Speech by Mr. K. M. Mahinda Siriwardana, Secretary to the Treasury, and the Ministry of Finance, Planning and Economic Development, on "Sri Lanka's Journey from Economic Stabilisation to a Sustainable Development Trajectory" at the International Conference on Sustainable Globalization (ICSG) Award Ceremony held at the Cinnamon Grand Hotel, Colombo on 11th January 2025

Distinguished guests, esteemed colleagues, and participants of the International Conference on Sustainable Globalization 2025.

I stand before you today at a pivotal moment in Sri Lanka's journey toward sustainable development. As we gather under the theme of *"Sustainable Transportation, Technology, and Tourism"*, we are not just discussing abstract concepts. We are mapping out the very future of our nation. Sri Lanka has faced significant economic challenges in recent years, but these challenges have become our catalyst for transformative change. The reforms implemented during the last two and a half years have helped stabilize the economy, and created the foundation for sustainable and inclusive economic growth.

Before we look ahead, it is always useful to look back to ensure that we learn from the past and do not repeat the mistakes of history.

Since 2022, Sri Lanka has been through its deepest and most complex economic crisis in post-independence history. The crisis was the result of deep structural macroeconomic vulnerabilities being exposed by domestic policy errors and compounded by exogenous shocks, such as the COVID-19 pandemic. Domestic policy errors included the large tax cuts in end 2019, excessive monetary financing of the resultant budget deficits, pricing fuel and electricity below cost leading to large SOE losses, and the attempt to fix the value of Rupee at around Rs. 203/USD since mid-2021.

Sri Lanka lost foreign capital market access in early 2020 – following which Sri Lanka continued to service external debt using its limited foreign exchange reserves in the absence of the ability to refinance maturing external debt. By April 2022, usable foreign currency reserves completely depleted, and Sri Lanka had no option but to declare a temporary standstill on selected external debt, resulting in the Republic's first sovereign default.

Policy makers at the time mis-diagnosed Sri Lanka's crisis as a liquidity crisis and attempted to resolve it through foreign currency swaps, temporary loan facilities (most of which did not materialise), and import restrictions. In reality, Sri Lanka's problem was not a liquidity crisis but a solvency crisis which **required comprehensive macroeconomic reforms to restore confidence in the economy**. Although delayed, Sri Lanka eventually sought the assistance of the IMF – which was essential to restore confidence in the economy, and enable financing flows to gradually resume. However, the IMF's rules do not allow it to lend to countries whose debt is unsustainable.

Accordingly, Sri Lanka had to embark on two parallel processes;

- **i.** Comprehensive Macro-economic reform programme
- **ii.** Comprehensive public debt restructuring process

The IMF supported reform programme is based on 7 pillars;

1. Revenue based fiscal consolidation
2. Establishing a robust social safety net
3. Restoring public debt sustainability
4. Restoring price stability and rebuilding external buffers
5. Safeguarding financial sector stability
6. Reducing corruption vulnerabilities
7. Growth enhancing structural reforms

The comprehensive macroeconomic reforms implemented during the last two and a half years brought about significant positive economic outcomes.

Improved government revenue and reduced budget deficit resulted in reduced borrowing needs and allowed elimination of monetary financing and thereby helped bring inflation under control rapidly. Reduced government borrowing helped improve credit market liquidity, allowing a decline in interest rates and reducing finance costs for private enterprises and households. Reduced borrowing requirements of State-Owned Enterprises, such as CEB and CPC due to cost-reflective pricing also freed up liquidity which can be loaned out for productive economic activity to support economic recovery and growth. Coordinated fiscal and monetary policy reforms enabled a mitigation of the long standing "twin deficits" – resulting in a primary budget surplus and a balance of payments current account surplus, resulting in appreciation of the currency.

Table 1: Improvements in Macroeconomic Indicators

Indicator	2022	Present
Primary budget deficit	-5.7% of GDP (end 2021)	Rs. 830 billion (October 2024)
Government Revenue	8.3% of GDP (2022)	11% of GDP 2023 (projected at 13.6% of GDP 2024)
State Enterprises profitability	Rs. 775 billion loss (2022)	Rs. 456 billion profit (2023)
Treasury Cash Balance	Rs. 832 billion (OD end 2021)	Rs. 647 billion surplus (June 2024)
Registered tax payers	437,547 (2022)	1 million (2023)
Inflation	70% (September 2022)	-1.7% (December 2024)
Foreign Exchange Reserves	USD 1.9 billion (usable reserves less than 500mn end 2022)	USD 6.5 billion (usable reserves over USD 5.1 billion November 2024
LKR/USD	LKR 363/USD (end 2022)	LKR 295/USD
Interest Rate (1 Year T Bill)	29.3% (end 2022)	8.9% (end 2024)

These combined measures have resulted in a virtuous cycle of positive macroeconomic outcomes, that are now gradually translating into positive real economic impacts as well.

All Quantitative Performance Criteria (QPCs) were met in the last IMF-EFF review in June 2024, except for the QPC on Social Security Spending due to administrative challenges in distribution of transfers.

Key legislations have been passed, including;

- Central Bank of Sri Lanka Act
- Public Financial Management Act
- Public Debt Management Act
- Anti-Corruption Act
- Banking Act/ Banking (Special Provisions) Act

The results of these reforms have translated into positive outcomes in terms of economic stabilisation as evidenced through lower interest rates, currency appreciation, recent reductions in fuel and electricity pricing whilst being cost reflective, lower food prices, and so on. Continued focus on adhering to IMF programme parameters will enable stability to be entrenched, allowing continued improvements in these indicators.

Although macroeconomic indicators and reform outcomes are positive, and the economy has notably stabilised, **the impacts of the crisis particularly on the poor and vulnerable, continue to have adverse effects.** In the past, successive governments have attempted to address such public welfare concerns by providing tax reductions, tax exemptions, artificially lower prices of essential commodities, including electricity, and fuel.

However, the results of these past measures have been counter-productive due to a continuous erosion of the revenue base and higher borrowings. Today, these borrowings have to be serviced, and the resultant elevated interest costs have wiped out the fiscal space for targeted welfare expenditure.

It is important that we learn from these past mistakes and avoid mixing up tax policy with welfare policy and other objectives of the government. The government's welfare objectives should be addressed through targeted cash transfers as has been envisaged through the Aswesuma programme. Tax policy should be seen purely as a means of collecting revenue to finance public goods and services. We have learnt from the past that tax policy should not be used as a tool to achieve other policy objectives.

The fiscal reforms implemented over the last two and a half years have now restored some fiscal space that has enabled higher expenditure on social security and welfare measures to mitigate the impact of these shocks to some extent.

Table 2: Expenditure on Major Welfare Programmes

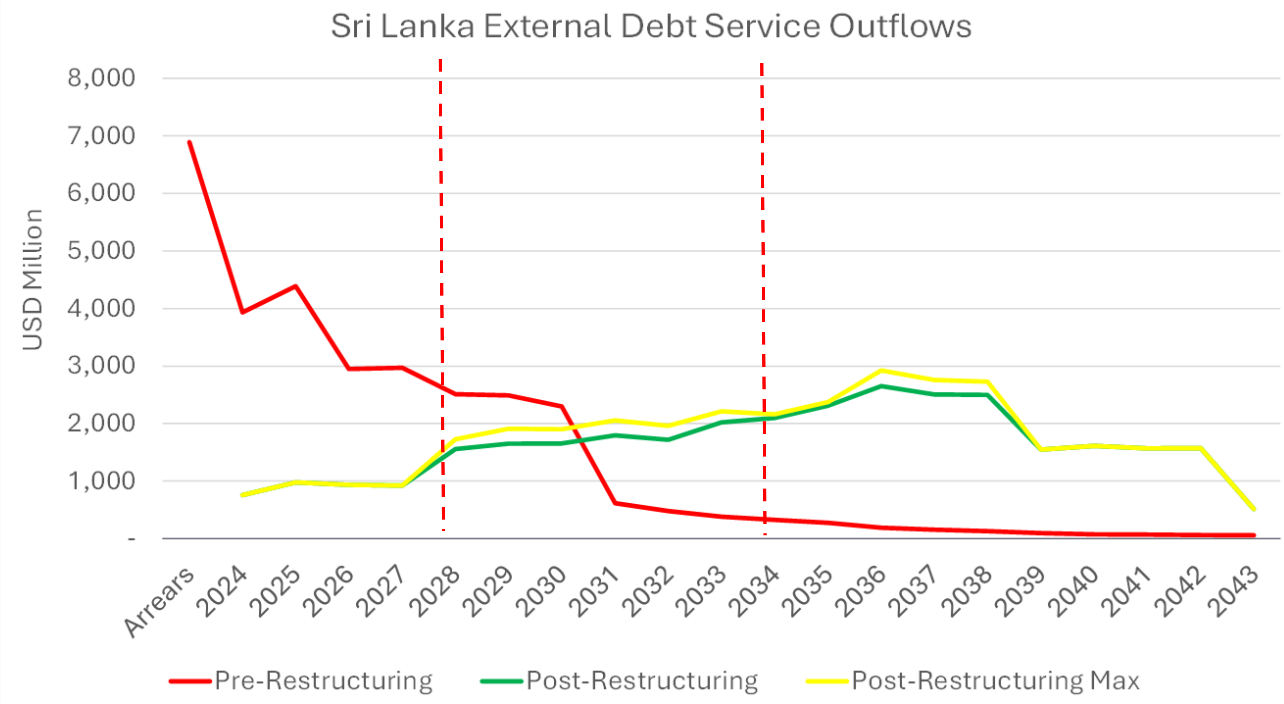
Summary of Expenditure on Major Welfare and Relief Programs Implemented by the Government (Rs. Mn.)

Welfare category	2019	2020	2021	2022	2023	2024 Estimate
Social Welfare	75,987	93,093	97,789	187,271	188,525	221,187
Social Security	332,367	384,897	390,046	428,164	566,227	618,894
Welfare Programmes for Education	18,618	17,803	15,993	15,449	40,873	46,278
Welfare about Health & Nutrition	12,856	8,248	8,274	7,862	21,580	37,802
Development Assistance	57,132	127,698	78,766	110,700	98,148	107,279
Other	61	35	22	22	59	48717[a/]
Total	**497,021**	**631,774**	**590,890**	**749,467**	**915,413**	**1,080,157**

a/ Includes MSME sector loan scheme, interest subsidy for pawning loans pf Aswesuma beneficiaries, rice and fuel subsidy etc.

The debt restructuring process has also been successfully concluded as at the end of 2024. **This resulted in significant cash flow relief and freeing up of further fiscal space for Sri Lanka to spend on essential public goods and services**. (Figure 1 below indicates the time and space that Sri Lanka has prior to the gradual increase in external debt service obligations).

Figure 1: Sri Lanka's Bilateral and Commercial External Debt Service (Excluding Multilateral Debt)



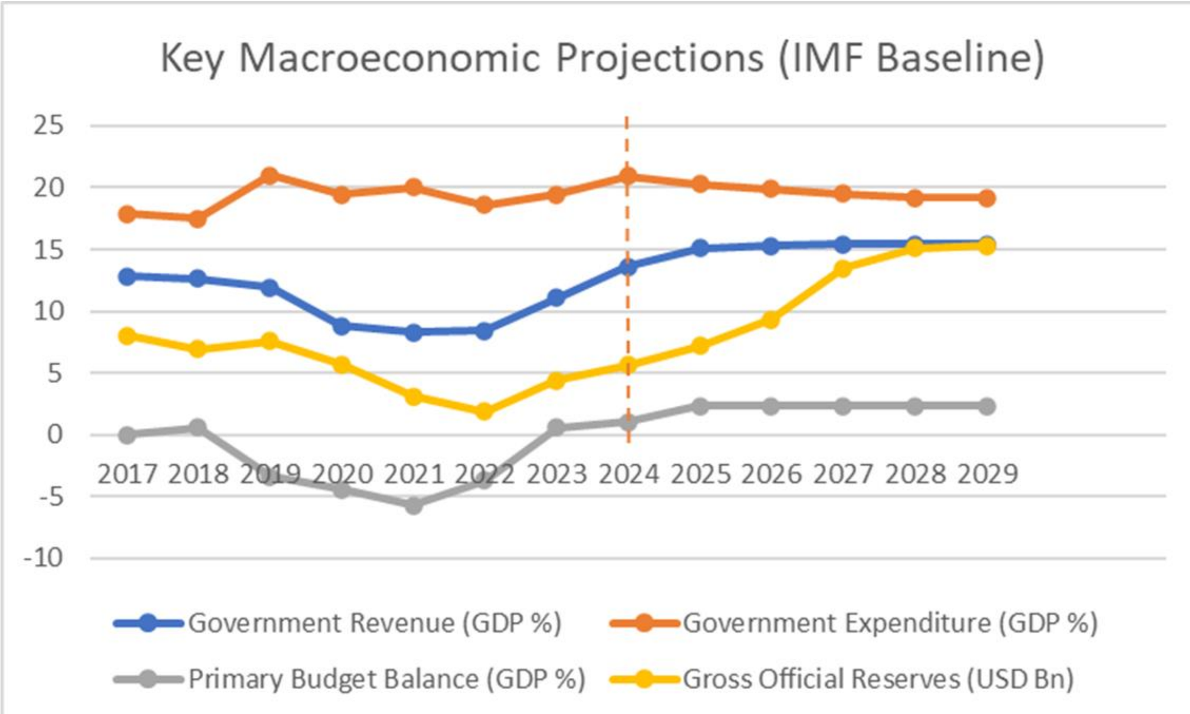
Note: <u>This includes</u> Sri Lanka's external debt service (capital and interest) from official <u>bilateral</u> debt and all <u>external commercial debt</u> (ISBs (actual flows post-Expiration of Exchange offer on 12 Dec. 2024 – considering GLB coupon adjustment activated), CDB (agreed debt treatment), other). <u>Multilateral debt (IMF, World Bank, ADB etc.) service is excluded.</u> Average multilateral debt service 2025-2029 is approximately USD 1.3 bn per annum in gross terms.

<u>Post-Restructuring</u> refers to debt service under the IMF baseline scenario, assuming no refinancing of existing debt.

<u>Post-Restructuring Max</u> refers to debt service under the highest MLB repayment threshold, assuming no refinancing of existing debt.

Sri Lanka must use the next ten years to build up its external and fiscal buffers to meet future debt service obligations. The IMF supported reform programme is designed, such that by end 2028, Sri Lanka's government revenue to GDP would reach 15.4% and Gross International Reserves would have reached USD 15.1 bn. as indicated in Figure 2 below. **If these targets are maintained, Sri Lanka will be able to meet its post restructuring debt obligations with a degree of comfort. In this context, it is critically important to understand as a nation that there is no time to be wasted. Although we have shown our resilience, working hard with a clear understanding on the path ahead, collective action, accountability and dedication are extremely important to ensure that the Sri Lankan economy will be taken to a comfortable position during the next ten years, rather than letting it to be another *"missed opportunity"*.**

Figure 2: Baseline Macroeconomic Path Under IMF Support Reform Programme



The importance of disciplined macroeconomic policy making is very evident in this context. It is essential that Sri Lanka develops a broad political consensus on the macro-economic policy framework. This should incorporate both fiscal discipline and sound monetary management. In the recent past, we have seen the initial signs of de-politicisation of macroeconomic management – and it is important that this persists.

Such a consensus is supported by a robust legal framework comprising the Public Financial Management Act, the Central Bank of Sri Lanka Act, and the Public Debt Management Act. The fiscal rules (primary expenditure limit of 13% of GDP and defined primary balance target in the Fiscal Strategy Statement (FSS)) are key anchors of fiscal stability and discipline. Collectively, this legislative and institutional framework can help Sri Lanka prevent another 2022 style crisis in the future. However, laws and institutions alone are insufficient, since this fundamental change also requires a change in mindset at a broader societal level. The public itself must demand and expect governments to deliver macroeconomic discipline.

The economic reforms implemented during the last 2 and a half years have provided the economy with a foundation of stability. This provides Sri Lanka with an opportunity to shift to a qualitative improvement in its economic trajectory as it embarks on a new growth path.

In the past, Sri Lanka's growth was driven by the non-tradable sector, with exports as share of GDP showing a continuous declining trend over the last 3 decades. In order to ensure continued growth of external buffers, **<u>it is essential that economic growth is driven by non-debt creating inflows</u> such as exports of goods, export of services, and foreign direct investment (FDI).** Towards this end, it is important to expand access to export markets through strategic trade agreements enabling integration with global value chains. At the same time, supply capacity must be improved by addressing impediments to factor markets: land, labour, and capital. Digitisation of the economy must be accelerated in order to enhance productivity.

Economic policy focus should be on productive, globally competitive, tradable sectors – regardless of whether that sector is in agriculture, manufacturing, or services. Institutional reforms are needed in areas such as investment facilitation and promotion, trade negotiation, and productivity enhancement. These economic policy measures must be complemented by improved governance with strong institutions, whilst addressing corruption vulnerabilities is essential to complement this envisaged development.

The other aspect of a qualitative shift in economic trajectory is the necessity to shift to a paradigm where sustainability isn't just a goal, but it is the foundation of our economic revival and growth strategy. The government's flagship "Clean Sri Lanka" programme envisages an environmental, social, and ethical re-awakening which embodies the core SDG principles and will no doubt contribute to Sri Lanka's efforts to progress in sustainable development.

Technology plays a crucial role in this transformation. The government is highly focused on leveraging digital solutions to optimize public services and economic efficiency. Priority sectors such as tourism represent more than just economic opportunity, but the opportunity to showcase our commitment to sustainable practices. **We must take all measures to ensure that economic growth doesn't come at the cost of our natural and cultural heritage.**

Sustainable finance will be a key opportunity in Sri Lanka's development strategy. Sri Lanka is proud to be among the emerging markets leading the way in green finance initiatives with green bonds and sustainability linked loans already evident in our financial markets. Furthermore, our National Sustainable Finance Roadmap will guide financial institutions in supporting the transition to a low-carbon economy, mobilizing private capital for sustainable infrastructure, renewable energy, and eco-tourism projects.

The Sustainable Development Council has given leadership to the National Strategy to Promote Inclusive and Sustainable Businesses to achieve the SDGs. The strategy aims to build a coherent ecosystem to drive business towards greater environmental stewardship and social responsibility. This is an example of a holistic and multi-stakeholder approach to sustainable development in the country.

Sri Lanka continues to embed sustainability into our national budget planning, such as the SDG budget coding and tagging system, ensuring that every major investment decision is evaluated through the lens of environmental and social impact. This integrated approach has the potential to attract significant international investment to Sri Lanka, and we expect this to continue throughout 2025 and beyond.

At this juncture, I must express my deep appreciation to the International Conference on Sustainable Globalization. Since its inaugural event in 2018, ICSG has played a vital role in fostering global partnerships and knowledge exchange. This platform, uniting prestigious institutions from the USA, Germany, Russia, India, and Sri Lanka, has consistently brought together the finest minds from academia, industry, and policy-making. The work of ICSG exemplifies the international cooperation needed to address global sustainability challenges.

Sri Lanka's transformation to a sustainable, inclusive, and digitally empowered economy represents our path to resilient growth. We are not just building infrastructure; we're creating a legacy of sustainable development that will benefit generations to come. Every person in this room, whether you're from academia, industry, or government, has a crucial role to play in this transformation.

Together, we can make Sri Lanka a model for sustainable development in the region. The future is not something we enter; it is something we create. Let us create it wisely and sustainably.

Thank you for your attention, and I look forward to our continued collaboration in building a more sustainable future for all.

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