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Press Release

The Final Budget Position Report (Annual Report) 2023 was published on May 31, 2024 under Section 13 of the Fiscal Management (Responsibility) Act, No. 3 of 2003. This press release includes the overview section of Chapter 1 of the report. The full report can be downloaded from the Website of the Ministry of Finance, Economic Stabilization and National Policies (www.treasury.gov.lk).

The Sri Lankan economy made significant progress toward restoring macroeconomic stability in 2023, following the tumultuous economic crisis that peaked in 2022. The path to revival was reflected in the recovery of economic growth and single-digit level inflation since the second half of the year, along with a primary budget surplus, and a surplus in the current account of the balance of payments by end 2023. These achievements were a result of the steadfast implementation of a comprehensive macroeconomic reform programme by the government to decisively handle the deepest, most complex and unprecedented economic crisis in the post-independence history of the country. In this process, the resilience shown by the Sri Lankan people in stabilizing the economy, within a relatively short period of time, is highly commendable. Whilst progress has been made, it is not a time to be complacent. The road to recovery for Sri Lanka is long and the country must stay the course. Committed and concerted efforts are essential to put the country on a sustainable development path. The ongoing macroeconomic rebalancing should be carefully understood and considered in designing and implementing respective policy responses.

The severe economic crisis in 2022, which led to major shortages of essential supplies, subjected almost all citizens to unimaginable hardships—job losses, income depletion, business downturns, diminished living standards and increased multidimensional poverty — was most acutely felt by the poor and vulnerable people. A rapid policy response was warranted given the fact that remedial policy measures had been delayed for a prolonged period, as identified by judicial scrutiny of the causes of the economic crisis[1]. After almost two years, whilst the continuous supply of essential goods and services has been re-

[1] *"…. As we have discussed hereinbefore, prolonged inaction due to arbitrary, irrational and/or manifestly unreasonable decisions and inadequate measures over the period under consideration had heavily contributed to disastrous consequences", p. 117, Decision of the Supreme Court on the Case No. SC FR 195/2022, 14 November 2023, Supreme Court of Sri Lanka.*
Source: https://supremecourt.lk/images/documents/sc_fr_195_2022_and_212_2022.pdf

established, the government is in the process of gradually restoring a sustainable and inclusive economic growth path through a range of reforms and policy initiatives. The government is determined to make a concerted effort to implement changes which are conducive for the advancement of the country and its people.

The Government has made progress in stabilizing the economy through nuanced economic policy that balances long term structural reforms whilst minimizing near term disruption. In stabilizing the economy, a wide range of reforms had to be implemented within an extremely narrow window of opportunity. This includes numerous fiscal reforms covering tax policy, tax administration, and legislation; financial/monetary sector reforms, such as the new Central Bank of Sri Lanka Act and revisions to the Banking (Special Provisions) Act; State Owned Enterprise (SOE) reforms, including cost reflective pricing, liberalization of the fuel market, balance sheet restructuring and strategic divestment process to reduce fiscal risks; debt restructuring, governance reforms, and welfare reforms, including the overhaul of a three decade old Samurdhi programme through the introduction of the Aswesuma programme. Many of these reforms are included in the Extended Fund Facility (EFF) programme, supported by the International Monetary Fund (IMF), approved in March 2023 and the other reform efforts are particularly being supported by the World Bank and the Asian Development Bank (ADB). The ongoing support of international partners and multilateral institutions has been crucial in navigating the deep crisis that the country is in.

Following the stabilization of the economy due to measures taken to decisively address the root causes of macroeconomic vulnerability, transformative policy reforms are being implemented in key areas to fundamentally restructure the economy to achieve a high, sustainable, and inclusive growth by exploiting Sri Lanka's potential and using available opportunities to prevent a recurrence of such an economic crisis. Hence, in addition to the above measures, a number of new policies and laws are being implemented, including public finance reforms in the new Public Financial Management Bill (PFM Bill); debt management reforms in the new Public Debt Management Bill; and the growth enhancing reforms, such as those in the new Economic Transformation Bill, to institutionalise and give legal effect to the reform programme. Fiscal institutions are also being established or revamped in order to bolster the institutional framework that can support the envisaged reform process. This includes new institutions such as the Public Debt Management office (PDMO), the State Owned Enterprises Restructuring Unit, and a broader strategy for restructuring the Treasury as a whole to create an institution that is fit for purpose to catalyze economic development in the modern era. The structural shift to a competitive outward oriented economy is embodied in trade and tariff reforms, as well as entering in to comprehensive trade agreements with strategic partners. Sri Lanka intends to join the Regional Comprehensive Economic Partnership (RCEP) agreement which would enable the country to link into dynamic regional value chains to drive investment, trade, and growth. Factor market reforms are being pursued to unlock productive capacity of the economy, including labour and land market reforms, along with education and energy sector reforms, agriculture modernization, digitalization and climate related policies, towards a new economic framework that optimizes local capabilities to capitalize on emerging global opportunities. Factor market reforms that unlock the production economy are a necessary complement to enable the achievement of low and stable long term inflation. Such measures will reduce the requirement for ad-hoc administered price interventions to support affordability going forward.

Many of these long neglected reforms have been discussed for around two decades and in some cases, for up to 50 years, as can be seen in the agreements signed by the Sri Lankan authorities with the IMF in 1977[2] and 1983[3]. During this period, our neighbours, particularly in South East Asia, have adopted sound macroeconomic policies, integrated with the global economy and built competitiveness, invested in education, and attracted global capital and know-how, allowing rapid economic take-off and improvement of the quality of life of their populations. However, it is very unfortunate that Sri Lanka is still trying to implement some of the policies that were planned to be implemented 50 years ago, leaving the country well behind its peers. Therefore, the present extremely narrow but unique window of opportunity should be used wisely to once and for all to implement deep and permanent structural reforms to address the fundamental flaws in the economy, without being swayed by ideological dogma, but following an evidence based professional approach, while avoiding any policy mistakes or experiments, which will be extremely costly and unaffordable to the country.

The inter-connected nature of the crisis makes navigating the required multi-dimensional reforms a difficult task. For instance, the interactions between fiscal policy measures, SOE restructuring, the state banks and financial sector, monetary and exchange rate policy, welfare policies, debt restructuring, result in a single policy measure having multiple impacts across other policy areas. Hence, a very carefully coordinated policy mix is required to bring Sri Lanka out of this deep economic crisis on a sustainable manner.

More importantly, disruption in the reform measures related to these multiple, interconnected moving parts has the potential to unravel the entire system and quickly reverse the gains that have been achieved in the last 2 years. Hence, the reform process

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[2] *"Statement of Economic and Financial Policies of the Government of Sri Lanka" attached to "Sri Lanka – Standby Arrangement", 16 December 1977, International Monetary Fund. Source:https://stoprdcom01e2.blob.core.windows.net/allfiles/IG/Production%20Hosting/Adlib/Public%20Documents/EB/236464.PDF*

[3] *"Sri Lanka - Letter of Intent", 08 August 1983, International Monetary Fund. Source:https://stoprdcom01e2.blob.core.windows.net/allfiles/IG/Production%20Hosting/Adlib/Public%20Documents/EB/103356.PDF*

requires an extensive level of support from all the stakeholders, strong coordination, effective communication, and careful implementation.

The depth of this economic crisis is such that there is no choice but to implement the reforms as quickly as possible whilst managing potential short term risks, although state capacity is stretched to the limit, requiring simultaneous efforts to strengthen capacity. It is important to understand that the reforms are essential to overcome the crisis, instill investor confidence as well as to create critical macroeconomic buffers. In the process, the protection of the poor and the vulnerable, who have been severely affected, was given highest priority with a three-fold increase in the expenditure on social safety nets in 2023 (compared to pre-crisis 2019) and the same amount being allocated for 2024 as well with enhanced coverage, improved targeting and delivery, and increased governance and transparency. Social protection has extended beyond cash transfers through granting free hold land rights to citizens. This is expected to economically empower a large number of households by making land assets more useful for economic purposes. Accordingly, it is particularly important that all Sri Lankans understand the necessity for such radical restructuring measures as a last chance for emerging from this serious crisis, restoring economic stability, and bringing about prosperity and well-being of all citizens.

Hence, the next stage of the policy implementation will be towards solidifying the stability and implementing above mentioned structural reforms to bolster the economic recovery, which is a task that needs broader political and social consensus. In this process, the government has to simultaneously implement policies to address legacy issues as well as identified new policies to unlock growth and prosperity. Addressing legacy issues in many areas has already been given the priority, but these measures often create headwinds for other economic activity. For instance, restructuring legacy debt of SOEs creates pressure on the balance sheets of state banks, requiring the government to allocate funds to re-capitalise these banks.

At the same time, the new policies are envisaged to create a competitive, export-oriented, green, and digitalized economy with higher economic growth over time to improve living standards and to prevent the country from experiencing a second default of the debt in the period ahead. It is critically important to understand that Sri Lanka cannot afford another crisis of this magnitude.

Towards this end, it is essential to ensure continuity of the IMF-EFF programme, completion of the debt restructuring process and the uninterrupted execution of productivity and efficiency enhancing reforms to address the structural issues in the economy. In fact, the intention of the government is to implement economic reforms that go beyond the IMF-EFF programme. It is in that context that the Economic Transformation Bill has been presented, which will be complemented by PFM Bill and Public Debt Management Bill, coupled with the already implemented Central Bank of Sri Lanka Act No. 16 of 2023. These laws establish a strong foundation to undertake economic management in a sustainable manner to ensure the transition of the economy towards a sustainable path in the future. The Economic Transformation Bill in particular outlines a set of key macroeconomic targets that articulate a common minimum economic framework that can prevent the repeat of a crisis and ensure inclusive prosperity. This includes a sustainable level of growth, export orientation, multi-dimensional poverty reduction, a robust and inclusive labour market, debt sustainability objectives, and a stable fiscal path. It is expected that these targets can be agreed upon in a bi-partisan manner, whilst future governments may retain the policy flexibility as to how these outcomes can be achieved. The Bill also establishes the key institutional framework to support this process of structural reform.

One of the most critical steps in the economic recovery has been the process of restructuring Sri Lanka's debt to restore debt sustainability, and rebuild credibility and confidence. As the IMF does not allow it to lend to countries with unsustainable debt in the absence of a credible process of debt restructuring, the very complex process of debt restructuring is being undertaken amidst diverse types of instruments and creditors. As Sri Lanka was not eligible for the Common Framework being a middle income country, Sri Lanka had to chart its own course in navigating this complex process. The debt restructuring negotiations are progressing satisfactorily with the constructive engagement and cooperation of all creditor groups, which is an essential step towards the completion of the debt restructuring process. The cash-flow relief envisaged through the debt restructuring process will significantly reduce the burden on the fiscal structure, enabling budget deficits to be financed in a sustainable manner without relying on inflationary monetary financing.

Fiscal and debt related reforms are critical to ensure disciplined fiscal operations and effective debt management in the post-debt restructuring environment to create the fiscal space to invest in social and economic infrastructure. It is important to understand that prolonged fiscal indiscipline has been a root cause for many of the ills in the macroeconomy at present. In fact, the government's fiscal reform efforts have been able to convert a Treasury overdraft of close to Rs. 900 billion with two state banks in 2021 into a positive cash balance with thestate banks, creating a buffer to withstand potential shocks in the absence of monetary financing and provisional advances from the Central Bank and limited foreign financing. In order to sustain this, the generation of adequate revenue and maintenance of the quality and appropriate quantity of expenditure in priority areas like education, health, public transport, and social protection, in line with the desirable aggregates, is essential. The provisions in the new PFM bill, which will establish a framework of fiscal rules, Debt Management Bill, which will establish a separate PDMO, the Economic Transformation Bill which will provide medium to long term commitments in key economic variables, and the forthcoming Procurement Law will provide the necessary guidance and commitments in this regard to ensure responsibility, transparency, cost effectiveness and much needed discipline in managing government fiscal operations.Improving governance, addressing corruption vulnerabilities and preserving integrity are paramount in all these endeavours to instil public confidence and improve service delivery.The Anti-Corruption Act No. 9 of 2023 and the strengthened authority of the Commission to Investigate Allegations of Bribery and Corruption (CIABOC) will particularly facilitate the achievement of these objectives.

Parliamentary oversight of the public finances and government policy matters has been strengthened further with the establishment of twenty Sectoral Oversight Committees (SOCs). The SOCs are authorized to review any Bill, except those specified in Article 152 of the Constitution, as well as Treaties, Reports (including Annual and Performance Reports) concerning institutions under their scope, or any other matter referred to them by Parliament, another Committee, or a Minister that pertains to their designated subjects and functions. The effective Parliamentary oversight has become critical in an environment where there had been only a very minimal number of SOC meetings held in 2020 when the crisis was gradually approaching, in comparison to the significant increase of the number of SOC meetings in the post-crisis period. In addition, the Parliamentary Budget Office Act, No. 6 of 2023 establishes a Budget Office in Parliament (PBO) to evaluate and conduct an independent assessment of the reports and proposals provided to Parliament for the policy making process while providing independent and non-partisan costing analyses related to policies in manifestos of recognized political parties or independent groups, which will lead to more transparent and affordable public policy.

Institutional and legal reforms constitute an integral part of the reform efforts. Significant progress has already been made by the Government by introducing a number of new laws and making necessary revisions to the existing laws. These legal and institutional reforms will empower key institutions and this should be used effectively by the respective entities to ensure that the country's much needed reform process is strongly supported, their actions are aligned with the government's policies, and the overall development objectives of Sri Lanka are met as envisaged.

The above process will be complemented with the other growth promoting reforms indicated above to create employment opportunities, raise income of the people and improve living standards. In this endeavour, a shift from inward oriented growth drivers in the non-tradable sector to an economy driven by non-debt creating inflows, such as export of goods and services, as well as foreign direct investment, is envisaged with opening up of the economy to international trade and investment, and integrating into global value chains while fostering an innovative entrepreneurial Sri Lanka. The revival of Micro, Small and Medium Enterprises (MSMEs) sector with appropriate policies is also a priority of the government. With these policies and measures, the economy is expected to shift to a more inclusive and sustainable trajectory, where the growth is led by green initiatives, while taking advantage of opportunities associated with climate prosperity. The challenges, such as climate change and population ageing, could act as headwinds to progress along this path. In addition, exogenous factors, such as escalating conflicts and geopolitical tensions that could disrupt supply chains and amplify commodity price volatility could also disrupt the progress. Hence, efforts are being stepped-up to promote resilience by re-building fiscal and external buffers, enhancing trade and other inflows, cross-border investment, and commodity supply networks.

It should be clearly noted that the improvements in the macroeconomy, particularly in the fiscal sector, have been achieved with the sacrifices made by everyone, particularly the general public, who felt the brunt of the crisis and the subsequent corrective measures. While the extensive reforms that are being implemented may cause difficulties for the current generation, already burdened by the impacts of multiple crises, those are intended to secure a brighter Sri Lanka for the generations to come with an accommodative economic environment, progressive tax structure, improved, efficient and transparent public financial management system, strong institutions, and enabling legal framework for both the private and public sector to operate efficiently and effectively with integrity. Hence, preserving and sustaining the hard earned progress in fiscal consolidation and all other areas is essential without any policy reversals. Such policy reversals could adversely affect the continuation of the IMF supported EFF programme, undermine investor confidence, and irreversibly damage policy credibility of the country, all of which could lead to a deeper socioeconomic and political crisis, which will be far worse than the economic crisis experienced in 2022. This is true in the context of the environment prior to as well as after the forthcoming elections. Given that the first steps on this difficult journey have already been taken, it is essential that as a country, Sri Lanka does not go back to its past practices of living beyond its means. Hence, in order to arrive at a sustainable solution, it is important for Sri Lanka as a country to reach a "new social contract".