eliminated, Sri Lanka's economic progress could be seriously hampered, given the lack of sufficient economic safety buffers.

In order to arrive at a sustainable solution, it is also necessary for Sri Lanka to get the maximum out of the new social contract that is being created by the new administration. The ongoing transformation is expected to change various decades-long economic, social and political practices and traditions in the country. In this context, the the effective management of the economy based on contemporary domestic and international developments, and with a professional approach is critically important to preserve the hard-won gains in ensuring economic stability while improving governance and put Sri Lanka strongly on a path to economic recovery to achieve a higher, sustainable, green and job-rich growth to address poverty and inequality, and ensure much needed social protection and social justice, along with political stability in Sri Lanka.

What is undeniable is the fact that Sri Lanka can no longer carry on in a "*business as usual*" manner. As a country, we have to be able to adapt to a changing environment. Going forward, Sri Lanka must adopt a path of fiscal and macroeconomic discipline. The governance weaknesses and corruption vulnerabilities must be eliminated, which is one of the highest priorities of the new administration along with the recovery of stolen assets. And, as a country, we must strive to stand on our own feet whilst integrating with and competing with the rest of the world. The first steps on this difficult journey have now been taken, it is essential that as a country we do not go back to our past practices of "*living beyond the means*", and if we maintain discipline and work hard, there is no doubt that due reward will materialize. We all must learn from the past and learn from the practices of other countries that have succeeded from similar contexts.

In this regard, I wish to quote Mr. Nigel Clarke, former Minister of Finance, Jamaica, and the recently appointed Deputy Managing Director at the IMF, who said *"**Deep macroeconomic reforms are painful at first, but if you stick to it, even you wouldn't believe the positive outcomes.** In Jamaica's experience, the gradient of the crisis got steeper. Meaning the crisis began gradually and then gathered pace exponentially. **The same thing happens on the upside. The gradient will be steeper. Things start improving slowly, then improves very rapidly. Success feeds on itself as confidence builds**, and investors want to get a head start when they see the government and the public are serious about reforms. **A virtuous cycle is created when reform momentum is sustained.** The public starts to see positives that have never been seen before. In Sri Lanka, you just have to get there. You just have to stick to it. You got to get the IMF-EFF program completed by completing all the reforms in it. You want to make sure that you meet all the Quantitative Performance Criteria (QPCs) consistently"*.

However, **in order to enjoy the benefits that will materialize, patience is critical**. When a country goes through a sovereign debt default it is said to experience a "lost decade". Inflation causes prices to rise rapidly whilst real wages take far longer to catch up. During this period the public experiences substantially diminished in living standards. For incomes to recover the economy must first stabilize and then grow. Sri Lanka is today at the stage of stabilization, and following 4 successive quarters of economic growth, is poised for sustained growth.

However, **it is essential that this growth is not achieved at the cost of stability**. In the past Sri Lanka has made the mistake of trying to stimulate growth through fiscal and monetary stimulus, leading to further macroeconomic imbalances and cycles of crises. Instead, growth must be driven by productivity growth and continuous improvement in competitiveness. This does not take place overnight. It needs investment in skills development and education, it needs good infrastructure, stable macroeconomic conditions, strong institutions, law and order, access to finance, good governance, access to international markets and global production networks. Once these fundamentals are in place it will be possible to attract new investment and expansion of existing capacity, leading to job creation and productivity driven income growth. It should be very clear that these changes will not take place overnight – it requires a persistent period of sound economic policies, during which time the public must exercise patience. This is why I reiterate that while there has been tremendous progress during the last two and a half years, there is still a long way to go until we can feel comfortable and satisfied that the economy is in safe and settled path.

Finally, I wish to emphasize that there are many unsung heroes in the public service during the last two and half years, including DST Priyantha Rathnayake and my other colleagues at the General Treasury. Your silent contribution has never come to the limelight appropriately. Hence, **I would like to take this opportunity to pay a tribute to the members of the public service who actively contributed to the efforts to address the crisis related adversities, thus helping to bring the country from a dire situation to a position of relative stability today.** Your jobs are not easy; in general, public servants work with limited resources and are asked to meet our country's ever-growing demand for public services and satisfying ever-increasing expectations.

Mr. Rathnayake, you did not work for your personal enrichment, but for the satisfaction which comes from serving your country. I wish to place on record my deep personal appreciation for all the support and guidance provided to me by DST Rathnayake since I took office in April 2022, and for all the service provided to the General Treasury/Ministry of Finance and the country during your long and distinguished career. I applaud your contributions towards our collective effort to take our beloved country permanently out of this serious and deep economic crisis.

I wish you the very best for a peaceful, happy, and very well deserved retirement….!!!!

Thank you.