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

A Ten-Point Common Minimum Program for Sri Lanka's Economic Recovery

Document prepared by Harsha de Silva [1] [2]

EXECUTIVE SUMMARY

Sri Lanka's economic crisis is not unexpected. Decades of shortsighted policies and halfhearted reforms weakened our foundation. Sudden global crises pushed us to a brink. Appalling mismanagement took us over the edge. Today, our state is bankrupt, inflation is rampant, the economy is at a standstill, and our socio-political order is in crisis. Yet we can still recover: we can reach out for the few lifelines left, regain our ground, reform our economy, and rebuild our country. This Blueprint tells us how.[3]

We must manage our immediate debt crisis by obtaining bridging financing until the International Monetary Fund (IMF) disburses funds, and productively engage the IMF while restructuring our debt. We must maintain financial system stability as we do so. The exchange rate should be carefully floated to market levels and interest rates should rise to control inflation. Monetary policy reform will ensure that we do not backslide into crisis.

Fiscal reform is critical. Tax revenues must be increased, and expenditure rationalised. Reforming unproductive or corrupt state-owned enterprises will be a key part of this process. This is especially true for energy and utilities, for which consumers will now need to pay cost reflective tariffs. Targeted, means-tested cash transfers will help the needy meet these unsubsidised market prices. The public sector must be transformed into a productive, efficient, high-quality, digitally enabled workforce that serves the needs of Sri Lanka's citizens.

As we stabilise, we must also grow. It is essential that we promote trade, industry, agriculture, and services by unshackling markets, increasing competitiveness and productivity, promoting exports and investment, and integrating with global production networks. Land and labour market reform will enable and amplify this growth.

A strong, transparent, effective social safety net that safeguards those who need it must underpin these changes. Moreover, it is essential to execute and uphold anti-corruption and transparency laws for these changes to last.

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

---

[1] Harsha de Silva is a member of the main opposition Samagi Jana Balawegaya (SJB). This document has been ratified by the SJB Economic Policy Unit consisting of the author, Kabir Hashim, MP and Eran Wickremeratna, MP, and endorsed by SJB Leader Sajith Premadasa, MP. Valuable advice and comments from Professor Premachandra Athukorala on several previous drafts are acknowledged with gratitude.

[2] This document incorporates, in tables, the short-medium term action plan detailed in the 'Common Minimum Program' compiled by the National Movement for Social Justice (NMSJ) using the proposals of 8 groups (Advocata Institute, BASL, Elle Gunawansa Thero, independent economists, NMSJ, NPP, SJB, 43 Brigade) and discussed with the SLFP and business leaders. 'Timeframe' refers to timeline for completion, denoted as S: until staff-level agreement with IMF; M: up to Extended Fund Facility with IMF; L: Beyond.

[3] This document focuses solely on economic stabilisation and recovery: it does *not* include the views of the author, the SJB, or any other parties on reforms in critical areas such as education, health, justice, reconciliation, environment, or any other aspects.

CONTENTS

Executive Summary 1

Diagnosis of an Economic Disaster 3

Blueprint: A Ten Point Plan for Economic Survival 5

1. Debt Crisis Management 5
   - 1.1 Manage imports and obtain bridging finance 5
   - 1.2 Engage the IMF and restructure debt 6
   - 1.3 Ensure financial system stability 7
2. Monetary and Exchange Rate Policy 8
   - 2.1 Exchange rate adjustment 8
   - 2.2 Interest rate adjustment 8
   - 2.3 Monetary policy reforms 8
3. Revenue Consolidation 9
4. Expenditure Control 10
   - 4.1 Rationalise public expenditure 10
   - 4.2 State owned enterprise (SOE) reform 10
5. Energy and Utilities Reform 11
6. Public Sector Management and Digitalisation 11
7. Trade, Industry, Agriculture, and Services Promotion 12
   - 7.1 Unshackling markets 12
   - 7.2 Competitiveness 12
   - 7.3 Export promotion 13
   - 7.4 Investment promotion 13
   - 7.5 Integrating with Global Production Networks (GPN) 13
   - 7.6 Productivity 13
8. Factor Market Reform 14
9. Stronger Social Safety Nets 15
10. Transparency and Accountability 15

Beyond Survival: The Foundation of Prosperity for All 16

DIAGNOSIS OF AN ECONOMIC DISASTER

In the 74 years since our independence, Sri Lanka has achieved much in terms of human development, despite lingering human rights issues and gaps in democratic governance. Yet we have been economically mediocre: our per capita income was only USD 3,815 in 2021 and will be far lower in 2022. We have been left behind by nations that were lagging us in the 1960s. Why?

Historical local causes: Shortsighted and inward-looking policies

In the 1970s, Sri Lanka followed statist, inward-looking policies while other countries liberalised markets and integrated globally. After liberalising in 1977 and 1988, subsequent leaders did not allow markets to function efficiently: they postponed essential reforms, took short-sighted decisions for political gain, and allowed crony capitalism to prosper. Every post-independence administration ran fiscal and current account deficits and used welfare politics to win votes. The 2003 attempt to bring fiscal discipline was thwarted by weakening the Fiscal Management (Responsibility) Act. In 2016, the coalition government attempted to reverse this trend with International Monetary Fund (IMF) support: it entered a disciplined revenue-enhancing fiscal consolidation program and registered a primary account surplus for the first time in decades. Yet key reform items (e.g., rationalising border tariffs, unbundling utilities, revamping foreign direct investment (FDI) policy, entering into regional trade agreements) were abandoned due to ideological clashes between the coalition parties, so external debt continued to grow.

Contributing global factors: Major external shocks

The onset of the Covid-19 pandemic in 2020 and the complete closure of national borders caused a major external shock to the economy, demolishing forex inflows through tourism. The Russian invasion of Ukraine in 2022, and the global supply chain crisis it prompted, exacerbated our crisis.

Immediate local causes: Poor policies, mismanagement, and ego

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

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

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

After 18 months of denial, the CBSL abandoned the LKR 200/USD rate on 7 March 2022, and since they did not sequence the adjustment (e.g., relaxing import and forex transaction restrictions), the market exchange rate plummeted to LKR 365/USD by July 2022. The black-market rate of the dollar continues to trade at 10% over the official rate. The weak rupee meant that the price of all goods and services would inevitably shoot up.

The consequences: A predictable but terrible crisis

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

- **Sovereign insolvency**: In April 2022 Sri Lanka announced unilateral suspension of all external debt repayments (apart from multilateral debt), signaling bankruptcy for the first time since independence. The government has run out of forex and is unable to open letters of credit for essential imports.

- **Inflation, critical shortages, and a national shutdown:** Inflation is at unprecedented levels for almost all goods and services. Lack of forex for fuel resulted in 12-hour power cuts due to power plant closures and fuel queues that are kilometers long. Private and public transport has been decimated, so schools and government offices have closed. Agriculture, fishing, and industry cannot function. Other essential items such as medicine and food are also facing shortages and inflation, affecting the average person's daily subsistence. More than 15 people have died in fuel queues, and there have been incidents of parents unable to feed their children committing suicide. Crime has increased and shortages may result in further breakdown of social order.

- **Political crisis:** The public demanded leadership change, especially President Rajapaksa's resignation – hence the cry, "#GotaGoHome." On 31 March, there were protests outside his private residence. Despite emergency laws, a 36-hour curfew, and a social media ban, crowds reiterated this call across Sri Lanka on 3 April, causing the Cabinet including Basil and Namal Rajapaksa to resign. Protestors established 'Occupy'-style protest sites outside the Presidential Secretariat in Colombo (GotaGoGama), and around the island. On 19 April, the police killed a protester in Rambukkana. On 9 May, goons from the Prime Minister's (PM) official residence attacked GotaGoGama, prompting counter-violence from protestors. A ruling party Member of Parliament (MP) and his security officer were killed, and some 50 government MPs' properties were burnt down. Mahinda Rajapaksa resigned as PM. The President falsely promised constitutional reform and appointed Ranil Wickremesinghe, the sole representative of the United National Party in Parliament, as the new PM. On 9 July, enormous crowds gathered in Colombo despite the lack of transportation and stormed the President's and PM's official residences. PM Wickremesinghe's private residence was torched. President Rajapaksa fled the country, and finally resigned on 15 July. PM Wickremesinghe took oaths as interim President and was elected President by Parliament on 20 July, despite protestors rejecting his leadership as being proxy for the Rajapaksas. Sri Lanka is under a dark cloud of upheaval and uncertainty.

BLUEPRINT: A TEN POINT PLAN FOR ECONOMIC SURVIVAL

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

The ten pillars of reform:

1. Debt Crisis Management
2. Monetary and Exchange Rate Policy
3. Revenue Consolidation
4. Expenditure Control
5. Public Sector Management
6. Energy and Utilities Reform
7. Trade, Agriculture, Industry and Services Promotion
8. Factor Market Reform
9. Stronger Social Safety Nets
10. Transparency and Accountability

1. Debt Crisis Management

Sri Lanka's urgent needs are to manage its immediate sovereign debt crisis by obtaining bridging finance until the IMF disburses funds, and to engage the IMF while restructuring debt. Maintaining financial system stability is also critical.

1.1 MANAGE IMPORTS AND OBTAIN BRIDGING FINANCE

Sovereign credit rating agencies have downgraded Sri Lanka to 'default,' signaling tough times until we enter an Extended Fund Facility (EFF) with the IMF. During this period, we must manage import flows of essentials in line with current account receipts (made up of export earnings, remittances, and tourist receipts), unless we secure bridging financing from friendly nations or from the IMF under its Rapid Finance Instrument (RFI) facility.

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

The bridging requirement for essential imports and (mandatory) payment of multilateral debt is approximately USD 3-4 bn for the rest of 2022 (besides India's generous USD 4 bn of assistance via credit lines, currency swaps etc.). Ongoing discussions with Japan, China, the Middle East, and Russia have not resulted in tangible results. The US and the EU have thus far provided some emergency assistance (e.g., the US provided a USD 20 mn grant for feeding school children). The IMF cannot release RFI funding until the government reaches significant progress in debt restructuring, which could take up to several months *after* the IMF completes a debt sustainability analysis (DSA). This DSA, which was submitted to the Government in end-June, will serve as credible benchmark for negotiating debt restrictions with creditors: the more fiscal adjustment Sri Lanka is willing to take, the larger 'haircut' the creditors will accept.

Therefore, to solve our immediate liquidity crisis it is essential that we obtain short-term bridging finance from friendly nations, such as credit lines for imports, foreign currency swaps, or barter trade (e.g., the China-Sri Lanka Rubber-Rice Pact of 1952). Privatisation is also an option, but desperately selling assets without transparency and competition will be disastrous. This includes the previous Cabinet's approval to sell downstream fuel distribution to foreign companies who can import fuel on their own account for 6-12 months, as these entities will still require USD from the domestic banking system at the end of this grace period.

1.2 ENGAGE THE IMF AND RESTRUCTURE DEBT

Deep, extensive economy-wide changes are needed to come out of the crisis: we must address our solvency issues through reforms that allows debt sustainability. Designing and implementing an IMF-assisted EFF program would be the best place to start. However, the previous government rejected this option in favour of "home-grown solutions" that allowed political control of public resources, and due to a misconception that the program would be anti-welfare. This is not true: the IMF-supported reform agenda promotes fiscal adjustments alongside proper targeting of subsidies and greater investment in health and education.

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

The IMF is engaging deeply with Sri Lanka. Its Executive Board met in Washington DC on 25 February to discuss Sri Lanka's consultation report, and the Staff Report published on 26 March stated that our public debt is "unsustainable". After a weeklong meeting with the Sri Lankan delegation on 23 April, the IMF stated that the "authorities plan to engage in a collaborative dialogue with their creditors". The first IMF delegation arrived in Sri Lanka on a 10-day mission on 20 June. At each instance, the IMF has reiterated the need for credible, coherent strategy for macroeconomic stability and debt restructuring.

This restructuring will be a complex and difficult process, with different types of creditors requiring different approaches (i.e., multilateral lenders such as the IMF and World Bank, vs. official bilateral creditors, vs. private creditors and international sovereign bondholders (ISBs), vs. China). This process, from consent solicitation to issuing new bonds with revised terms, will take a minimum of six months if the government cooperates with negotiators. Otherwise, it could even take years. This has been complicated by one creditor (the Hamilton Reserve Bank) suing for immediate and full repayment of its debt in New York federal courts.

The IMF Staff Level Agreement for financing under an EFF program can only be approved by its Board of Directors after the process of debt restructuring is successfully completed or significant progress is made towards it. This is therefore critical for economic stability.

1.3 ENSURE FINANCIAL SYSTEM STABILITY

The government has so far limited restructuring discussions to foreign debt, believing that domestic debt issued in LKR will not have to be restructured – but this would be considered if DSA targets cannot be met by restructuring only foreign debt. The forex debt restructure will impact private banks as they are exposed to ISBs and Sri Lanka Development Bonds (SLDBs), but domestic debt restructuring would be extremely detrimental. Any haircut to these creditors would negatively impact liquidity and solvency of the banking system and the Employees' Provident Fund. The interconnectivity of the financial system means that stress in one bank or institution will spread quickly, causing systemic instability. Rating agencies have already placed all state and private banks on a negative rating and downgraded state banks to default. It is critical that the two state banks are adequately recapitalised (estimated USD 2-3 bn), to recover from the CBSL's mismanagement since end-2019. Banks and financial institutions will not be able to extend much patience to borrowers, despite the economic downturn and inflation. In this context, there will be opportunities for attractive risk adjusted returns for FDI into the banking system, requiring innovative financial engineering.

Intervention	Timeframe
Manage imports in line with Current Account receipts and obtain some bridge financing from friendly nations in terms of (a) credit lines for imports; (b) foreign currency swaps or (c) some innovative mechanism on barter trade.	S
Continue to engage the IMF with view to obtain Staff Level Agreement leading to IMF Board approval for an Extended Fund Facility (EFF).	S
Based on the Debt Sustainability Analysis (DSA) proceed with external debt restructuring with Lazard and Clifford Chance (appointed financial and legal advisors). Use all possible avenues to bring China into the negotiations at the earliest.	S
Minimise domestic currency debt restructuring. If domestic restructuring must take place, limit treatment to reprofiling with some regulatory forbearance (this may be under the purview of the public debt office). Consider converting to bonds and listing on Colombo Stock Exchange. It is critically important to ensure financial system stability (some banks are significantly exposed to forex debt; ISB and SLDB).	M
Create a central public debt office, which will require highly skilled (and well-paid) professionals. Downside to locating inside CBSL.	M

2. Monetary and Exchange Rate Policy

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

2.1 EXCHANGE RATE ADJUSTMENT

Balance of payment difficulties and the black-market premium in the official forex market will be eliminated by adjusting the exchange rate to the equilibrium (market) level. This can be done through a transitional phase of floating the currency to permit market forces to reveal the equilibrium rate, and then stabilising that rate through CBSL intervention in the forex market. There are three prerequisites for doing this: firstly, forex restrictions on current account transactions, quantitative import restrictions, and forced conversion rules must be removed; secondly, debt restructuring with the IMF must begin to increase confidence in fiscal/monetary discipline and improve dollar inflows; and thirdly, there must be reserves to support the currency. It is worth noting that none of these prerequisites were done when the CBSL floated the currency in March. It has also been speculated that workers in the Middle East are not remitting foreign exchange to protest the Rajapaksas, though the accuracy and impact of this is difficult to assess.

2.2 INTEREST RATE ADJUSTMENT

Policy interest rates should have been raised significantly before the currency float – this would have helped to bring export proceeds in the country and compressed demand. With year-on-year national headline inflation (NCPI) at 54.6% and food inflation at 80.1%, there is now no way to establish price stability without a major interest rate adjustment. Accordingly, the first action of the new CBSL Governor was to raise policy rates by 700 basis points on 8 April, and again by 100 bp on 5 July. The term structure of interest rates has now shifted up (364-day TB yield as at 15 July was 29.9%, an year ago it was 5.2%). This, along with the depreciated currency, should reduce aggregate demand as expected. The CBSL should not try to suppress rates by refusing to accept market determined bids, as this would lead to money printing and inflation. The CBSL must obtain its weekly bill and bond funding requirement from the market at market clearing rates. Of course, these high rates will negatively impact growth, which will need to be addressed later – but they are needed now to avoid hyperinflation.

2.3 MONETARY POLICY REFORMS

Sri Lanka has long allowed monetary policy to be dominated by fiscal policy: the CBSL has printed money for the Treasury's political objectives, leading to high inflation and loss of competitiveness. The existing Monetary Law Act (MLA) allows this. It is important to legislate amendments to the MLA based on the draft that the Cabinet approved in 2018. The most important revision will be to prevent the monetisation of government and public sector debt.

Intervention	Timeframe
Allow exchange rate to reach equilibrium market value, through transitional phasing and subsequent stabilisation.	S
Raise interest rates to level required to manage inflationary pressure.	S
Move towards obtaining weekly bill and bond funding requirement from the market at market clearing rates.	S

Ensure the independence of the CBSL, pass Monetary Law Act with necessary improvements to bring an end to discretionary money printing, build institutional independence of CBSL, and create legislative framework for inflation targeting.	M
Gradually unwind CBSL domestic balance sheet in a carefully sequenced manner alongside market interest rate adjustments and foreign inflows.	M

3. Revenue Consolidation

Fiscal sector reform is fundamentally important: the budget deficit must be reduced by both widening the tax base and restraining spending. There is ample room to strengthen the tax base as populist policies have resulted in Sri Lanka having one of the lowest revenue-to-GDP ratios in the world (8.7%, with tax at only 7.7%). The 2017 Inland Revenue Act (which was scrapped in December 2019) brought this ratio to 13.5% within a year and should be reintroduced immediately. Efficiency in tax administration must be improved via pay-as-you-earn and withholding mechanisms, which were recently reintroduced along with revisions to VAT, corporate and personal income tax, and turnover tax. Unjustifiable tax exemptions should be eliminated. The Fiscal Management (Responsibility) Act of 2003 must be strictly enforced with revised targets and thresholds. Non-tax revenue should also be increased systematically.

Intervention	Timeframe
Reintroduce 2017 Inland Revenue Act with necessary amendments to address DSA and restructuring requirements, by (a) broadening VAT tax base and withholding taxes (including capital and service payments); (b) broadening income tax base and reverse decline in number of taxpayer files; and (c) creating a progressive corporate tax regime with the rate increase being gradual.	S/M
Create a taskforce to assess government assets and identify opportunities to increase non-tax revenue. Increase revenue on government owned assets, fees, and returns from government organisations. Ensure service quality is improved at the same time. Where agency-specific funds exist, flow through to Consolidated Fund.	S
Formulate long term, stable tax policy, with investment credits instead of tax incentives for FDI. Halt giving out Strategic Development Projects (SDP) status for new investments, who will be subject to pay 15% minimum alternative tax.	M
Improve tax collection mechanisms.	M
Become signatory to Base Erosion and Profit Shifting (BEPS) Digital Economy frameworks. Introduce 15% minimum alternative tax for multinational companies (Pillar 2).	M
Introduce customs reforms such as enhanced risk-based investigations, reform of customs officers' rewards schemes and rationalisation of penalties to address perverse incentives.	M
Streamline duty under 3 bands and remove para tariffs.	M
Establish a unified revenue administration for 3 entities (customs, excise, and inland revenue).	L

4. Expenditure Control

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

4.1 RATIONALISE PUBLIC EXPENDITURE

Rationalisation must take place to eliminate waste and improve efficiency. While defense expenditure has long been protected, this must now be assessed critically. Exorbitant pricing on non-transparent procurements and unnecessary gigantic building projects can be addressed at once. A revised budget should be passed immediately so that at least the primary deficit in the budget could be eliminated at the earliest. The new budget should contain all fiscal adjustments to reflect a move towards a turn-around in the primary deficit.

4.2 STATE OWNED ENTERPRISE (SOE) REFORM

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

Intervention	Timeframe
Reprioritise capital expenditure from the general budget on long term projects such as roads and highways where possible.	S
Stop all projects that lie outside of the National Physical Plan and were implemented without a rigorous feasibility study, financial analysis, environment analysis and/or social analysis.	S
Impose hard budget constraints on SOEs, begin to cease capital and current transfers to them.	S
Tighten Fiscal Management (Responsibility) Act, to address the prevailing fiscal numbers. Clearly define escape clauses (justified deviations from rules), path to recovery, and accountability measures.	M
Privatise high profile SOEs (e.g., Sri Lankan Airlines); establish Public Private Partnerships (PPPs) where relevant; increase efficiency and productivity of SOEs. Establish task force to review all SOEs and prioritise those to be divested, reorganised as PPPs, or subjected to management reforms.	M
Liberalise markets in which SOEs operate, where relevant. Risk weight lending to SOEs by state banks.	M
Situate entity responsible for the National Physical Plan in an appropriate Ministry, ensuring adequate funding and empowerment to ensure compliance.	M
Reform the management of airports to make them attractive for all airlines. Price ground handling services in a manner that makes the airport attractive to low-cost carriers.	M
Liberalise up to 5th freedom rights after privatisation of Sri Lankan Airlines.	M

5. Energy and Utilities Reform

Although this is part of SOE reform, it is important enough to address separately. Energy pricing must be revised urgently to avoid damage to the fiscal and banking system. While petrol and diesel prices have been revised upward, the transparent, automatic cost-reflective pricing mechanism must be reintroduced for fuel and implemented for LP gas. A fuel/LP gas price stabilisation fund should be created to smooth price adjustments for the consumer.

Corruption in energy and utilities procurements (in power purchase agreements for electricity, or bulk procurement for fuel or LP gas) is a major problem that needs urgent and comprehensive attention, as is the inefficiency of these state-owned utilities. The CEB is a case in point: its losses in 2022 may exceed LKR 500 bn (total government revenue from January to April 2022 is only LKR 540 bn), and it faces serious concerns of corruption in power purchase agreements and merit-order-dispatch of generation units. There is a compelling case for unbundling the CEB and introducing competition in generation and distribution, while also investigating and correcting corruption. Increasing electricity tariffs to the consumer for cost-reflective pricing will be unjust if the high costs are from dishonesty and inefficiency: these costs must *not* be shifted on to the consumer.

Intervention	Timeframe
Implement transparent, automatic market-based energy (fuel, gas, electricity) and water pricing.	S
Bring all petroleum products under Public Utilities Commission of Sri Lanka (PUCSL) regulation through legislation. Entrust price and quality regulation to PUCSL.	M
Restructure energy and utility SOEs. Unbundle CEB and introduce competition in generation and distribution. Separate the transmission grid to allow the necessary investments to permit the absorption of wind and solar and to introduce services such as wheeling.	M
Invest in public transport, through foreign assistance.	M

6. Public Sector Management and Digitalisation

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

Intervention	Timeframe
Freeze public sector recruitment. Calculate personnel requirements of the state, the armed forces, and SOEs. Any recruitment at the lower levels requires green sheeting [hire from within existing state worker cadre]. Re-examine and reassess defence expenditure.	S
Engage in capacity building for retained public sector employees, especially for high level staff.	M
Develop outcome-based Key Performance Indicators (KPIs) for public sector.	M
Contract out system-wide audit process reengineering and digitalisation of the entire public sector. Start with the least resistance service (or most incentivised) and move forward.	M
Begin improving delivery of public service delivery through digitalization.	M
Convert corporations/board/department to a company to ringfence liabilities. Establish a formal mechanism for appointment approvals (like a fit and proper test).	L
Bring professional level control and regulation to key entities. Conduct management audits for those that cannot be revamped, and restructure completely, or find alternatives. Amalgamate different institutions relevant to the same field or service under one institution.	L

7. Trade, Industry, Agriculture, and Services Promotion

While we stabilise the economy, it is also critical to strengthen it by promoting trade, industry, agriculture, and services. This involves unshackling the markets from unnecessary tariffs, improving competitiveness, promoting exports and investment, integrating with Global Production Networks (GPNs), and enhancing productivity.

7.1 UNSHACKLING MARKETS

Although import duty (tariff) reform is important, immediate crisis management requires maintaining relatively high tariffs as a 'first-aid' measure. Total import liberalisation (removal of tariffs *and* quantitative restrictions) would put too much pressure on the CBSL's forex reserve position, because tariff revenues relieve stress on the government budget. Lifting quantitative restrictions (even at high tariff rates) would be a much better option to address immediate supply shortages in domestic markets. Tariff reform and rationalisation should be considered subsequently.

7.2 COMPETITIVENESS

Beyond tariff reform, it is important to remove the multitude of unsustainable price controls, movement and allocation controls, and monopoly purchases in certain imports (e.g., import monopoly of the Food Commissioner). The government should only participate in domestic trading for equity reasons, and even then, should do so on a competitive basis, with private enterprises also allowed to participate. Lack of competition has bred inefficiency and corruption in government procurement and service provision.

7.3 EXPORT PROMOTION

Reforms in exchange rate, trade, investment, and fiscal consolidation restore international competitiveness and lessen the anti-export bias in the country's economy, setting the stage for export expansion. This must be supplemented with a strong, politically supported effort to promote export oriented FDI. Sri Lanka's experience in the 1970s and 1990s demonstrates how trade and investment liberalisation complements the growth of export-oriented industrialisation. Moreover, sectors such as apparel and tea have long held up Sri Lanka's export sector: it is now time for high tech manufacturing, and high-end services including information technology services, knowledge process outsourcing (KPO) and business process outsourcing (BPO) to come to the fore.

7.4 INVESTMENT PROMOTION

The BOI should be restored to its original state as the apex 'one-stop-shop' for promoting FDI, to link Sri Lanka's manufacturing to global production networks and markets. BOI reforms should rationalise the fiscal incentives offered to export-oriented investors (i.e., they should time-bound, performance-based, and transparent). The current practice of constantly extending tax holidays drains collectable revenue. The Strategic Development Projects (SDP) Act which offers ad-hoc incentives should be rescinded and replaced with a rule-based mechanism for incentives. A minimum alternate tax should be applied on enterprises enjoying complete exemptions.

7.5 INTEGRATING WITH GLOBAL PRODUCTION NETWORKS (GPN)

Products are no longer manufactured from beginning to end within national boundaries – certainly not complex products. With improved global integration and technological advances, rapidly evolving GPNs are generating new opportunities for countries to participate in international division of labour. Cross-border production processes, with each country specialising in a stage of the production sequence, now define economic globalisation. We must take urgent action to integrate Sri Lanka into GPNs to move away from low-wage simple products to high-wage technologically complex products. Entering free trade agreements (FTAs) with trading nations with which Sri Lanka has strong trade complementarity (particularly the USA, UK, and EU) will facilitate this process. However, the immediate reform priority should be unilateral trade and investment policy reforms that remove obstacles for domestic manufacturing to intertrade globally. It is also possible to link local farmers with agricultural value chains overseas, to move beyond local markets and subsistence agriculture.

7.6 PRODUCTIVITY

Economies can expand by increasing either inputs (labour and capital) or the efficiency by which they are used (productivity), which comes from better management and technical advances. As labour and capital are inherently limited, improving productivity is necessary for self-sustained growth. The discussed policy reforms for outward-oriented, private-sector led growth naturally set the stage for improving productivity by exposing domestic manufacturing to global competition and technology, and through the inputs of FDI. The government must facilitate this process by promoting technical education and designing apprentice and on-the-job training schemes in collaboration with the private sector. Productivity improvements are also critical in the agricultural sector, which employs a quarter of the workforce but contributes to just 7% of national output. This can be done through technology infusion to the agriculture sector (e.g., better information management to handle weather variations, post-harvest crop management including climate-controlled warehousing).

Intervention	Timeframe
Fast track trade facilitation reforms, by removing distortions, reconsidering import controllers' function and roll back permit raj.	S
Promote understanding on the necessity of imports for exports.	S
Minimise unnecessary and unsustainable anti-competitive regulations and controls.	M
Enter into trade agreements with nations with which Sri Lanka has strong trade complementarity.	M
Promote export oriented FDI; restore the BOI to its original one-stop-shop status.	M
Enact enabling legislation for private industrial zones and start-up facilities.	M
Improve productivity of agricultural sector through encouraging technology infusion.	L

8. Factor Market Reform

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

Sri Lanka's labour market is also notoriously inefficient: public recruitment is excessive, and termination in both the public and private sectors is almost impossible. This makes the cost of retrenchment one of the higher in the world, which is a major disincentive for firms to expand operations in Sri Lanka as it is very costly to downsize if required. Urgent steps must be taken to create an efficient labour market by enacting new legislation. The labour force should be prepared through education and training to take advantage of this dynamic economy, rather than being denied opportunities for growth and social mobility. Labour protection should take the form of unemployment insurance rather than archaic laws.

Intervention	Timeframe
Promote technical education and design apprentice an on-the-job training schemes in collaboration with private sector.	M
Fast track unified bankruptcy laws for all enterprises.	M
Replace Termination of Employment of Workmen Act (TEWA) with an Unemployment Insurance Fund.	M
Create a digital land registry, completing ongoing Bim Saviya programme.	L

9. Stronger Social Safety Nets

This crisis has already devastated the low income and informal sectors, with the World Bank estimating that the number of Sri Lankans in poverty increased by 500,000 people from 2020 to 2021, with this number even higher now. Therefore, the coverage, targeting, and per-family benefit of social security should be strengthened to protect vulnerable groups. Unfortunately, the current Samurdhi program misses an estimated 40% of Sri Lanka's poorest households, with many benefits going to families with relatively high welfare. Its administration is also expensive, accounting for one third of its cost; and is easily corrupted. An innovative cash-transfer mechanism targeting up to the bottom 60% of homes might have to be considered instead. The financing for this transfer to the lower-mid income population would be directly linked to the removal of various subsidies from the higher income population, which does not require this support. The work already completed by the Welfare Benefits Board in 2019 would be the base for this new program, so that it could be structured to eliminate selection bias and corruption. Technology should be used to streamline this process.

Intervention	Timeframe
Provide cash transfers to vulnerable sections of the population; directly to bank accounts/mobile money accounts, using existing databases. This should be linked to the subsidy rationalising program, particularly in energy.	S/M
Improve coverage and targeting for social safety nets programmes.	M
Consolidate welfare schemes under the Welfare Benefits Board and build unified beneficiary database. Design and implement Unique ID project with the technical and financial assistance (e.g.: India's Aadhar programme).	M
Create funded pension schemes, expanding pensions beyond public sector to a national scheme.	M

10. Transparency and Accountability

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

Intervention	Timeframe
Empower the Independent Commission to Investigate Bribery and Corruption.	S
Enable implementation of the United Nations Convention Against Corruption.	M

BEYOND SURVIVAL: THE FOUNDATION OF PROSPERITY FOR ALL

A Social Market Economy

Philosophically, we believe in a social market economy: a synthesis between economic liberalism emphasising individual freedom and autonomy, and political freedom emphasising equity and justice. In this context, we must drive market competition and competitiveness while providing public support and social protection. We firmly believe that market competition is the key to economic success of the individual and the economy; yet we know that this requires regulation and assistance.

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

Yet we know that growth does not provide every need in poverty alleviation: the government must combine growth-promoting policies with a well-targeted social safety mechanism. Building a strong, transparent, and equitable social welfare system is an integral part of our development strategy: this facilitates achieving shared growth and makes difficult economic reforms palatable. That is why we believe in the total transformation of welfare politics, so that the subsidy is provided to the consumer directly rather than to the supplier of the service, which is then consumed mostly by the rich. Paraphrasing the economist Jagdish Bhagwati, although growth “opens the doors” for everyone, some people have starting lines further back than others – their government should help them over the threshold.

Concluding Remarks

At independence, Sri Lanka was one of the most prosperous countries in Asia, with per capita income above even South Korea and Thailand. Yet over the next 70 years, we fell further and further behind, eventually ending up in a sovereign debt crisis with the stigma of being the only Asian country to default on foreign debt in half a century. Our mission is to make this unprecedented crisis the springboard for lifting Sri Lanka onto a sustainable growth path, to regain our lost paradise. We are committed to transforming the closed ‘twin deficit’ economy characterised by stop-start growth and periodic macroeconomic crises, into a dynamic, outward-oriented economy that delivers sustainable, shared growth for all its citizens to enjoy. This requires achieving a strong, sustainable fiscal position by undertaking government revenue and fiscal reforms with complementary monetary, exchange rate, trade, factor market, and competition reforms; and underpinning this with a coherent, well-targeted social welfare net and strong anti-corruption legislation.

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