Sri Lanka's Bailout Blues:
Elections in the Aftermath of Economic Collapse

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Pluralism, Human Security & Sustainability Centre
Centre du pluralisme, de la sécurité humaine et du développement durable

Table of Contents

Principal Findings

What's new? Two years after Sri Lanka's economy imploded and its president resigned amid mass protests, the country has returned to modest growth. But hardship and anger at the political establishment fester, and opposition to economic reforms is likely to shape the outcome of the presidential election on 21 September.

Why did it happen? Years of under-taxation, weak exports and over-reliance on debt, combined with the COVID-19 pandemic and major policy errors, triggered the 2022 economic meltdown and political crisis. Tax hikes and lost subsidies since then have hit many Sri Lankans hard, while sparing many of the country's wealthy and powerful.

Why does it matter? Despite a bailout from the International Monetary Fund (IMF), the risk of return to debt distress remains high – as does the possibility of renewed unrest and political turmoil. The election offers Sri Lanka a chance to reconsider the direction of the reform program and correct some of its worst flaws.

Executive Summary

With a presidential election due on 21 September amid widespread economic misery, 2024 is a pivotal year for Sri Lanka. President Ranil Wickremesinghe has enjoyed some success carrying out International Monetary Fund (IMF) reforms, but millions of Sri Lankans mired in poverty and debt have yet to feel much relief. Wickremesinghe came to power in July 2022 after his predecessor Gotabaya Rajapaksa was forced to resign following waves of mass protest; but he owes his appointment to the Rajapaksa clan's political party, and he has relied on it for his majority in parliament. While that relationship has helped the president undertake sweeping reforms to right Sri Lanka's listing economy, it has sapped his public support. His aggressive response to dissent – including curbing protests and drafting tough new security and media laws – has stoked tensions.

Sri Lanka's meltdown in 2022 – when lack of hard currency to pay for imports led to crippling shortages of food, fuel and medicine – had deep roots. Years of extremely low taxation and high budget and trade deficits led to debt levels that reached a breaking point when combined with global disruptions resulting from the COVID-19 pandemic and major policy errors by the government of Gotabaya Rajapaksa, who was elected president in late 2019. An overly powerful presidency, lack of independent oversight bodies, and a pliant police and judiciary fostered Rajapaksa's mismanagement; his brother Mahinda's presidency, from 2005 to 2015, had also witnessed largely unchecked high-level corruption. As Sri Lanka's economy teetered, a nationwide protest movement emerged to demand immediate relief and the departure of Gotabaya and his clan from office, along with judicial accountability for their actions. Protesters called for a radical overhaul of the political system as well as constitutional reforms to strengthen democracy.

After Rajapaksa resigned in July 2022, parliament selected Wickremesinghe to replace him, and the new president moved quickly to shore up economic stability. He resolved the most urgent shortages and took austerity measures to balance the books in preparation for an IMF bailout, eventually approved in March 2023. With support from the Central Bank, and in part thanks to natural cyclical processes, inflation has fallen from historical highs to single digits; interest rates have come down; and currency reserves have increased. Major economic reforms are under way, as part of the IMF package, and negotiations with creditors on essential debt restructuring are nearing completion. The modest scale of the relief, however, will still leave Sri Lanka's debt at precarious levels and the economy vulnerable to external shocks, even if the tough fiscal targets are met.

Improved economic indicators, meanwhile, have offered little relief to millions across the country, with poverty rates more than doubling since 2020. Government responses, including a new and much-touted anti-poverty cash transfer system, have failed to meet the needs of many citizens, especially women and youth. Hundreds of thousands have left the country to find employment abroad, including many of the island's best-educated professionals.

Given the extent of the economic debacle, some degree of belt tightening was inevitable. But many Sri Lankans consider the government's new policies to be unfair in the way they have been targeted. Fiscal reforms such as tax increases and higher utility prices have been shouldered by poor and middle-income Sri

Lankans, while economic and political elites, including those who designed and benefited from the policies that led to the crisis, have been left largely unscathed. Key decisions have been made by a government including senior ministers who approved the policies that precipitated the crisis and relying on the same parliamentary majority that backed it then. The lack of action against the alleged corruption of the Rajapaksa family and its cronies, as well as some in Wickremesinghe's United National Party, has fuelled public perceptions of injustice.

The president's gamble to shun the sweeping governance reforms demanded by protesters in exchange for the stable parliamentary majority needed to pursue economic adjustment will now be put to the test at the polls. Running as an independent candidate backed by an ad hoc coalition, including much of Rajapaksa's Sri Lanka Podujana Peramuna, President Wickremesinghe is presenting himself as a "non-partisan" candidate committed to completing the economic recovery with IMF backing. Opinion polls indicate he is trailing his two main competitors, Sajith Premadasa, head of the Samagi Jana Balawegaya, and Anura Kumara Dissanayake, leader of the left-leaning National People's Power coalition. Both have pledged to renegotiate the IMF agreement to reduce the strain on working people, but neither has detailed how he would do so. What looks to be the country's first-ever three-way race could prove tight and tense. In another precedent, it may be decided by voters' second and third preferences.

Irrespective of the final electoral result, voters' demands are likely to focus on the outstanding flaws of economic reforms. If these polls are handled responsibly by all sides, and the public sees the final result as credible and legitimate, Sri Lanka could have an opportunity to begin addressing both the unfairness of the current adjustment program as well as the roots of economic mismanagement and political misrule that led to the 2022 collapse.

September 2024

Sri Lanka's Bailout Blues: Elections in the Aftermath of Economic Collapse*

I. Introduction

In early March 2022, Sri Lanka's economy imploded, spurring a political crisis unlike any the country had seen before.[1] Queues for petrol lasting days and massive crowds occupying government offices marked the onset of Sri Lanka's debt predicament and its first-ever default that April. On 13 July, nationwide protests demanding "system change" forced the resignation of President Gotabaya Rajapaksa. A week later, parliament selected Prime Minister Ranil Wickremesinghe to serve the remaining two and a half years of his presidency.

Upon taking office, President Wickremesinghe, ruling with the support of Rajapaksa's Sri Lanka Podujana Peramuna (SLPP) party, clamped down on protests questioning the legitimacy of his succession. He has since overseen the stabilising of Sri Lanka's economy while committing to a major economic reform program as part of a $2.9 billion bailout deal with the International Monetary Fund (IMF) that formally began in March 2023. The government's agreement with the IMF – known as an Extended Funds Facility (EFF) – commits it to an extensive list of politically and economically difficult reforms over a four-year period.[2]

At the top of the IMF program's priorities is to reduce Sri Lanka's chronically large budget deficits, principally through raising its extremely low rates of taxation. The program aims to do so while still protecting Sri Lanka's "most vulnerable" through "better targeted" anti-poverty cash transfers.[3] Essential to the IMF plan is for Sri Lanka to reduce its debt, especially to foreign lenders. To do so, the government has pursued debt restructuring negotiations with foreign governments and international commercial creditors. To "unlock Sri Lanka's growth potential", meanwhile, the IMF program promotes a series of "structural reforms" designed to encourage foreign and private investment, boost exports, and "reduc[e] the government's … role in the economy".[4] A key, but controversial, aspect of this liberalising agenda is to privatise or otherwise restructure state-owned companies, many of which are chronically loss-making. More popular with the public – but so far challenging for political leaders to put in practice – is an IMF plan to tackle the country's many and deeply entrenched sources of corruption.

*Plusec-Pluralism, Human Security and Sustainability Centre/Plusec-Centre de pluralism, de la sécurité humaine et du développement durable (Plusec) retained the International Crisis Group to conduct this research and analysis and to prepare this report.

[1] For earlier Crisis Group reporting on the economic crisis and its political effects, see Alan Keenan, "Sri Lanka's Economic Meltdown Triggers Popular Uprising and Political Turmoil", Crisis Group Commentary, 18 April 2022; "Sri Lanka's Uprising Forces Out a President but Leaves System in Crisis", Crisis Group Commentary, 18 July 2022; and "For Lanka, a Long Road to Democratic Reform Awaits", *Hindustan Times*, 25 July 2022.

[2] For the full terms of the agreement, see "Request for an Extended Arrangement under the Extended Fund Facility", IMF Country Report No. 23/116, 20 March 2023 (hereafter "EFF Agreement").

[3] Ibid.

[4] "Government of Sri Lanka Letter of Intent", EFF Second Review, IMF, 12 June 2024, p. 85.

This report examines the roots of the economic and political crisis that led to Wickremesinghe becoming president and outlines his government's attempts to stabilise the country. It examines the main challenges posed by the IMF program. It also considers the possible outcomes of and risks surrounding the forthcoming presidential election, in which the two leading candidates are calling for the IMF agreement to be revised. The report draws on interviews with economists, social activists, business owners, trade unionists, women activists, academics, religious leaders, politicians and diplomats, almost half of whom were women, conducted in person in Sri Lanka and by telephone or video conference between November 2022 and August 2024.

II. The Economic and Political Crises of 2022

A. *Economic Collapse*

The economic crisis that came to a head in April 2022 was long in the making. Since the mid-1990s, Sri Lanka had run increasingly large budget deficits, due mostly to its efforts to maintain a modest welfare state on the basis of progressively declining tax rates.[5] At the same time, it ran chronic current accounts deficits, as income from exports, tourism and remittances from overseas workers failed to cover the cost importing oil, petrol, cooking gas, food, medicine and consumer durables. Unable to develop new and more profitable export markets, successive governments financed deficits through international borrowing. After the country's graduation to middle-income status in 1997, however, Sri Lanka gradually lost the ability to borrow at concessionary rates. From the early 2000s, it was increasingly relying on issuing sovereign bonds on international credit markets alongside commercial loans from various Chinese sources, both at high interest rates.[6] By April 2022, the central government's total outstanding external debt was $34.8 billion, with total public debt reaching 126 per cent of GDP.[7]

While President Maithripala Sirisena, who served from 2015 to 2019, made modest attempts to address the country's mounting debt, his successor Gotabaya Rajapaksa quickly reversed course. He enacted large-scale income tax cuts that took effect in early 2020, reducing government revenue by a quarter. Almost immediately afterward, COVID-19 struck, and the resulting global recession did not spare Sri Lanka. Tourism, one of the country's principal sources of revenue, already hit by terrorist attacks in April 2019, came to a standstill.[8] Remittances dropped precipitously. Domestic economic activity contracted by 4.6 per cent in 2020, due in part to extended nationwide lockdowns.

President Rajapaksa's sudden ban on the import of chemical fertiliser and pesticides in April 2021 as part of an ill-advised effort to promote organic farming and save hard currency caused further damage to the national economy. Harvests of tea – one of the country's major exports – plummeted. Rice production dropped by 20 per cent; whereas previously the country had been self-sufficient in the staple, it was now forced to buy it from abroad. The total cost of imports necessary to make up for reduced domestic production exceeded what was saved in fertiliser and pesticide costs, deepening the budget and currency deficits.

To cover gaps in the budget, the Central Bank printed money, which added to already strong inflationary pressures. To maintain the value of the Sri Lanka rupee (and prevent a surge in the cost of imported goods), the government also drew down its limited foreign currency reserves, even as billions of dollars in debt were

[5] Central Bank of Sri Lanka statistics show the country's revenue-to-GDP ratio declined from 23.2 per cent in 1990 to 8.3 per cent in 2021. The emerging market and middle-income average is 26 per cent. See "IMF World Economic Outlook Database 2022", cited in Sharmini Coorey, "Economic policies in an election year: some inconvenient arithmetic: Part II", *Daily Mirror*, 14 March 2024.
[6] For a balanced analysis of Chinese lending to Sri Lanka, see Umesh Moramudali and Thilina Panduwawala, "Evolution of Chinese Lending to Sri Lanka since the Mid-2000s: Separating Myth from Reality", SAIS China Africa Research Initiative, November 2022.
[7] "Foreign Debt Survey", Department of External Resources, Sri Lanka Ministry of Finance, April 2022.
[8] On these attacks, see Alan Keenan, "Sri Lanka's Easter Bombings: Peaceful Coexistence Under Attack", Crisis Group Commentary, 23 April 2019; and Crisis Group Asia Report N°302, *After Sri Lanka's Easter Bombings: Reducing Risks of Future Violence*, 27 September 2019.

due for repayment in 2022. Despite increasing warnings from economists and admonishments to seek assistance from the IMF, President Rajapaksa and his advisers, all of whom are longstanding economic nationalists, maintained they would devise "homegrown solutions" to the country's debt and currency problems.[9] The emptiness of that promise became plain by the end of March 2022: with global prices of oil, wheat and other essentials surging due to the war in Ukraine and supply chain disruptions related to COVID-19, Sri Lanka in effect ran out of foreign reserves. On 4 April, it officially announced it was defaulting on its foreign debt payments and requested support from the IMF.

B. *The Aragalaya Protest Movement*

By early 2022, economic hardship had spurred growing public protests. Lack of hard currency and high global prices had led to shortages of petrol, electricity (generated in part by imported oil and coal), cooking gas and medicine – not to mention rice, wheat and other basic foodstuffs. Small-scale protests in Colombo's middle-class neighbourhoods, many led by women, slowly grew. On 31 March, demonstrators congregated outside President Rajapaksa's private residence; security forces violently dispersed them. The government declared a state of emergency, but over the next few days much larger crowds gathered on the streets, forcing Rajapaksa's entire cabinet, but not the president himself, to resign.[10]

The largely middle-class and Colombo-based protests were soon reinforced by student, trade union and farmer organisations that had been agitating against various government policies across the country since mid-2021. On 9 April, protesters, brought together under the slogan (and hashtag) "GotaGoHome" ("Gota" being the widely used nickname for Gotabaya) established the GotaGoGama ("GotaGo Village") encampment outside the presidential secretariat on Colombo's iconic Galle Face Green, calling for the president's resignation. Widely known by the Sinhala words for "people's struggle", *janatha aragalaya*, or simply *aragalaya*, the protest movement initially focused on the shared demand for economic relief. But demonstrators soon took up cries for the ruling family and its cronies to be held accountable, including demands that they return assets believed to have been stolen and hidden overseas. Over four and a half months of nationwide protests, sections of the *aragalaya* developed a wider critique of the mismanagement, corruption and unchecked executive power that many Sri Lankans saw as the sources of the economic crisis.[11]

[9] "Sri Lanka stopped from going to IMF by Attygalle, Jayasundera, Cabraal: Finance minister", *Economy Next*, 13 April 2022.

[10] Among those who resigned were two of Gotabaya's brothers – Basil and Chamal Rajapaksa – and their nephew, Namal Rajapaksa, son of the former president Mahinda, who stayed on as Gotabaya's prime minister for another month.

[11] Crisis Group interviews, political activists and community leaders, Southern Province, March 2023. Large-scale corruption was widely seen to have increased during Mahinda Rajapaksa's presidency from 2005-2015. Dozens of cases of alleged large-scale corruption – with the money at stake adding up to billions of dollars – began to be investigated, and in a few cases, prosecuted, during the 2015-2019 coalition government, when Wickremesinghe was prime minister. These included cases of allegedly corrupt arms purchases, money laundering, misappropriation of public funds and insider dealing in government bond issues. See Crisis Group Asia Report N°286, *Sri Lanka's Transition to Nowhere*, 16 May 2017, Section III.B. Since late 2019, almost all these cases

Eventually, the movement coalesced behind the catchphrase "system change", evoking desire for radical reform of Sri Lankan politics. Protesters moved from calling for the Rajapaksa clan's ouster to insisting that the whole parliament resign. Popular demands for an end to corruption and the entrenched power of the political class combined with longstanding calls to abolish the powerful office of executive president and end the partisan misuse of the civil service, judiciary and security forces – and the impunity – that has come with this presidential system.[12]

Key to the *aragalaya's* success was the fact it brought together poor, lower middle-class and privileged Sri Lankans, ranging across a wide ideological spectrum, under one umbrella. Its focus on shared economic suffering and the political causes thereof also enabled it to elude temporarily the religious and ethnic divisions that have long dominated Sri Lankan society and politics. Like "occupy"-style protests in other countries, the movement had no central leadership. Overlapping networks, broadly sympathetic to one another, were unified by the desire to end the Rajapaksas' rule and bring about major political reforms. The *aragalaya*'s popularity helped compensate for the political weakness that came with the lack of coherent leadership and organisation.[13]

On 9 May, the *aragalaya* encountered its first major challenge when angry government supporters destroyed the GotaGoGama encampment, beating protesters as police largely stood by.[14] More surprising than the attack was the sight of protesters fighting back, leading the pro-government mob to flee. Later that evening, across the country, anti-government protesters attacked the homes of roughly 100 ruling-party politicians, burning many to the ground. Who exactly organised the retributive violence remains unclear, but it tarnished the *aragalaya*'s reputation as peaceful and hardened attitudes among government and ruling party officials toward the movement.[15] The next day, Mahinda Rajapaksa resigned as his brother's prime minister. On 11 May, after intense negotiations, the president appointed Wickremesinghe, leader of the once powerful United National Party (UNP), as prime minister.[16]

Two months later, on 9 July, massive crowds flooded the capital, responding to calls from a wide range of groups to join the final push to dislodge Gotabaya

have been abandoned or dismissed by courts following prosecutors' failure to present evidence. For a useful list of key cases, see Namini Wijedasa, "Cases galore, convictions rare in Yahapalana govt's anti-corruption sham", *The Sunday Times*, 16 February 2020.

[12] Rajapaksa's term was marked by expanded constitutional powers for the already very strong presidency and increasingly direct rule through presidential task forces. See Alan Keenan, "Sri Lanka: Prevention Should Be at Heart of New Human Rights Council Resolution", Crisis Group Commentary, 25 February 2021.

[13] Crisis Group interviews, Northern, Central and Western Provinces, March 2024. A national survey conducted soon after the *aragalaya* had largely disbanded found that more than 80 per cent of Sri Lankans agreed it was a necessary movement that had a positive impact on the country. "The Survey on Aragalaya: Topline Report", Centre for Policy Alternatives, September 2022.

[14] "Sri Lanka MP among five killed as violence escalates", Al Jazeera, 10 May 2022.

[15] See Tisaranee Gunasekera, "The revenant nine?", *Daily FT*, 3 May 2023.

[16] Many believe that Rajapaksa was on the verge of resigning and would have done so had Wickremesinghe not accepted the job. The president had earlier offered the position of prime minister to several other senior politicians. All refused unless he agreed to step down as part of an agreed sequence that would see an interim government leading to elections and a referendum to end the strongly presidential system of government and return to a Westminster parliamentary model. Crisis Group interviews, politicians, journalists and activists, Colombo, March 2023.

Rajapaksa. The throng proved too much for security forces to handle: thousands surged into the president's official residence and offices and proclaimed them open to the public, leading to two weeks of peaceful occupation. After four days in hiding, Rajapaksa flew out of the country on 13 July, the same day protesters stormed the prime minister's office and unknown forces later burned down his private residence.[17] Rajapaksa formally resigned the next day, making Wickremesinghe acting president. A week later, on 20 July, parliament elected him to serve out the remaining two-and-a-half years of Rajapaksa's term.[18]

At the time, Gotabaya's resignation represented the *aragalaya* movement's greatest achievement. But it also paved the way for a program of short-term stabilisation and crisis management that would quickly eclipse the movement's push for deeper political reforms, while enabling parts of the political establishment that the movement has vehemently opposed to entrench themselves.

[17] Wickremesinghe and police blame the protesters, but no one has ever been arrested and no concrete evidence about such a link has been presented. Nonetheless, Wickremesinghe regularly cites the fire as an example of the dangers arising from the protest movement. See "President sets ambitious timeline for Sri Lanka's debt restructuring and reconciliation efforts", Presidential Media Division, 22 June 2023.
[18] "Ranil Wickremesinghe elected crisis-hit Sri Lanka's new president", Al Jazeera, 20 July 2022.

III. The Wickremesinghe Presidency

Immediately upon assuming office, Wickremesinghe adopted a strategy aimed at stabilising the country. Designed to contain the immediate economic crisis, the new president's policies also sought to tighten his grip on power so he could push through unpopular reforms with IMF backing. Despite praise for returning the country to a path of modest growth, the government has been accused of authoritarian leanings, while its reforms have also contributed to the closure of businesses, a sharp rise in poverty and an exodus of skilled workers.

A. *The Promise of Stability*

Upon taking office, the new president continued the work he had begun as Rajapaksa's prime minister to address the most urgent and crippling economic needs. These included power cuts that extended as long as thirteen hours a day, as well as shortages of petrol and cooking gas that saw people standing in lines for several days.[19] Through careful marshalling of limited hard currency reserves, the government was able to earmark money to import the fuel needed to power the national electricity grid as well as supply the cooking gas essential in most Sri Lankan kitchens. Meanwhile, the rollout of a rationing system using digital QR codes rapidly shortened queues at petrol stations. Together, these moves helped dispel the sense of imminent economic collapse and assuaged the concerns of a large segment of the wealthy and middle class in Colombo, whose political, financial and moral support had played a crucial role in the *aragalaya*'s growth.[20]

Alongside these emergency steps, a second pillar of Wickremesinghe's stabilisation strategy proved far more controversial. The president ordered an immediate crackdown on street protests, beginning with an order on 22 July to clear what was left of the GotaGoGama encampment near the presidential secretariat. Arrests of key protest leaders followed, in some cases under the Prevention of Terrorism Act (PTA), as did a policy of using court orders and deploying the police and army to clear anti-government protests, especially those led by the leftist Inter-University Student Federation.[21] With new measures removing or mitigating the most obvious signs of economic crisis, especially for the better off, the government could more easily demonise the remnants of the *aragalaya* as disruptive and threatening to the possibility of economic recovery.[22]

Worries about an authoritarian turn by the Wickremesinghe government deepened with the March 2023 release of draft legislation for a new Anti-Terrorism Act (ATA), designed to replace the draconian PTA, which the government had

[19] Avani Dias and Som Patidar, "Inside Sri Lanka's worst economic crisis, people are dying in line for fuel", ABC News, 11 April 2022.

[20] Crisis Group interviews, politicians, diplomats, journalists and civil society activists, Colombo, March 2023.

[21] See "Sri Lanka: Authorities continue to stifle protests, harass activists and push repressive laws", Civicus, 7 March 2024.

[22] While in effect criminalising most street protests, the president also repeatedly praised the army's role in preventing what he claims was the attempt by protesters on 13 July to storm parliament and seize power. There is no independent evidence that such an attempt took place. For a critique of Wickremesinghe's claims, see Dayan Jayatilleka, "Flawed narrative, fake history: Deconstructing Ranil's London discourse", *Daily FT*, 29 June 2023.

promised the European Union and UN it would repeal.[23] The ATA's broad definition of terrorism and expanded powers of detention and proscription prompted criticism from the EU and individual Western governments, as well as furious rebukes from Sri Lankan civil society organisations and opposition parties.[24] The Online Safety Act, approved by parliament in January 2024, has also been held up by critics as a grave threat to free speech and democracy, as have other draft laws that aim to regulate broadcast media and non-governmental organisations.[25]

Thirdly, Wickremesinghe has sought to avoid major reform of Sri Lanka's system of governance and declined to demand judicial or electoral accountability from the nation's leaders. Part of the reason is the political constraints upon him: retaining the support of the Rajapaksa-led SLPP and its majority in parliament depends on foiling *aragalaya* demands that the executive presidency's powers be trimmed and that state officials be held accountable for misuse of office. Instead, the Wickremesinghe government secured a largely ineffectual amendment of the constitution that restored a modicum of independence to oversight commissions for the police, human rights and other issues.[26] Wickremesinghe's reliance on SLPP support has also inhibited investigations into alleged cases of corruption involving the Rajapaksa family or the economic mismanagement that led to the 2022 crisis.[27]

In addition, Wickremesinghe has sought wherever possible to avoid elections, relying on controversial procedures – later ruled unconstitutional – to postpone indefinitely local government polls scheduled for 9 March 2023.[28] Needing the

[23] "UN experts say Sri Lanka's counter-terrorism bill fails to heed their recommendations, status quo fundamentally unchanged", UN Office of the High Commissioner for Human Rights, 18 October 2023.

[24] "EU raises concern over new anti-terrorism draft ahead of trade pact renewal", *Economy Next*, 3 April 2023. For an analysis of the bill, see Ermiza Tegal, "Anti-Terrorism Bill version 2.0: still worse than PTA", *Daily FT*, 23 September 2023.

[25] In the face of criticism from global tech and social media firms, as well as the U.S. government, the UN, local and international media and human rights groups, the government has promised to amend this act. See Sanjana Hattotuwa, "The rise of the panopticon state", *Groundviews*, 12 February 2024. For a useful overview of government legislation that threatens to restrict democratic rights, see "Acts that cut civil space", *Sri Lanka Briefing Notes*, no. 32, June 2024.

[26] The 21st amendment was approved by parliament on 21 October 2022. For a discussion of parliamentary efforts in 2022 to abolish the executive presidency, see Keenan, "Sri Lanka's Economic Meltdown Triggers Popular Uprising and Political Turmoil", op. cit.

[27] The Supreme Court did issue a landmark judgment in November 2023 holding Gotabaya, Mahinda and Basil Rajapaksa and ten other former senior officials responsible for "actions, omissions and conduct" that led to the economy's collapse, but the accused have faced no legal consequences. "Sri Lanka: Rajapaksa brothers among 13 leaders responsible for crisis", BBC, 15 November 2023. For examples of alleged corruption during the three Rajapaksa presidencies, see footnote 11 above.

[28] On 22 August, the Supreme Court held that by postponing the local elections – ostensibly for lack of funds – the president and other officials were guilty of "arbitrary and unlawful" conduct that violated voters' constitutional rights. "Sri Lanka court convicts president over vote delay", Agence France-Presse, 22 August 2024. In the opinion of various interviewees, the cancellation pandered to fears among businesspeople and diplomats that the expected victory of the leftist Janatha Vimukthi Peramuna, running under the banner of the National People's Power, might weaken the government's legitimacy and hinder finalisation of the IMF agreement. Crisis Group interviews, diplomats, politicians and lawyers, Colombo, March 2023. Likewise, the lack of international pressure for fresh parliamentary elections stems in part from the belief among many diplomats and

support of the SLPP parliamentary majority to get through as much of his economic program as possible, the president also rejected widespread calls for early parliamentary elections (due no later than August 2025).[29]

Finally, by defanging the *aragalaya*, retaining the support of the SLPP and postponing elections, Wickremesinghe acquired the political leeway to introduce a series of unpopular austerity measures designed to prevent the country from falling into even more dire financial straits and prepare the ground for final approval of an IMF bailout.[30] In particular, his government took three key steps to reduce the government's ballooning budget deficit: it increased taxes, removed subsidies that had kept fuel and electricity rates below cost and, in early 2023, imposed a 6 per cent spending cut on all government departments. Wickremesinghe's policies were assisted by, and built on, a series of policy changes the Central Bank had adopted. While several of the bank's measures made economic sense, such as no longer printing money to cover state expenses and ceasing to (artificially) prop up the Sri Lankan rupee's value, in combination they contributed to a spike in prices for basic goods, generating more hardship for poor and working-class Sri Lankans.[31]

B. *The Human Cost of Austerity*

With the Sri Lankan economy hit by the absence of fresh international credit and much reduced foreign currency inflows, the austerity measures mentioned above prolonged an already severe recession. After contracting by 7.3 per cent in 2022, GDP shrank by another 2.3 per cent in 2023. Small and medium-sized businesses were starved of affordable credit, and they saw the cost of servicing their existing loans, as well as fuel and electricity costs, rise exponentially. As a result, many businesses collapsed. Levels of private indebtedness, which had already risen during the pandemic, rose even further.[32] The poverty rate more than doubled, jumping from 11.3 per cent in 2019 to 25.9 per cent in 2023; city dwellers fared even worse, with urban poverty tripling over that same period.[33] In response, the government launched a new anti-poverty cash transfer program, Aswesuma, in July 2023, but the project has been underfunded, and its launch hampered by delays and confusion (see Section IV.C).[34]

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development partners that Wickremesinghe is the only politician who can see the IMF agreement through. Crisis Group interviews, March-April 2023.

[29] The SLPP supported Wickremesinghe's efforts to secure an IMF bailout, despite provisions amounting to a fundamental repudiation of the economic policies of the Rajapaksas' twelve years in power.

[30] The broad outlines – though not the full text – of the Staff-Level Agreement signed between the IMF and the Sri Lankan government were made public on 1 September 2022.

[31] "Monetary Policy Review: No. 03 – April 2022", Central Bank of Sri Lanka.

[32] By late 2023, 54.9 per cent of Sri Lankan households were indebted and 60 per cent of families had lower monthly incomes as a result of the economic crisis. "Household Survey on Impact of Economic Crisis 2023", Department of Census and Statistics, December 2023.

[33] "Sri Lanka Development Update", World Bank, April 2024. Extensive field research by a Sri Lankan think-tank found that poverty had risen even higher, from 17 to 31 per cent. "Social Safety Nets and the State of Poverty in Sri Lanka", LIRNEasia, 7 June 2023. For a detailed study of the intense pressures faced by the urban poor, see "Borrowing to Eat: The Impact of Sri Lanka's Economic Crisis on Colombo's Working Class Poor", Colombo Urban Lab, September 2023.

[34] Iromi Perera, "Aswesuma: High exclusion, low transparency?", *Groundviews*, 4 December 2023. See the discussion in Section V.B.1 below.

With inflation averaging over 50 per cent from mid-2022 into the first quarter of 2023, the combination of high prices and loss of income made a quarter of Sri Lankan families food insecure, forcing many to take out loans to meet their basic needs.[35] A disproportionate amount of the burden has fallen on women, many of whom are compelled to take on extra jobs, often at lower wages, even as the workload at home has increased due to lack of affordable electricity or gas.[36] Rates of child malnutrition have also risen sharply.[37] School attendance is down, due to the cost of travel and supplies, while mental health problems among children have soared.[38] The health system has suffered lasting damage, with patients now expected to purchase their own medicines, which means that many often go without. Unprecedented numbers of doctors and nurses have left the country.[39]

Despite these bleak statistics, Sri Lankan leaders and several international observers have proclaimed the country's austerity program a success. In early 2024, President Wickremesinghe declared that the economy had "undergone a remarkable turnaround".[40] He pointed to the return to growth (5.3 per cent in the first quarter of 2024) as well as the sharp drop in inflation (to single digits since July 2023), which allowed the Central Bank to cut interest rates by almost half by mid-2024. Tourism has picked up considerably, as have remittances from Sri Lankans working overseas, which has helped the Central Bank rebuild currency reserves as the rupee gains strength.[41] IMF officials have praised the government for making "good progress in implementing an ambitious reform agenda", and key economic partners are pointing to Sri Lanka as an inspiring "comeback" story.[42]

For the millions of newly poor and now struggling middle-class Sri Lankans, however, the dividends of economic stabilisation remain elusive.[43] Given how sharp the fall in living standards has been for many, it will take years for the undeniable improvements in macro-economic indicators that began to appear in the second half of 2023 to percolate down to the majority. Over the longer term, questions remain as to whether growth can be sustained without over-reliance on new debt and whether it will be shared more widely.

[35] "Household Food Security Survey", World Food Programme, December 2023.
[36] Crisis Group interview, poverty researcher, Colombo, January 2024. For a valuable analysis of the factors that place disproportionate burdens on women, see Iromi Perera, "The Gendered Burden of Care in Sri Lanka's Polycrisis", Institute of Development Studies, 18 March 2024.
[37] "Sri Lanka: Economic Crisis 2023 Situation Report No. 1", UNICEF, July 2023.
[38] Ibid.; and Crisis Group telephone interview, poverty researcher, August 2023.
[39] Of Sri Lanka's 20,000 doctors, an estimated 1,500 have left the country and 3,000 have requested long leave. The entire health system, until recently the pride of Sri Lanka's tattered welfare state, is under enormous strain. See Anbarasan Ethirajan, "Sri Lankan parents spending hundreds on children's leukaemia meds", BBC, 17 March 2024.
[40] "President's policy statement to parliament", President Media Division, 7 February 2023.
[41] "Sri Lanka Development Update", World Bank, April 2024.
[42] "Sri Lanka: IMF Reaches Staff-Level Agreement on the Second Review of Sri Lanka's Extended Fund Facility and Concludes the 2024 Article IV Consultation", press release, IMF, 21 March 2024; "Key US official hails SL's economic recovery as greatest comeback story", *Daily FT*, 20 February 2024.
[43] Even as the inflation rate has dropped sharply, the cost of living has more than doubled as the incomes of most Sri Lankans have remained stagnant. Crisis Group interviews, Vavuniya and Kandy districts, January and April 2024.

IV. The IMF Program: Risks and Resistance

Despite popular discontent with its austerity measures, the Wickremesinghe government was able to make the initial package of policy changes needed to gain formal approval of the four-year EFF from the IMF Executive Board on 20 March 2023. The same day, Sri Lanka received the first of eight scheduled tranches of roughly $333 million each, for a planned total of $2.9 billion. Yet while the president celebrated, proudly declaring that the IMF deal meant "we are no longer bankrupt and can restructure the debt", the number, complexity and often painful nature of the reforms required, alongside the modest amount of debt relief promised, pose major economic and political difficulties.[44]

A. *The Reform Package*

Faced with rapidly growing streets protests, the Rajapaksa government finally accepted a financial reality it had long tried to evade by announcing on 7 April 2022 that it would stop servicing its foreign debt. International credit agencies had downgraded Sri Lankan bonds to B- status in 2020, in effect locking Sri Lanka out of international financial markets. But rather than deciding then to default or restructure its debt, the government pursued a slow, self-destructive process of drawing down its foreign currency reserves, using these not only to purchase crucial imports but also to pay off bondholders.[45] Alongside the announcement of a default, the government declared on the same day that it would turn to the IMF in the expectation that the Fund would help it restructure its debt with international creditors, address the causes of the collapse and return to growth.

Details of the negotiations between the IMF and Sri Lankan government and Central Bank that resulted in the four-year $2.9 billion EFF announced on 1 September 2022 are not publicly known.[46] Despite calls at the time from opposition parties and civil society organisations for the particulars of what the government had agreed to do in order to win the Fund's support to be divulged, the government chose not to make public the staff-level agreement with the IMF until it was formally approved by the Fund's Executive Board six months later. By this point, many of the most important policy decisions – on tax rises, market pricing of electricity, state-owned companies and targets for debt sustainability – had been made.[47] Backed wholeheartedly by bilateral and multilateral creditors, the reform package was negotiated by Wickremesinghe, first as prime minister from 10 May to 21 July 2022 and then as president, as well as by a small number of advisers, ministers and

[44] "Sri Lanka will be led to the path of success despite repeated setbacks – President", *Daily News*, 20 March 2023.

[45] These reportedly include a number of politically influential Sri Lankans, but the Central Bank does not make public the identities of its bondholders. Crisis Group telephone interviews, economists, May 2024.

[46] This program is Sri Lanka's sixteenth with the IMF, though only some have been elaborate EFF bailouts.

[47] The government continues to refuse to release the technical analyses that underpin the EFF's calculations about debt sustainability and future growth rates, despite President Wickremesinghe's promise to do so in response to repeated requests in parliament by M.A. Sumanthiran of the Tamil National Alliance.

finance ministry and Central Bank officials. Parliament was invited to endorse the deal only after it had begun to be implemented in April 2023.[48]

At the top of the IMF program's priorities – and the focus of most public debate – is what the IMF calls "fiscal consolidation", featuring the goal of more than halving Sri Lanka's chronically large budget deficits and achieving a yearly "primary surplus" sizeable enough to begin paying down the massive debt.[49] The plan requires the government to reduce expenditures, while simultaneously expressing a commitment to protect Sri Lanka's "most vulnerable" through a strengthened "social safety net" and "better targeted" anti-poverty cash transfers.[50] But the principal means of achieving more balanced budgets is through raising the state's extremely low rates of taxation to 15 per cent of GDP. This task is unlikely to be easy. It will require a sustained commitment to tax wealth, which is both politically and administratively difficult, and to rein in tax concessions, as the IMF has urged.[51] Furthermore, in the words of one tax expert, "Sri Lanka's institutional capacity to improve the efficiency of its tax collection is very weak".[52]

The IMF agreement has also supported the Central Bank's use of high interest rates to bring down inflation, despite the harmful effects this measure has had on businesses and individuals, and its effort to rebuild the state's dangerously low foreign currency reserves. In pursuit of a long-term anti-inflationary monetary policy, the government has moved from an ad hoc policy of not printing money to fund its budget deficits, adopted in 2022, to establishing in law the independence of the Central Bank, charged with a mandate to control inflation and maintain a flexible exchange rate.[53]

Beyond measures designed to address the acute fiscal and monetary problems at the centre of the 2022 crisis, the IMF program also contains a series of "growth-enhancing structural reforms", seen by economists as essential for raising Sri Lanka's growth rates beyond the 2 to 3 per cent estimated for the next few

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[48] The deal was endorsed by a comfortable margin, with the leftist National People's Party opposing it and the main opposition Samagi Jana Balawegaya abstaining. "Parliament passes IMF deal", *Daily FT*, 29 April 2023.

[49] The "primary balance" is the difference between government revenue and expenditures, excluding debt payments. The IMF deal includes an ambitious target of reaching a "primary surplus" of 2.3 per cent of GDP in 2026, while shrinking the overall deficit from 11.6 per cent of GDP in 2021 to 4.8 per cent by 2026.

[50] EFF Agreement, op. cit. The agreement also includes a government commitment to increase spending on "social safety nets" to at least 0.7 per cent of GDP.

[51] The IMF's analysis of Sri Lanka's key "corruption vulnerabilities" notes the huge cost of tax concessions, many of which are given to politically connected firms with little demonstrable economic benefit. See "Sri Lanka: Governance Diagnostic Assessment", Technical Assistance Report, IMF, 30 September 2023, Sections V and VI. The finance ministry's March 2024 Tax Expenditure Statement revealed tax concessions in fiscal year 2022/23 totalling 978 billion rupees, which, according to one analysis, amounts to 56 per cent of all tax revenues. "Tax concessions cause Rs. 978 b in revenue loss in FY 2022/23 for govt.", *Daily FT*, 2 March 2024.

[52] Crisis Group telephone interview, Umesh Moramudali, Colombo University, April 2024. The IMF has conducted a series of short-term tax administration trainings for government staff, but much more is needed.

[53] The Central Bank Act became law in July 2023. The IMF program also aims to strengthen the stability of banks and other financial institutions, weakened by high levels of customer debt due to the pandemic-induced recession and excessive amounts of now devalued government debt. As part of this effort, parliament amended the Banking Act in April 2024 to ensure that state-owned banks would meet the same regulatory requirements as private banks.

years.[54] Among these proposed changes, some promise to spark widespread public opposition, especially a new labour law and new land and agriculture policies that the government argues will "unlock Sri Lanka's growth potential" by encouraging foreign and private investment, boosting exports, and "reducing the government's … role in the economy".[55]

Selling or otherwise restructuring state-owned enterprises, many of which are chronically loss-making, is another core part of the IMF-government liberalising agenda that could become a source of increased government revenue in the short term and the long run.[56] There is broad agreement among economists, which extends even to some opposition politicians, on the need to sell at least some loss-making state corporations, and the government has established a special "restructuring unit" in the finance ministry to manage the process.[57] Public concern runs much higher, however, when it comes to the potential sale of profitable state-owned enterprises and the possibility that these national assets might end up in the hands of politically connected groups and individuals.[58] Some critics fear that the expected benefits to growth and tax revenues may never appear, or will not be shared equitably, and that what drives policy is an ideological commitment to a small state rather than any real economic rationale.[59]

Finally, among the IMF's "growth-enhancing structural reforms" are much more popular – but politically hard to execute – policy changes designed to address corruption. Based in part on a detailed, damning analysis by the IMF of the country's "corruption vulnerabilities", the government has agreed to a wide range of legal reforms designed to increase the transparency of government finances and strengthen accountability.[60]

[54] Crisis Group interviews, economists, Colombo, April 2024. See also Coorey, "Economic policies in an election year", op. cit.

[55] "Government of Sri Lanka Letter of Intent", EFF Second Review, IMF, pp. 85 and 107.

[56] Restructuring is not limited to privatisation. For example, it can include opening a government-owned company to market competition or the creation of public-private partnerships. See "SOE reform must happen one way or the other: Dr. Malathy Knight", *The Sunday Morning*, 14 May 2023. At the height of the crisis in the first eight months of 2022, total losses of the 52 entities listed for sale or restructuring in the IMF program reached 727 billion rupees (approximately $2.25 billion); Sri Lankan Airlines alone lost $525 million between March 2022 and March 2023. Policy changes, including cost-recovery pricing, have returned the largest loss-makers to profitability, but the "legacy debt" remains huge. See Staff Report, EFF Second Review, IMF, Annex VIII: Resolution of SOE Legacy Debt.

[57] Crisis Group interviews, economist, Samagi Jana Balawegaya and National People's Party representatives, April 2024.

[58] See Dhanusha Gihan Pathirana, "Advocata's privatisation campaign: The anti-social market solution to Sri Lanka's economic collapse", *Daily FT*, 7 November 2023.

[59] President Wickremesinghe was quoted as asking, "Why is the state engaged in business? That's not our mandate". "Sri Lanka president says state need not do business; seven SOEs to be divested", *Economy Next*, 23 March 2023. The head of the restructuring unit, Suresh Shah, has said it plans to "retain critical public services in government control". "Human capital and natural resources are the real assets of Sri Lanka, not its SOEs: Suresh Shah," *The Island*, 19 June 2023. For a critic's view, see B. Skanthakumar, "Budget 2024: 'Deep Marketisation' in Sri Lanka", Polity.lk, 17 December 2023.

[60] See "Sri Lanka: Governance Diagnostic Assessment", Technical Assistance Report, IMF, 30 September 2023.

B. *Debt Restructuring*

An essential element of the IMF plan for economic recovery is to reduce overall public debt to what it considers a "sustainable" level, whereby Sri Lanka's economy generates enough hard currency to purchase the imports it needs and can still service its debt.[61] The country's debt servicing costs have proven overwhelming, in recent years gobbling up more than three quarters of all government revenue and underpinning chronic budget deficits.[62] Achieving IMF targets requires a process of "debt restructuring", in which the government negotiates with its international creditors – both bilateral (foreign governments) and commercial ones, who mostly hold sovereign bonds – to reduce the overall debt pile.[63] Completing this process is a requirement for Sri Lanka to borrow once again in international markets.

After an initial delay in getting "financing assurances" from all creditors, negotiations have run on three tracks since the formal start of the EFF.[64] Negotiations with most bilateral creditors were co-chaired by France and Japan – both members of the Paris Club of creditor nations – as well as India; separate talks were pursued with Chinese creditors; a third set of talks has taken place with commercial creditors.[65] Agreements in principle with China and the other bilateral donors were reached in late 2023.[66] Finalised on 26 June 2024, the deal, whose details have yet

[61] According to the terms of the IMF program, making Sri Lanka's debt "sustainable" will mean reducing overall public debt from 126 per cent at the end of 2022 to 95 per cent of GDP by 2032. The IMF's definition of debt sustainability also requires cutting the government's annual foreign debt service in half – from 9.2 per cent of GDP in 2022 to an average of 4.5 per cent between 2027 and 2032 – and keeping overall borrowing costs (known as gross financing needs) below 13 per cent of GDP. See "EFF Agreement", op. cit. See also Theo Maret and Brad Setser, "Is the IMF setting Sri Lanka up for a second car crash?", *Financial Times*, 26 September 2023.

[62] For a useful chart using IMF figures, see Sharmini Coorey, "Economic policies in an election year: some inconvenient arithmetic: Part I", *Daily Mirror*, 29 February 2024.

[63] Of Sri Lanka's $37 billion in external debt, $14.7 billion is commercial debt (mostly in sovereign bonds, plus $2.2 billion in loans held by the China Development Bank) and $10.8 billion is owed to bilateral creditors. Of this last group, Chinese state banks own the most debt ($4.7 billion), followed by Japan ($2.7 billion) and India ($1.7 billion), while the remaining $1.8 billion is owed to the assorted Western governments that, with Japan, form the Paris Club of creditor nations. A third category of international creditors – multilateral development banks like the World Bank and IMF – are not part of debt restructuring, as Sri Lanka continues to repay their low-interest loans. "Quarterly Debt Bulletin", Sri Lanka Ministry of Finance, First Quarter 2024.

[64] The main reason for delay – from the signing of the staff-level agreement on 1 September 2022 until early March 2023 – appears to have been Chinese reluctance to provide debt relief assurances to meet the IMF debt sustainability framework. Western governments, along with India and Japan, had worried China could strike a separate deal with Sri Lanka, in which more attractive terms would be offered in exchange for greater political influence. China, in turn, has called for major changes in the international financial architecture, dominated by the U.S. and its allies, in order to give the Chinese and other emerging economies greater influence. Crisis Group interviews, economists and diplomats, Colombo and Washington, March and April 2023. See also "China left out of Sri Lanka debt talks amid angst over delays", Bloomberg, 13 April 2023.

[65] The main bilateral group invited China to join, but Beijing agreed to participate only as an observer, preferring to pursue separate, bilateral negotiations. "Sri Lanka's creditors hold 1st meeting, with China as observer", *Nikkei*, 10 May 2023.

[66] "IMF resumes Sri Lanka bailout after China's debt deal", Agence France-Presse, 12 December 2023. After reviewing China's still confidential offer and finding it within the parameters set by the IMF's debt sustainability analysis, Sri Lanka's Official Creditor Committee (the Paris Club and India) came to its own framework agreement with Colombo in late November. "Sri Lanka reaches agreement with India, Paris Club on debt treatment", *The Hindu*, 29 November 2023.

to be released, will reduce interest rates and extend the repayment terms by eight years, until 2043, which together will save Sri Lanka $5 billion in interest costs.[67]

Sri Lanka struggled harder to reach a deal to restructure its $12.5 billion in international sovereign bonds, but eventually reached a framework agreement with bondholders in late June.[68] The complex deal – which replaces existing loans with "macro-linked bonds" – offers varying degrees of relief on interest rates and principal depending on Sri Lanka's rate of GDP growth in 2025-2027, with payments to bondholders increasing if the economy grows faster than IMF estimates.[69] Until the IMF and bilateral creditors accept that the sovereign bond deal is compatible with the terms of their own restructuring agreement, none of the other deals can be finalised. The same rule applies to the sole restructuring agreement yet to be completed, that with the China Development Bank.[70]

As the government engaged in slow-moving talks with its various foreign creditors, it moved quickly to restructure domestic debt, triggering widespread charges of unfairness.[71] Controversy centred on the differential treatment given various categories of creditors. On one hand, the government chose not to restructure debt held by domestic banks or private bondholders. On the other hand, "superannuation" (public pension) funds – principally the Employee Provident Fund (EPF) and Employees' Trust Fund (ETF) – were forced to exchange their current bonds for new ones with reduced interest rates, or else pay twice the tax on the profits of their current bonds.[72] According to some calculations, which the Central Bank disputes, the losses incurred by the EPF and ETF could be enormous.[73] For trade unions, grassroots activists and opposition politicians, the burden imposed on EPF and ETF funds, which are mandatory-contribution retirement funds chiefly

[67] "Sri Lanka to save $5 billion after big debt rework, president says", Reuters, 2 July 2024; "Sri Lanka Reaches Final Debt Treatment Agreements with the Official Creditor Committee and Exim Bank of China", Sri Lanka Ministry of Finance, 28 June 2024.

[68] The government and bondholders held talks in March and April, but failed to reach agreement. "SL reveals outcomes of meetings with bondholders", *Daily FT*, 17 April 2024. Negotiations resumed in June, and a framework agreement was announced in early July.

[69] "Sri Lanka's International Sovereign Bond Restructuring", Sri Lanka Ministry of Finance, 4 July 2024.

[70] There is "zero transparency" about the talks to restructure the $2.2 billion owed on commercial loans from the China Development Bank. Crisis Group telephone interview, debt analyst, September 2024. Continued delay in these negotiations will prevent Colombo from finalising the bilateral and bond deals. See "Sri Lanka-China Economic Brief: Issue II", Arutha Research, August 2024.

[71] Approved by parliament after little debate on 1 July, the domestic debt restructuring plan responded in part to demands by international creditors that domestic owners of Sri Lankan bonds also accept losses. Crisis Group interviews, diplomats and economists, Colombo, January 2024. Some analysts have questioned the necessity of domestic debt restructuring, given that Sri Lanka's crisis was caused by the difficulties of servicing foreign debt. See C.P. Chandrasekhar, "Sri Lankan debt crisis to get worse if IMF prescription is heeded", *Frontline*, 13 July 2023.

[72] Critics point out that Sri Lanka is the only country whose domestic debt restructuring affected state pensions funds alone – and not banks or private bondholders, many of whom made large returns on the risky but high-yield bonds. "Exceptionalism of domestic debt restructuring in Sri Lanka", PublicFinance.lk, 8 August 2023; Nishan De Mel, "Let's shield the EPF with the instincts of Winston Churchill", *Daily Mirror*, 6 July 2023. For their part, government officials argue that insulating the banks from losses was essential to preserve the financial sector's stability, which benefits everyone, including pensioners. "Sri Lanka central bank chief defends DDR, disputes projected losses for EPF", *Economy Next*, 7 July 2023.

[73] "Sri Lanka central bank chief defends DDR, disputes projected losses for EPF", *Economy Next*, 7 July 2023.

held by low-income workers, shows that the government is placing the cost of economic reforms on working people and the poor while sparing the wealthy.[74]

Independent of questions of fairness, there is a strong case to be made that the debt relief Sri Lanka is due to receive through restructuring will be too modest and will leave the country at risk of further default. Even if all goes according to the IMF's plan, public debt will remain worryingly high, at 95 per cent of GDP in 2032.[75] With low interest rates, and assuming Sri Lanka overcomes its longstanding inability to raise enough revenue to cover its expenses, realistic forecasts suggest that interest payments would still absorb 30 to 50 per cent of state revenues, levels elsewhere seen as indicative of debt distress.[76] With a surge of major payments due in 2028, just after the IMF program ends, the structure of the proposed macro-linked bonds, which are set to replace existing bonds being restructured, heightens risks further.[77]

To escape its debt troubles more sustainably, Sri Lanka will almost certainly need more extensive relief. The IMF itself admits that "even after a successful program and debt restructuring, debt risks will remain high for many years" and mentions "deeper debt restructuring" as a possible "policy response".[78] While policymakers appear to be increasingly aware that Sri Lanka's debt relief will likely be inadequate, and that a second default is a real danger, public discussion of how the country might get additional relief remains limited.[79]

C. *Unfair Reforms?*

The Wickremesinghe government's initial policy changes – budget cuts and higher taxes, higher energy costs and interest rates – were bound to be unpopular, imposing adjustments before people could see any benefit of renewed economic growth. But

[74] Swasthika Arulingam, "Hands off EPF and pension funds", *Daily FT*, 10 July 2023; Nisha Arunatilake, "Sri Lanka's debt restructuring is hurting older women", Project Syndicate, 10 January 2024. Lawsuits challenging the differential treatment between banks and the two funds were dismissed. "SC dismisses another FR petition against Domestic Debt Restructuring", *Daily Mirror Online*, 11 August 2023.

[75] The average public debt-to-GDP ratio of emerging market economies (excluding China) in 2022 was 55.3 per cent. "Global Debt Monitor 2023", IMF, 2023.

[76] Critics have challenged the IMF's decision to apply its Market Access Debt Sustainability Framework when calculating how much relief Sri Lanka will need to achieve through restructuring, arguing that the model is designed for markets with broader access to capital. For a detailed analysis, see Brad W. Setser, "The IMF needs to focus on setting good targets for external debt sustainability", Council on Foreign Relations (blog), 22 February 2024. See also Maret and Setser, "Is the IMF setting Sri Lanka up for a second car crash?", op. cit.

[77] According to a prominent analyst, the "macro-linked bonds" that would replace existing bonds are structured so that "good performance over the next few years … creates more risk of trouble after 2028", when Sri Lanka's external debt service will already be rising even as its debt-to-GDP ratio will be near 100 per cent. Brad Setser, "Sri Lanka's bond deal should not set a precedent", Council on Foreign Relations (blog), 16 July 2024. A separate critique of the ISB restructuring argues it gives bondholders a much more generous deal than bilateral creditors. See "Sri Lanka's Unfair Debt Restructurings with Bondholders", Yukthi, Institute for Political Economy and Debt Justice, July 2024.

[78] Staff Report, EFF First Review, IMF, Annex III: Debt Sustainability Analysis: An Update; and Annex VIII: Risk Assessment Matrix.

[79] Worries among diplomats and government officials that debt relief will be inadequate remain private, as no one wishes to weaken public support for the IMF program further. Crisis Group interviews, diplomats and economists, Colombo, April 2024.

while some pain was inevitable even before the government turned to the IMF, the choices the government made about how to meet the Fund's fiscal and other targets have stirred widespread discontent. Many Sri Lankans perceive that the burden of higher taxes and higher energy costs has fallen disproportionately on those in the low- and middle-income brackets, a large number of whom were already reeling from the economic effects of COVID-19 lockdowns and growing levels of indebtedness.

Apart from the controversy over pension funds (see Section IV.B above), the income taxes that came into effect in early 2023 mainly affected government employees and the small portion of the middle class with regular paychecks from which taxes can be withheld at the source.[80] Efforts have since begun to broaden the payroll tax base, including by requiring all adults to register for a taxpayer number, but plans to introduce property, gift and inheritance taxes by the start of 2025 have been delayed and replaced by a controversial proposed rental income tax.[81] Meanwhile, the January increase in value-added tax hit poorer Sri Lankans, more of whose income is spent on food and other consumer essentials, the hardest.[82] As a senior economist and former official put it, "the rich in Sri Lanka are not used to paying taxes".[83] Even after these various hikes, tax still amounted to only 10 per cent of the country's GDP in 2023, though they did allow the government to achieve a small but coveted primary budget surplus, an essential element of the IMF-government plan for paying down the debt.[84]

Likewise, the sharp increase in electricity tariffs – jumping 75 per cent in August 2022 and another 66 per cent in January 2023 – affected low-income users disproportionately, while failing to address the well-documented inefficiencies and alleged corruption that plague the state-owned electric company, the Ceylon Electricity Board.[85] In 2023, over a million households – approximately one sixth of the population – lost connection to the grid due to non-payment of bills (pressures

[80] For a detailed critique of the payroll taxes, see Nishan de Mel, "2022 October taxes: A signal why suspending democracy will not save the economy", *The Morning*, 30 October 2022.

[81] The "imputed rental income tax" is described in detail in "Sri Lanka: Property Taxation at the National and Sub-national Level", IMF Technical Assistance Report, May 2024. The government blamed constitutional and technical obstacles for the delay in planned property, gift and inheritance taxes. "Government of Sri Lanka Letter of Intent", EFF Second Review, IMF, pp. 86-87. Pressed by the IMF, the government has also introduced a special unit in the revenue department focused on tax compliance by the wealthiest. "IRD gets tough with Lanka's richest 100", *The Sunday Times*, 17 March 2024.

[82] In response to the failure to meet the 2023 revenue targets in the IMF program, value-added tax was increased from 15 to 18 per cent and made applicable to many items that had previously been exempt. "Blow after blow: After VAT new excise tax on fuel, other items", *Sunday Times*, 31 December 2023.

[83] Crisis Group telephone interview, June 2023.

[84] Tax revenues jumped 54 per cent in 2023, reaching 9.8 per cent of GDP, while total revenues reached 11 per cent of GDP. The overall budget deficit fell from 10.2 to 8.3 as a percentage of GDP, resulting in a primary surplus of 0.6 per cent of GDP. "Sri Lanka budget deficit down in 2023, tax revenue up 54-pct", *Economy Next*, 27 April 2024. Tax revenue from January through August 2024 was a further 28.5 per cent higher than during the same period in 2023. "Major increase in income tax and other tax revenues", *Newswire*, 12 September 2024.

[85] See, for instance, "CEB, Corruption and Renewable Energy", Numbers.lk, 11 June 2022.

have since eased after rates were cut in early 2024).[86] While higher taxes and energy tariffs are needed to balance the state's budget, many resent paying taxes or higher electricity rates when they see no sign that the rich and politically connected are paying a bigger share or that the state is taking action to end large-scale fraud and corruption.[87]

Furthermore, Wickremesinghe's lack of transparency and often domineering ruling style has fuelled the sense that economic reforms are unfair. The refusal to make public the government's staff-level agreement with the IMF during the six months between when it was signed, on 1 September 2022, and when it was finally approved on 20 March 2023, fostered public perceptions that the program was being imposed undemocratically, as have the president's regular threats to impose his policies over the objections of striking teachers, bankers worried about domestic debt and bureaucrats allegedly working too slowly.[88]

That said, the government has taken steps to create a social safety net for those most affected by the IMF program. The anti-poverty program in place for decades – known as Samurdhi (Prosperity) – came in for much criticism due to the highly politicised nature of its cash transfers: many beneficiaries were chosen for their loyalty to whichever political party was in power, and many eligible recipients were denied benefits.[89] The new program, Aswesuma – which debuted in July 2023 – aimed to avoid these shortcomings through proper targeting.[90]

Aswesuma got off to a rocky start, however. Eligibility is determined through a complicated algorithm that few recipients understand and that critics say ignores claimants' debt levels and overvalues their assets.[91] "The uncertainty of who and how many will be included and with what benefits has created a lot of fear and even panic", said a researcher.[92] For those who do manage to get access to Aswesuma, the amounts they receive are in most cases far from adequate, while eligibility is limited to a maximum of three years.[93] The government did earmark more money for

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[86] "Millions chopped off national power grid over unbearable bills", *The Sunday Times*, 25 February 2024. In March, the company reduced electricity rates. "Electricity tariffs slashed by 21.9%", *The Morning*, 5 March 2024.

[87] Crisis Group interviews, business owners and market shoppers, Colombo and Vavuniya, March 2024. See also "Sri Lanka's First Taxpayer Perception Study", Ceylon Chamber of Commerce and UN Development Programme, 12 June 2024.

[88] Wickremesinghe's demand that opposition legislators "shut up and sit down" became a symbol of his confrontational approach. "Shut up and sit down: President tells MPs", *Daily Mirror Online*, 23 February 2023.

[89] Only 32 per cent of those eligible for Samurdhi benefits received them, while only 40 per cent of recipients were actually below the poverty line. Most recipients stayed in the program for many years, making it difficult for the newly poor to join. See "Social Safety Nets and the State of Poverty in Sri Lanka", op. cit.

[90] For the IMF's justification of the new program, see EFF Agreement, op. cit., Annex IV: Reforming the Social Safety Nets.

[91] Critics argue that "the process fails to measure the ability to ensure food security, meet basic nutritional needs and account for household debt". "Social Protection for Sri Lanka: A Progressive Gender Sensitive Response to the Crisis", Feminist Collective for Economic Justice, May 2023. The Welfare Benefits Board "has not publicised how the district level allocations were arrived at and families also do not know what their scores were". Perera, "Aswesuma: High exclusion, low transparency?", op. cit.

[92] Crisis Group telephone interview, August 2023.

[93] Amounts range from 2,500 rupees (approximately $8) a month for those families whose poverty is deemed temporary to 15,000 rupees ($50) a month for the worst-off.

Aswesuma in the 2024 budget, and the number of beneficiary families increased from 1.9 to 2.4 million for its second year.[94] This change helps the government achieve the IMF's target of spending 0.7 percent of GDP on social safety nets. But the program still falls far short of what is needed.[95]

D. *Fighting Corruption*

Corruption is widespread in Sri Lanka and "has been a major factor" in its economic collapse, according to a former top official.[96] In one of its few politically popular sections, the IMF agreement committed the government to addressing "corruption-related vulnerabilities", including by allowing IMF staff to conduct a Governance Diagnostic Assessment (GDA), the results of which it agreed to publish.

Released on 30 September 2023, the report offers a damning indictment of institutionalised corruption and the economic losses it entails. "Governance and corruption issues have imperilled national and social well-being", the 139-page report argues, with "impunity afforded top officials, even for ruinous behaviour".[97] Concrete recommendations focus on the need to enhance transparency of government financial operations, especially with regard to procurement contracts; establish more effective monitoring and accountability within state institutions; and make easily available the information needed for civil society and parliament to track the use of public funds.[98] Despite the popularity of these anti-corruption provisions, the government is widely seen as less than enthusiastic about adhering to them.

The government's main achievement to date in fighting corruption has been approval in August 2023 of the Anti-Corruption Act, which strengthened existing legislation and brought Sri Lankan law into line with the UN Convention against Corruption.[99] Activists and opposition politicians are generally pleased with the new law. In particular, they applaud how it increases the powers of Sri Lanka's

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[94] "Provision of Relief Benefits Set to Expand to 2.4 Million Family Units from June 2024", Presidential Media Division, 28 February 2024. The government has issued conflicting figures for how many have benefited from Aswesuma's initial phase. Crisis Group interview, Colombo, March 2024.

[95] Prior to the rise in poverty that began with the pandemic, Sri Lanka spent less than 0.4 per cent of GDP on social safety nets, much lower than many of its economic peers. A 2020 UNICEF study estimates that adequate welfare programs for the elderly, children and disabled would cost 1.42 per cent of GDP – a figure that has likely grown subsequently as poverty has risen. "Investing in the Future: A Universal Benefit for Sri Lanka's Children", UNICEF Working Paper, February 2020.

[96] Crisis Group telephone interview, retired senior civil servant, June 2023. Sri Lanka ranked 115 of 180 countries in Transparency International's 2023 Corruption Perceptions Index.

[97] The document lays out "systematic and severe governance weaknesses and corruption vulnerabilities across state functions", citing "the compromised independence of key governance institutions, critical gaps in the legal and regulatory infrastructure for managing and overseeing public resources, limited fiscal discipline and transparency, and a disorganised regulatory and legislative process that provides for insufficient review and engagement". The report also details the abuses of the discretionary powers ministers and other officials have to revise tax and customs policies, including frequent tax exemptions for politically connected businesses. See "Sri Lanka: Governance Diagnostic Assessment", op. cit.

[98] The IMF GDA was informed by an analysis by Sri Lankan organisations. See "Civil Society Governance Diagnostic Report: An Assessment of the Anti-Corruption Landscape of Sri Lanka", Civil Society Initiative on Anti-Corruption Reform for Economic Recovery, September 2023.

[99] The law was certified on 8 August and became effective on 15 September 2023.

longstanding anti-corruption commission, the Commission to Investigate Allegations of Bribery or Corruption (CIABOC), better protects its independence and budget from political interference, and makes it easier for the commission to cooperate with foreign investigative agencies and judiciaries.[100] In the words of one prominent activist, "provided there is proper political will, there is no reason for the newly empowered bribery commission to fail".[101]

More than a year after passage of the new law, however, the commission is struggling.[102] CIABOC has been slow to set up its new organisational structure and draft the internal procedures needed to function effectively, though a number of new measures were unveiled in July.[103] The bribery commission has also been hampered by the delayed, and then legally contested, appointment of its director general.[104] Large-scale redactions and missing information weakened the value of the long-awaited online release – also in July – of senior government officials' asset declarations.[105]

The bribery commission's sluggish restart results in part from a weak and divided Constitutional Council, a body established in 2001 to vet appointments of key officials and members of independent oversight commissions, including the head of the CIABOC and the attorney general. The council's own political independence

[100] Activist Rohan Samarajiva, for example, argues that the law makes a series of technical and procedural changes to CIABOC's powers that could considerably increase its effectiveness. See "Criticisms of Anti-Corruption Act: Ideological or lazy?", *Daily FT*, 3 September 2023.

[101] Crisis Group telephone interview, Sankhitha Gunaratne, Verité Research, April 2024.

[102] The IMF's delayed first six-month review of the program, made public in December 2023, found that the government had missed agreed deadlines for key reforms; in response, the IMF designated certain points in the plan as "structural benchmarks", meaning that Sri Lanka must meet them before future IMF reviews. At about the same time, a coalition of Sri Lankan NGOs criticised the government for being "slow and incomplete in operationalising … the expected anti-corruption activities including implementation of the new Anti-Corruption Act". "CSI calls for inclusion of IMF identified actions in programme", *Island*, 19 December 2023. Crisis Group telephone interview, anti-corruption activist, April 2024.

[103] See "Restructuring Details: Operationalising the Anti-Corruption Act No. 9 of 2023: A New Era for the CIABOC", CIABOC, 28 July 2024. The plan laid out a new organisational framework, with new job titles and salary scales designed to attract more skilled personnel, and seems to fulfil in part the requirement in the IMF's second review of the reform program, made public in June, which sets an October deadline for CIABOC to "publish a strategic plan … describing its mission, objectives, timebound actions for operations and a monitoring framework, together with submission of CIABOC's annual budget". Staff Report, EFF Second Review, IMF, p. 22. Anti-corruption activists have worried that CIABOC could miss the March 2025 statutory deadline to establish its internal procedures, which could undermine the legal validity of its actions. Crisis Group telephone interviews, April 2024.

[104] Activists have challenged the propriety and legality of the Constitutional Council's April decision, approved by the president, to reappoint the previous CIABOC director general, under whom numerous prosecutions either failed or were withdrawn due to "lack of evidence". The case is before the Supreme Court. The IMF governance diagnostic had called for the council to appoint a panel of experts to advise it on its appointments to CIABOC, but this recommendation was ignored. "Sri Lanka: Governance Diagnostic Assessment", op. cit., p. 24; "Who guards the guardians?", *Daily FT*, 28 May 2024.

[105] These apparently resulted from amendments that were added quietly to the draft law in the final stages of parliamentary debate. Crisis Group telephone interview, anti-corruption activist, August 2024. See also "Obscured info keeps real assets of politicians from public view", *The Sunday Times*, 11 August 2024.

is limited, given that it is composed mostly of senior parliamentarians.[106] Controversy over the council's choice of a new head of police early in 2024 has highlighted concerns that this crucial cog in the system of state appointments is malleable under political pressure.[107]

Besides the Anti-Corruption Act, the government has also committed to an ambitious agenda of other new anti-corruption legislation and policy changes – many of them laid out in an Action Plan requested by the IMF.[108] Perhaps the most important of these is the Proceeds of Crime Act, designed to establish a system for asset recovery in line with UN-established norms. Originally due in April, its enactment is now promised for November, "to accommodate needed public consultation and technical work"; experts have already pointed to alleged flaws in the new law and in other related reforms.[109]

Meanwhile, the Wickremesinghe administration appears to have little enthusiasm for investigating or holding anyone to account for the corruption that is widely believed to persist at all levels of government.[110] The serious allegations include accusations of malfeasance implicating sitting ministers and senior government legislators, in some cases dating back to when they served under either Mahinda or Gotabaya Rajapaksa.[111] Critics point to a number of recent or current high-profile examples as evidence of the Wickremesinghe administration's tolerance of, or complicity in, large-scale corruption.[112] The arrest and indictment of a former

[106] Originally, seven of the ten members of the Constitutional Council were drawn from civil society. Subsequent constitutional amendments have weakened, and then partially strengthened, the council, but at present only three of ten positions are reserved for non-parliamentarians.

[107] In February, under pressure from Wickremesinghe, and through a process later challenged in court, the Constitutional Council approved his nomination of Deshabandu Tennakoon as inspector general of police. His appointment followed a Supreme Court judgement the previous December that found Tennakoon responsible for torture. A temporary injunction issued by the Supreme Court in July barred Tennakoon from serving as police chief, but the government and president initially refused to comply with the ruling. "Opposition, lawyers slam Ranil Wickremesinghe for defying Supreme Court order", *The Hindu*, 29 July 2024.

[108] Published at the end of 2023, the Action Plan promises a range of new laws and regulations that align with the IMF's sixteen priority recommendations regarding corruption.

[109] "Government of Sri Lanka Letter of Intent", EFF Second Review, IMF, p. 103. For criticisms of the draft law, see Sankhitha Gunaratne, "Stolen Assets Recovery Framework: There is much room for improvement", *Daily Mirror*, 16 May 2024. Anti-money laundering experts have also voiced concern about proposed amendments to the Companies Act rules on beneficial ownership, intended to complement the forthcoming assets recovery law. The amendments are designed to comply with Financial Action Task Force standards, but experts have spotted loopholes not in line with this guidance. Crisis Group correspondence, financial expert, August 2024. See also "Letter of Intent", op. cit., p. 105.

[110] According to a veteran journalist, "Corruption is worse than it's ever been". Crisis Group interview, April 2024.

[111] See "The Pandora cabinet", *Daily FT*, 7 November 2023. Despite being sentenced to a five-year suspended prison term, after being found guilty of threatening a businessman as part of a land dispute, Prasanna Ranatunga remains sports minister. "Prasanna Ranatunga sentenced to 2-year RI, suspended for five years", *NewsFirst*, 6 June 2022. Little progress appears to have been made in reopening indictments of senior officials that were withdrawn, often "for technical reasons", by the attorney general and CIABOC during Gotabaya Rajapaksa's brief time in office. See "Discontinued Corruption Cases", Transparency International Sri Lanka, 8 December 2021.

[112] Recent cases include the "sugar scam" and alleged manipulation of import taxes, controversy over an unsolicited and expensive contract for a new electronic visa system, and allegedly inflated

health minister, Keheliya Rambukwella, is a rare example of a high-level prosecution, which followed months of public outrage at his alleged involvement in the fraudulent purchase of ineffective – and deadly – drugs.[113] In the words of a Western diplomat, "The government is largely going through the motions when it comes to corruption".[114]

prices for a large-scale wind power project. See "Second sugar scam after questionable sugar tax hike", *The Sunday Times*, 5 November 2023; "Lack of transparency and loss to country: Visa outsourcing under CoPF fire", *The Sunday Times*, 21 July 2024; and "TISL raises concerns over Adani's Sri Lanka power deal; demands transparency", *Economy Next*, 5 June 2024.

[113] Wickremesinghe's initial response to weeks of public outrage was to shift Rambukwella from the health to the environment ministry in October 2023. Rambukwella denies any wrongdoing. "Sri Lankan Cabinet minister resigns after being arrested in a counterfeit drugs scandal", Associated Press, 6 February 2024.

[114] Crisis Group interview, Colombo, April 2024.

V. An Electoral Shift?

The Election Commission's August announcement that the presidential election would be held on 21 September ended months of fevered speculation that the president might attempt legal manoeuvres to postpone the vote.[115] The election will in large part be a referendum on how Wickremesinghe's government has handled the economic crisis and ensuing modest recovery; it will also, in a more limited way, indicate the degree to which the *aragalaya* protest movement's demand for "system change" still resonates with Sri Lankans. Concern among international partners that the campaign and its possible outcomes could complicate implementation of the IMF reform program is high, with one senior Fund official in Sri Lanka warning that any shift in government policy would have to be "realistic and achievable within the timeframe of the program" since the country was on a "knife-edged path" to recovery.[116] Despite these worries, the polls also offer the chance for important adjustments and the prospect of winning greater popular support for a more inclusive, equitable reform program.[117]

Opinion polls indicate widespread dissatisfaction with the economy and suggest that, despite recent gains, Wickremesinghe remains the underdog, running behind his two main rivals, opposition leader Sajith Premadasa, who heads the Samagi Jana Balawegaya (SJB) and Anura Kumara Dissanayake, leader of the leftist Janatha Vimukthi Peramuna (JVP) and its National People's Power (NPP) alliance.[118] With the political landscape more fluid and unpredictable than ever, what looks to be the country's first-ever three-way race could well be very close, particularly given the uncertainties surrounding preference votes.[119]

Presenting himself as a non-partisan candidate and promising to complete his work of economic recovery by continuing with IMF-backed reforms, Wickremesinghe is running as an independent backed by a range of parties and individual

[115] Crisis Group telephone interviews, August 2024. "To confuse or not to confuse: Govt. and opposition battle it out over bill regarding president's term", *The Sunday Times*, 21 July 2024. The constitution requires that a presidential election be held between 17 September and 16 October. Parliament's five-year term ends in August 2025, but most observers expect the presidential election winner to use his powers quickly to dissolve parliament and call elections. Following the Supreme Court's order of 22 August, local government elections must also be held as soon as practically possible; provincial council elections, overdue by years, could also come soon.

[116] "Press Briefing of the Second Review of Sri Lanka's IMF Support Program", IMF, 21 March 2024.

[117] See "Get policies right before elections: World Bank", *Sunday Times*, 7 April 2024.

[118] The Institute of Health Policy's widely cited monthly Sri Lanka Opinion Tracker Survey has been the only regular gauge of electoral opinion nationwide, but its reliability is untested. In a separate survey taken in July, it found 72 per cent of Sri Lankans believe the country is "heading in the wrong direction", while only 8 per cent believe it is on the right track. "Majority of Sri Lankans continue to believe country is moving in the wrong direction", Institute of Health Policy, 12 August 2024. A July poll by a different organisation revealed a somewhat more positive picture, with 28 per cent of Sri Lankans rating the economy as good or excellent, and 24 per cent approving of the government's performance. Both ratings, while low, were up sharply from the previous poll five months earlier. "Mood of the Nation", Verité Research, 14 July 2024.

[119] Sri Lanka's constitution requires a winning presidential candidate to have more than 50 per cent of the vote on the first count. When that threshold is not met, an "instant run-off" is held, wherein the second or third preferences of voters whose first choice was defeated are added to the totals of the two leading candidates. Sri Lanka Constitution, Article 94. In past elections, few voters marked their second or third preferences, and many are unclear about how the system works. "Major political alliances won't cooperate with EC's initiative", *Island*, 17 August 2024.

politicians.[120] Having planned on the SLPP's formal backing, his campaign suffered a setback when the party decided to put forward its own candidate, Namal Rajapaksa, son of former president Mahinda Rajapaksa. While the large majority of SLPP legislators, many of them government ministers, are backing Wickremesinghe, his campaign will lack support from the SLPP's formidable party machine, probably lessening his already modest chances of victory.[121]

Opinion polls in the months immediately prior to the vote have shown the SJB's Premadasa in or near the lead, in a close race with the NPP's Dissanayake.[122] As the largest parliamentary opposition party, with a number of veteran legislators who have extensive economic knowledge and government experience, the SJB may be well placed to devise more inclusive policies under the terms of the IMF deal. The party announced its intention to revise the agreement, but SJB members have also made clear that they would respect much of the existing deal.[123] Premadasa has regularly declared his support for a "social democracy" that aims at "reducing inequalities", and senior SJB legislators have stressed the importance of developing a more equitable tax system.[124] To date, however, the party has struggled to articulate a clear vision or a convincing platform and has suffered from internal divisions. Having served as ministers under Wickremesinghe when he was prime minister from 2015 to 2019, Premadasa and other SJB leaders also have trouble distinguishing themselves as a credible alternative force.[125]

The NPP's Dissanayake, who has led in polls for much of 2023 and 2024, promises a more radical break from current policies and ways of doing politics. Organising intensively across the country since the end of the protest movement, Dissanayake and the NPP aim to channel popular anger at economic hardship and lack of action on corruption. They are positioning themselves as the inheritors of the *aragalaya*'s project of "system change" and the only real alternative to the establishment parties that have ruled Sri Lanka since independence, given that the JVP, which dominates the alliance, has only been in government once – and then

[120] "34 political parties back Ranil Wickremesinghe in presidential bid", *Hiru*, 16 August 2024.
[121] Crisis Group telephone interviews, journalists and political analysts, August 2024. While Namal is seen as having no chance of victory, reports suggest the Rajapaksa family feared backing Wickremesinghe as he could threaten its control of the party, already weakened as key SLPP ministers moved closer to the president during their two-year collaboration. See Pradeep Peiris, "2024 Presidential Election: Two-Cornered, Three-Way Fight", Polity.lk, 19 August 2024.
[122] "AK Dissanayake and Sajith Premadasa led in August voting intent amongst all adults, but continuing shift towards President Ranil Wickremesinghe", Institute for Health Policy, 11 September 2024.
[123] Crisis Group interview, Eran Wickramaratne, Colombo, April 2024. Following a meeting with IMF officials, the SJB announced it was "in agreement with the IMF's roadmap for Sri Lanka's economic recovery" but that "certain clauses require amendment". "SJB raises concerns during meeting with IMF delegation", *Newswire*, 21 March 2024. The SJB began as a UNP vehicle for Premadasa's failed 2019 presidential bid, but formally split from the UNP in 2020.
[124] "Sajith issues clarion call against 'classists, communists and extremists'", *Daily FT*, 16 April 2024. Premadasa often speaks of the legacy of his father, Ranasinghe Premadasa, who was president from 1989-1993 and undertook a number of high-profile initiatives to reduce poverty.
[125] The SJB's electoral alliance with former Rajapaksa allies in support of Premadasa's candidacy has cast doubt over its claim to be committed to combating corruption and undertaking other governance reforms. "Thalatha resigns alleging Sajith accepted corrupt crossovers", *Island*, 22 August 2024.

only briefly.[126] Many appear willing to give the NPP a chance to solve the country's problems.[127]

On economic issues, the NPP has made a major effort to moderate its image and adjust some of the JVP's more leftist policies, even as the JVP remains the driving force behind the coalition.[128] From its initial rejection of any role for the IMF, it now agrees that the Fund should play an essential role in economic recovery, but promises to renegotiate the bailout agreement so as to make it more equitable.[129] Despite its longstanding opposition to privatisation of state-owned companies, the party now also accepts that some sell-offs are acceptable, so long as strategic industries remain under state control. It will, however, almost certainly be opposed to many of the long-term "structural reforms" – to land, agriculture and labour laws – that the IMF believes are essential to increasing productivity and growth. More broadly, the JVP's socialist rhetoric, violent revolutionary past and limited government experience, alongside the absence of a detailed policy platform from the NPP, have raised concerns among many middle-class and wealthy voters, as well as Sri Lanka's international economic partners.[130]

Given the deep mistrust between many in Sri Lanka's elite and the JVP, and the longstanding bitterness between the JVP and Wickremesinghe, some observers worry that a close race in which the JVP/NPP's Dissanayake appears to have a real chance of winning could bring with it risks of violence. Either his victory or his narrow defeat could raise tensions. The fact that the system of preference votes could see the election produce, for the first time ever, a president who has not won a majority of votes, adds further potential for volatility.[131]

VI. Conclusion

Two years on from economic and political meltdown, Sri Lanka's crisis is far from resolved. Despite improved macro-economic indicators and the disappearance of

[126] The JVP had four ministers in President Chandrika Kumaratunga's cabinet in 2004-2005. The NPP, formed in 2019, brings civic organisations, unions and intellectuals together with the JVP, which is widely seen as the dominant force in the alliance. Crisis Group interviews, political analysts, Colombo, April 2024.

[127] "Look at how the other parties have destroyed the country", a trishaw driver in Colombo said. "We have no option but to vote for the NPP". Crisis Group interview, Colombo, April 2024.

[128] The NPP has also made a major push to engage foreign, especially Western, governments and move away from the JVP's traditional anti-imperialist nationalism. Most notable was Dissanayake's five-day official visit to India in March, during and after which the NPP expressed greater openness to investment from Indian firms and integration with the Indian market. "AKD: JVP-led NPP will not undermine India's national security", *Island*, 17 February 2024.

[129] Crisis Group interview, Prof. Anil Jayantha, NPP Economic Council member, Colombo, March 2024. Senior JVP member Sunil Handunnetti reportedly stated that "the party [is] not opposed to dealing with the IMF but would call for drastic changes in keeping with national responsibility". "JVP wants to deal with IMF in the future despite differences", *Sunday Times*, 21 January 2024.

[130] Crisis Group interviews, Colombo, March 2024.

[131] Crisis Group telephone interviews, rights activists and election observers, August 2024. There is also reason to worry about post-election instability should voters' expectations of a quick economic turnaround under an SJB or NPP administration be disappointed. Crisis Group interviews, diplomats, political activists and journalists, Colombo, April 2024.

most signs of turmoil, hardship remains acute and widespread. Amid an uncertain economic outlook, political volatility is high; it could rise still further as the country approaches a presidential election and embarks on a series of other polls, including parliamentary elections some time before August 2025.

Many of Sri Lanka's international development partners placed a bet on Wickremesinghe's ability to bring stability through top-down fiat. But pushing through a painful set of economic policies without the democratic backing gained through elections, while also paying little heed to demands for greater equity in budget cuts, tax rises and tariff hikes, or for more boldness in fighting corruption or reforming governance, has stirred a public backlash. Opinion polls and initial campaigning suggest the 21 September presidential election will be close. For the first time ever, it could produce a winner who fails to gain a majority of votes. Either a victory or a narrow defeat of the leftist NPP's candidate could stoke tensions. Should either the NPP's Dissanayake or the SJB's Premadasa win, the government will likely face high expectations of a respite from austerity that will be hard to meet within the current terms of the IMF bailout. The Sri Lankan economy may for now have been put back on its feet, but many citizens have yet to be convinced that the price has been worth paying.

September 2024

Appendix A: Map of Sri Lanka