

## Alternative External Debt Restructuring Strategy Framework

# Aligning with Sri Lanka's Foreign Currency Earnings and Capacity to Pay



**IPE**

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**Charith Gunawardena**

Co-founder, Institute of Political Economy

With kind assistance from

**Jayati Ghosh**

Professor of Economics, University of Massachusetts-Amherst, USA

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# TABLE OF CONTENT

GLOSSARY OF TERMS	4
EXECUTIVE SUMMARY	5
1. BACKGROUND	6
2. VISION	7
3. MISSION	7
4. OBJECTIVES	7
5. CURRENT CHALLENGES	8
6. GLOBAL CONTEXT	9
7. EXTERNAL DEBT OVERVIEW	10
8. EXTERNAL DEBT VOLUMES	12
9. EXTERNAL DEBT SERVICING AND RESTRUCTURING STATUS	13
10. EXTERNAL DEBT RENEGOTIATION STRATEGY	14
11. FOREIGN CURRENCY EARNINGS AND CAPACITY TO PAY	15
12. PEST ANALYSIS	18
13. SWOT ANALYSIS	19
14. CRITICAL SUCCESS FACTORS	20
15. STRATEGIC OPTIONS AND CHOSEN STRATEGY	21
16. RISK ASSESSMENT AND MITIGATION	22
17. MONITORING AND REVIEW	23
18. DATE TIMELINE AND KEY MILESTONES	23
19. CONCLUSIONS	24
REFERENCES	25

# GLOSSARY OF TERMS

## **Government of Sri Lanka (GoSL)**

Sri Lanka is a free, independent and sovereign nation with a population of 22 million. Legislative power is exercised by a Parliament, elected by universal franchise on proportional representation basis. A President, who is also elected by the people, exercises executive power including defence and finance. Sri Lanka enjoys a multi-party system, with parliamentary elections every six years.

## **International Monetary Fund (IMF)**

A major financial agency of the United Nations, and an international financial institution funded by 190 member countries, with headquarters in Washington, D.C. It is regarded as the global lender of last resort to national governments, and a leading supporter of exchange-rate stability.

## **International Sovereign Bonds (ISBs)**

Foreign currency denominated sovereign bonds issued by a government to foreign investors and typically listed in a major bond trading centre like New York, London and Singapore. ISBs are issued under foreign law, usually English or New York law.

## **Debt Sustainability Analysis (DSA)**

A formal framework for conducting an analysis of a country's capacity to finance its policy objectives and service the ensuing debt as tool to better detect, prevent, and resolve potential crises.

# EXECUTIVE SUMMARY

Sri Lanka's current debt restructuring framework falls short of delivering a meaningful reduction in the country's debt burden, heightening the risk of a second default. The current bi-lateral and private bondholder debt restructuring agreements do not provide a viable, long-term solution aligned with Sri Lanka's development goals or the 2030 United Nations Sustainable Development Goals (SDGs).

There is an urgent need to reframe the country's debt strategy around transparency, equity, and sustainability, **grounded in Sri Lanka's actual capacity to repay.**

## Key Points:

- **Risk of New Default:** The current restructuring deal offers limited relief, threatening long-term solvency and risking another default by 2028.
- **Unsustainable Framework:** The IMF-backed programme lacks alignment with SDGs and fails to address core structural issues.
- **Renegotiation Required:** A revised deal is essential to avoid an economic slump and the prevent reduction of social wellbeing.
- **Independent Debt Assessment:** An external debt sustainability analysis must be commissioned to underpin a credible and just renegotiation.
- **Transparency and Accountability:** A full audit of external borrowings is necessary to expose illegitimate or unproductive loans and improve Sri Lanka's negotiating position.
- **People-Centred Approach:** Citizens' wellbeing must guide all restructuring decisions, not creditor demands.

## Strategic Recommendations:

- **Foreign Exchange-Based Targeting:** Link debt repayments to a fixed share of current foreign exchange earnings, rather than GDP, to reflect real capacity to pay.
- **Set Realistic Repayment Benchmarks:** Cap total debt servicing (interest + principal) at a sustainable level—e.g., no more than 5% of current foreign exchange earnings.
- **Avoid Costly Global Borrowing:** Reduce and eventually eliminate reliance on volatile and high-interest global financial markets from 2028.
- **Protect Economic Sovereignty:** Resist IMF performance monitoring of domestic fiscal and monetary policy.
- **Join the Global South Debtors' Coalition:** Collaborate with like-minded nations to pursue collective negotiation strategies and advocate for structural reform of the global financial system.

# 1. BACKGROUND

**Sri Lanka's external debt crisis, which led to its first-ever sovereign default in April 2022, is a culmination of decades of fiscal mismanagement, unsustainable borrowing, external shocks and an unfair global financial and economic system. The country's debt-to-GDP and debt-to-foreign-exchange-earning ratios surged, while foreign exchange (FX) reserves plummeted, and are insufficient to cover essential imports.**

The crisis triggered severe socio-economic consequences:

- Hyperinflation (peaking at ~70% in 2022).
- Sharp currency depreciation (LKR losing ~80% value against the US dollar since 2019).
- Collapse in public services, with healthcare and education funding slashed.
- Mass protests (2022 Aragalaya movement) demanding systemic reforms
- Resignation of the President of the nation, and establishment of an interim government
- IMF invited by the then government to assist with the external debt restructuring.
- The interim government passed a number of acts through parliament to facilitate the restructuring process

The Public Debt Management Act No. 33 of 2024 (PDMA) sets out the framework for effective public debt management in Sri Lanka.<sup>1</sup> The PDMA requires the formulation and implementation of a Medium-Term Debt Strategy (MTDS).<sup>2</sup>

The MTDS is driven by the targets set by an IMF Debt Sustainability Analysis.<sup>3</sup> The inadequate emphasis of the IMF-DSA on Sri Lanka's **foreign currency earnings and its capacity for external debt servicing**, prioritises the financial interests of external and internal creditors over the well-being of people.

This Alternative External Debt Restructuring Framework provides a rights-based, sovereign, and sustainable structure for resolving Sri Lanka's external debt crisis, ensuring that future economic policies prioritise human development, transparency, and self-reliance over creditor-imposed austerity.

## 2. VISION

A sovereign and self-reliant Sri Lanka, free from perpetual external debt dependency, with an economy that prioritises equitable growth, social justice, and environmental sustainability.

## 3. MISSION

To achieve a fair, transparent, and legally grounded resolution to Sri Lanka's external debt crisis by:

- Prioritising people's needs and fulfilling the mandate given by voters.
- Challenging illegitimate and odious debt.
- Renegotiating unsustainable external debt repayment terms.
- Building a diversified foreign exchange earning economy to fulfil debt obligations.
- Ensuring that conditionalities in IMF agreements respect human rights.

## 4. OBJECTIVES

- **Prevent Future Defaults**  
Introduce fiscal responsibility laws, external debt servicing ceilings, and enforce stronger parliamentary oversight.
- **Protect Domestic Sovereignty**  
Resist IMF interference in domestic fiscal and monetary policy to maintain control over the rupee economy.
- **Audit All External Debt**  
Conduct an independent forensic audit of all external loans—especially high-risk instruments including International Sovereign Bonds.
- **Renegotiate Debt Terms**  
Push for deeper debt restructuring, including principal haircuts, lower interest rates, grace periods, and maturity extensions.
- **Boost Dollar Earnings**  
Diversify exports, reform remittance systems, revive tourism, and attract sustainable foreign direct investment.
- **Link Debt Payments to Foreign Currency Earnings**  
Commit only a fixed percentage of foreign exchange earnings to debt servicing, aligned with repayment capacity.
- **Prioritise Human Development**  
Tie debt agreements to measurable progress in poverty reduction, public health, and education outcomes.

## 5. CURRENT CHALLENGES

Sri Lanka's path to a fair and lasting solution to its external debt crisis is obstructed by structural, political, and systemic barriers—both domestic and international:

- **Legacy Debt Burdens**  
Past unsustainable borrowing, especially through high-risk sovereign bonds, has left the country with complex and opaque debt obligations.
- **Flawed IMF Framework**  
The IMF's debt sustainability analysis (DSA) imposes unrealistic targets for growth, fiscal consolidation, and debt reduction—while showing reluctance to revise assumptions that do not reflect Sri Lanka's economic realities and changing global conditions. (See Appendix)
- **Misaligned Debt Servicing Targets**  
Debt repayments are pegged to GDP rather than foreign currency earnings, ignoring Sri Lanka's actual repayment capacity in dollars.
- **IMF Overreach in Rupee Economy**  
Excessive IMF involvement in domestic fiscal and monetary policymaking compromises economic sovereignty over a largely rupee-based economy.
- **Absence of a Dollar Revenue Strategy**  
There is an inadequate plan to sustainably increase foreign exchange earnings or to project best- and worst-case foreign currency needs for reserves, imports, development and debt servicing.
- **Weak Creditor Engagement**  
A lack of trust-building and strategic engagement with bilateral and multilateral creditors hampers effective negotiation outcomes.
- **Global Power Asymmetries**  
The refusal by the EU and U.S. to move debt governance to the United Nations undermines multilateral reform efforts. The rejection of the UN Tax Convention's Terms of Reference further entrenches Global North dominance.
- **Geopolitical and Trade Shocks**  
External shocks, including the risk of Trump-era tariffs and the breakdown of the 'rules-based' global trade system, threaten export earnings and macroeconomic stability.
- **Control of IMF/WB** Effective veto power of US plus dominating vote share of US and Europe.
- **Currency hierarchies and capital flows** Sri Lanka suffers because of economic policies of North, without any control over these.
- **Tension Between Stability and Sovereignty**  
The need to maintain economic stability is often in conflict with the political imperative to assert national sovereignty and advance inclusive development.

## 6. GLOBAL CONTEXT

The cascading crises of recent years—the pandemic, the war in Ukraine, the climate emergency, the global cost-of-living crisis, volatile cross-border financial flows and rising geopolitical tensions—have deepened an already unsustainable situation for many developing countries. This has been compounded by the most aggressive monetary tightening in advanced economies since the 1970s.

In 2015, the IMF identified 16 countries eligible for the Poverty Reduction and Growth Trust as being in, or at high risk of, debt distress. By 2024, in the aftermath of the pandemic and the war in Ukraine, this number had more than doubled to 35.

These debt and development crises are rooted in the structural inequities of the international monetary and financial system.

A fragmented multilateral trading system, asymmetrical trade benefits, speculative volatility in commodity markets, and developing countries' subordinate roles in global value chains undermine their ability to generate sufficient export earnings to service external debt.

Moreover, the impact of the global financial system is uneven across developing countries, depending on their varying levels of integration and exposure—further reinforcing disparities in vulnerability and resilience.

### Global Economic System

- **Entrenched Resistance from the Global North:** The structures that govern globalisation, international trade, and finance have been designed to reflect and preserve the commercial and financial interests of large capital in the Global North. This has created systemic barriers to meaningful reform.
- **Undemocratic Multilateral Institutions:** Institutions such as the World Bank, International Monetary Fund, and World Trade Organisation, along with regional lenders like the Asian Development Bank, continue to shape the development pathways of Global South countries, including Sri Lanka, typically without adequate representation or voice for these nations and their citizens.
- **Persistent Calls for Reform:** Despite growing demands from Global South governments, regional blocs, and civil society organisations, efforts to democratise the global financial architecture have seen limited progress. Structural reforms remain urgent to ensure equity, sovereignty, and sustainability in international economic governance.

## 7. EXTERNAL DEBT OVERVIEW

**External debt refers to money a country owes to foreign creditors—governments, multilateral institutions, and private lenders. It is typically denominated in foreign currencies (e.g. US dollars). Excessive external debt burdens can lead to crises and austerity resulting in cuts to vital services like health and education. Many developing nations face unsustainable debt due to inadequate debt reduction, economic mismanagement, and external shocks such as recessions or commodity price volatility.**

The global debt architecture is shaped by systemic imbalances, reckless lending, and irresponsible borrowing. These factors entrench dependency and recurring crises in the Global South. Structural reforms—such as debt cancellation, fair restructuring frameworks, and equitable governance—are essential for long-term justice.

- **Government Public Debt**

- **Domestic Debt** (rupee-denominated): This refers to borrowing by the Treasury from local sources, primarily through the issuance of Treasury bills and bonds. While it can be a useful financing tool, excessive reliance may lead to inflation if the resulting increase in the money supply surpasses the economy's productive capacity.
- **External Debt** (37.5% of debt dollar-denominated, Dec 2024): Borrowed from foreign entities, it is vulnerable to exchange rate shocks, increasing repayment costs during currency depreciation.

- **Types of External Lenders**

- **Multilateral Lenders** (e.g., IMF, World Bank): Offer concessional loans but impose strict conditions like fiscal austerity or privatisation
- **Bilateral Lenders** (e.g., China, India, Paris-club): Provide government-to-government loans, often tied to geopolitical or commercial interests.
- **Private Creditors**: Profit-motivated commercial banks, bondholders, and hedge funds lend at higher rates, posing high risks of default and volatility.

- **Irresponsible Borrowing**

- Governments often borrow beyond their means, misusing funds for corruption, patronage, or unproductive projects. Such practices deepen debt without delivering public benefit, enabled by poor transparency and weak governance.

- **Odious Debts**

- Odious debt arises when authoritarian or corrupt regimes borrow without public benefit or consent.<sup>4</sup> Lenders complicit in such arrangements knowingly enable misuse. Activists argue these debts should be cancelled, as repayment punishes the public for elite misconduct.<sup>5</sup>

- **Restructuring Process**

Among the first steps a country needs to undertake when considering a debt restructuring is to verify its total debt claims, which means understanding the characteristics of the government's outstanding loans, bonds, and other debt instruments, including their legal and financial features.<sup>6</sup>

- The face and market values of bonds or loans;
- The amortisation schedule (a single lump sum payment of the entire principal at the end of the loan term, or regular payments that gradually pay down both the principal and interest over the loan term);
- Interest rate and coupons (fixed rates remain constant for the loan's term, while variable rates fluctuate based on market conditions);
- Currency (local or foreign) of denomination of the instruments.

- Enhancements, including embedded options or collateral
- Legal clauses, including collective action clauses and non-default clauses, and the ability to include exit consents.<sup>7</sup>

- **Global Debt Governance**

- Debt governance is dominated by wealthy nations and creditor-friendly institutions:
  - Restructuring processes favour creditors, imposing austerity on debtors.<sup>8</sup>
  - Debtor nations lack meaningful representation in forums like the IMF or World Economic Forum.
  - Power imbalances allow creditors to enforce harsh terms, limiting debtor sovereignty.
  - Sri Lanka's International Sovereign Bonds are governed by New York Law.<sup>9</sup>

- **Global South Debt Crises**

- Many developing countries face repeated debt distress due to:
  - Historical exploitation and unfair trade systems.
  - IMF-led structural adjustments that undermine public services.
  - Climate shocks, pandemics, and inflation—all exacerbating debt. Countries like Argentina, Ghana, Sri Lanka, and Pakistan now face defaults and rising public hardship.<sup>10</sup>

## 8. EXTERNAL DEBT VOLUMES

Sri Lanka's total external debts totalled US\$ 36 billion in December 2024 <sup>11</sup>

### Multilateral Debt

- ~\$10.5 billion
- ~28% of total external
- **Loans from International Financial Institutions.**
  - International Monetary Fund (IMF): ~\$3 billion (Extended Fund Facility, 2023).
  - World Bank (WB): ~\$4.5 billion
  - Asian Development Bank (ADB): ~\$3 billion
  - Other multi-laterals (AIIB, etc.): ~\$1 billion
  - *Sri Lanka as a Market-Access-Country does not qualify for concessionary loans which are only available to Low-Income-Countries.*

### Bilateral Debt

- ~\$11.5 billion
- ~31% of total external
- **Loans from Foreign Governments.**
  - Paris Club Creditors (~\$3.5 billion)
    - *Japan (~\$2.5 billion)*
    - *France, Germany, UK, and others (~\$1 billion)*
  - Non-Paris Club Creditors (~\$8 billion)
    - *China (~\$7 billion) – Includes loans from China EXIM Bank, China Development Bank, and syndicated loans.*
    - *India (~\$1 billion) – Provided through currency swaps and credit lines.*
    - *Other bilateral (Pakistan, Saudi Arabia, etc.) – Minor exposures.*

### Private Creditors

- ~\$15 billion
- ~41% of total external
- **Loans from Private Sector**
  - International Sovereign Bonds (~\$12.8 billion)
    - *Held by Ad-Hoc Bondholder Group (BlackRock, Amundi, Ashmore etc.)<sup>12</sup>*
    - *2025, 2026, 2027, 2028, 2030 maturities – High interest rates (6%-8%)*
    - *Sri Lanka defaulted on ISB payments in 2022*
  - Foreign & Local Commercial Debt (~\$2.2 billion)
    - Foreign banks (HSBC, Standard Chartered, etc.)
    - Local banks holding USD-denominated Sri Lankan debt.

## 9. EXTERNAL DEBT SERVICING AND RESTRUCTURING STATUS

Restructuring deals with multilateral, bilateral, and private creditors are critical for economic recovery. The IMF program provides a short-term lifeline, but long-term stability depends on foreign exchange revenue growth and sustainable debt restructuring solution. The current agreements do not provide that.<sup>13</sup>

### Multi-lateral Loans:

- No agreement to restructure multi-lateral loans. No reduction of the principal has been offered by multilateral institutions.
- USD 2.5 billion debt in 2022 and USD 2.6 billion debt in 2023 had been repaid to multi-laterals such as the International Monetary Fund (IMF), World Bank and the Asian Development Bank despite the default.
- Burdensome IMF surcharge has been added as additional interest fee on top of the standard interest rates for a large borrowing.

### Bilateral Restructuring:

- Sri Lanka has reached final agreements with the 17 members of the Official Creditor Committee (the OCC - co-chaired by Japan, India, and France) and China's Export-Import Bank (EXIM) to restructure the relevant debt
- Debt relief was provided through maturity extensions, capital grace periods, and interest rate reductions.
- No reduction in the principal debt stock has been offered during bilateral negotiations.

### Private Credit Restructuring<sup>2</sup>:

- Upfront debt stock reduction of USD 3.7 bn which can increase to USD 4.9 bn in case of economic downturn or reduce to USD 2.6 bn with over performance
- USD 9.6 billion debt service payments reduction during the 4-year IMF program period
- 33% reduction in the coupon rate of Sri Lanka's Bonds to 4.4%
- Extension of the average maturity profile of around 5 years
- Private bondholder resistance to steep cuts means that Sri Lanka's external debt crisis remains unresolved.

# 10. EXTERNAL DEBT RENEGOTIATION STRATEGY

Renewed debt restructuring negotiations between the IMF and Sri Lanka's newly elected government are essential to securing a truly sustainable and fair resolution to the country's debt crisis. The government preparations should include:

- **Focus:** Debt justice, transparency, sovereignty, sustainability, recognising new/changed global economic context
- **Mechanisms:** Debt cancellation (Debt Jubilee 2025), Cuts to principal, Coupons rate reduction, Extended maturity terms and grace periods
- **Resources:** Establish Debt Management and Restructuring Office and people-focused local negotiation team with high levels of technical expertise
- **Technical Preparation**
  - Conduct government-commissioned DSA
  - Payment capacity scenarios with different stress tests
  - Contingency planning
  - External debt audit (identify existing odious debts)
  - Support Collective Action Framework (binding creditors who dissent)
  - People wellbeing and development needs
  - Debt Jurisdiction (governing laws, sovereign immunity, enforcement)
  - Essential Imports Forecasts and Development Finance Needs
- Join Common Reporting Standard of automatic exchange of banking information
- **Diplomatic Engagement**
  - G77 coordination
  - Regional alliances - BIMSTEC, South Asia <sup>14</sup>
  - BRICS association <sup>15</sup>
  - Join Global South Debtors' Coalition<sup>16</sup>
- **Utilisation of Legal Framework for Debt Resolution**
  - International Law Foundations (UNCTAD Principles on Responsible Lending/Borrowing; UN General Assembly Resolution 68/304 (2014); Doctrine of Odious Debt (historical precedents))
  - Domestic Legal Tools (Constitutional provisions on sovereign borrowing; Revise Central Bank Act, Proposed new legislation (Sovereign Debt Responsibility Act)).<sup>17</sup>
- **Networking with Civil Society.**<sup>18</sup>
  - Debt Justice UK, APMDD, EuroDaD, Erlassjahr, Bretton Woods Project, Finance Watch, International Development Economics Associates, Tri-Continental

# 11. FOREIGN CURRENCY EARNINGS AND CAPACITY TO PAY

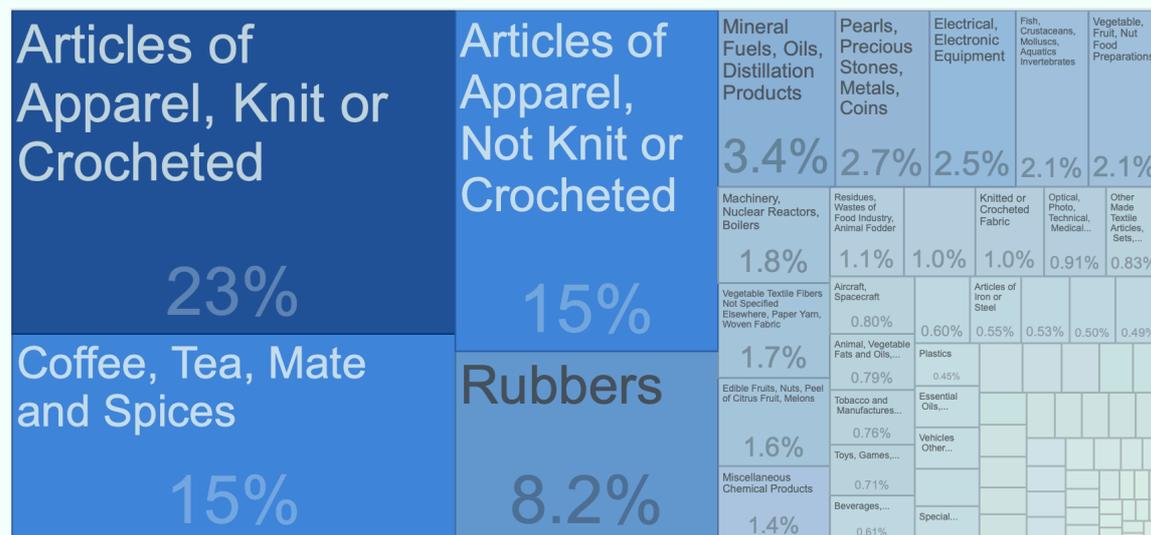
In 2024, Sri Lanka's foreign exchange earnings, including from exports of goods and services, tourism, and migrant remittances, reached **US\$ 26.23 billion**, a 12.6% increase from the previous year. This includes US\$ 12.7 billion from merchandise exports, US\$ 6.88 billion from service exports (including tourism), and US\$ 6.5 billion as remittances from labour exports.<sup>19</sup>

Sri Lanka's **capacity to service its debts** is constrained by its foreign exchange earnings. The IMF programme should support the country to increase its foreign currency earnings. For example:

- **Value-added export-oriented industrialisation and diversification**
  - Gem & Jewellery, Electronics and electrical assembly
  - Ban Exports of unprocessed Raw Minerals: Process ilmenite, graphite locally to add value.
  - High-Value Agriculture without compromising food sovereignty: Shift from low-value tea to spices, organic foods.
  - Expand access to export markets through strategic trade agreements enabling integration with global value chains.
- Strengthen **services** exports
- **Tourism** revival (e.g. medical tourism that may also stem brain-drain)
- **Information technology** and Business process outsourcing expansion
- **Logistics and shipping**
- **SME support** (Special economic zones with local governance laws, Technology transfer programs, Development finance)
- Diaspora bonds and **remittance channels** (e.g. Public Remittances Bank)
- Non-debt creating inflows - sustainable **foreign direct investment** (targeted ethical investment, strong regulatory environment and aligned with industrial strategy)
- Halt **Illicit Financial Flows** and stolen asset recovery.
- Transparency Laws (**public beneficial ownership registers**)

### Sri Lanka Exports By Category

Sri Lanka's total Exports in 2024 were valued at US\$12.11 Billion, according to the United Nations COMTRADE database on international trade. Sri Lanka's main export partners were: the United States, the United Kingdom and India. The top three export commodities were: Articles of apparel, knit or crocheted; Coffee, tea, mate and spices and Articles of apparel, not knit or crocheted. Total Imports were valued at US\$18.39 Billion. In 2024, Sri Lanka had a trade deficit of US\$6.28 Billion.



Source: [TradingEconomics.com](https://www.tradingeconomics.com)

## Sri Lanka's Capacity to Service its External Debts

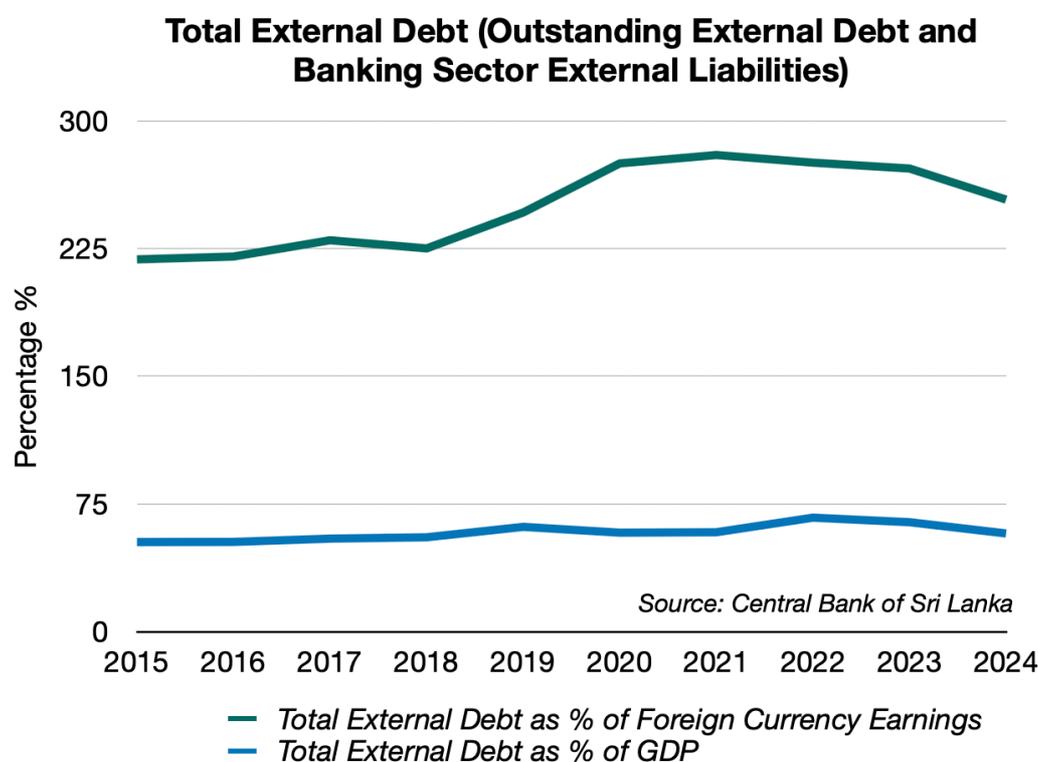
Sri Lanka's ability to repay external debt must be aligned with its foreign currency earnings, ensuring that repayments are both realistic and sustainable. To support this, it is essential to curb non-essential luxury imports and take effective measures to stop illicit financial outflows.

A just debt agreement should guarantee that repayment obligations do not undermine the country's capacity to finance essential imports, achieve development objectives, or maintain adequate foreign reserves.

A fair debt restructuring should support a sustainable debt solution that balances the country's multiple and competing dollar needs, including <sup>22</sup>:

- **Imports:** Estimated at US\$ 18.3 billion for goods and US\$ 6.9 billion of services in 2024.
- **Financing Development Projects:** Essential for long-term economic growth.
- **Building Foreign Exchange Reserves:** Totalled US\$ 6.5 billion by December 2024.
- **Debt Servicing:** Regular repayment of external debt obligations.

## Sri Lanka's Capacity to Pay



### IMFTarget

- *Based on flawed IMF-DISA; unsustainable solution for Sri Lanka*

- 
- Public Debt-to-GDP (including Rs debt) **95%**
  - Revenue-to-GDP **15%**
  - External Debt Servicing-to-GDP **4.5%** (from 2028)

### Debt Burden (Dec '24)

- *Requires a larger haircut for sustainability, growth strategy and more external support*

- 
- Total Debt **\$104bn** (Rs 300/\$)
  - External Government Debt **\$36bn** (\$57bn including Banking sector external liabilities)
  - External Revenue **\$26bn**

### Proposed Target

- *Anchoring the repayment of external debt to foreign earnings rather than rupee denominated GDP*

- 
- External debt servicing-to-External External Foreign Currency Earnings around **5%**
  - Sri Lanka's Total External Debt of over 200% of foreign currency earnings is unsustainable (see figure).

# 12. PEST ANALYSIS

## Political Landscape:

*Governance, Debt, and Institutional Weaknesses*

- Growing public demand for anti-corruption reforms due to elite capture and weak oversight.
- Erosion of trust in governance as institutions failed to prevent corruption.
- Geopolitical debt traps and predatory lending threaten national sovereignty.
- IMF-imposed austerity deepens inequality, harming the poor while ignoring global structural issues.
- Multilateral institutions remain undemocratic, favouring creditor nations.
- Global economic imbalances are reinforced by current international financial structures.
- Uncertainty created by recent tariff and other moves, leading to stagnation/decline of investment and activity

## Economic Challenges:

*Debt, Trade, and Industrialisation*

- Unsustainable external debt diverts resources from essential public services.
- Developing countries remain trapped in an unequal global trade and finance system.
- Economies rely on raw material and low-tech exports, increasing vulnerability to price shocks.
- Low reserves and high import dependency, especially for essentials, fuel trade deficits and instability.
- Weak industrial capacity limits value addition and deepens reliance on global supply chains.
- External shocks disproportionately impact economies lacking industrial resilience.

## Social Consequences:

*Poverty, Migration, and Austerity Backlash*

- External debt servicing diverts critical resources from essential public services.
- Austerity measures worsen social vulnerabilities.
- Rising cost of living and stagnant wages increases poverty levels.
- Limited fiscal space stops establishment of a strong social safety net.
- Lack of domestic opportunities drives “low-skilled” groups toward unsafe migration & skilled professionals to migrate, fuelling brain drain.
- High vulnerability to external shocks, increases the risk of crisis and social unrest.
- Undermines social cohesion and public trust in institutions, compounding the negative impact of policies.

## Technological Solutions:

*Blockchain and E-Governance*

- Technology provides tools for reform despite systemic challenges.
- Blockchain-based debt transparency (e.g., Ecuador) reveals hidden liabilities and promotes accountability.
- E-governance platforms improve oversight of foreign exchange, procurement, and budgets.
- Real-time transparency empowers citizens to monitor public finances.
- Digital tools strengthen integrity and public accountability in governance.
- Risk of data privacy risk in collaborations with external private solutions.

# 13. SWOT ANALYSIS

## Strengths

**Geo-strategic Location:** Sri Lanka's position along major trade routes offers opportunities to leverage maritime trade, logistics, and regional partnerships.

**Labour Force and Skilled Diaspora:** Despite brain drain, Sri Lanka has a relatively educated workforce and a large, skilled diaspora that can support recovery through remittances or investment.

**Natural Resources and Tourism Potential:** Rich agricultural land, marine resources, and cultural assets offer opportunities for sustainable development and foreign exchange earnings.

**Sovereign Currency:** The government retains monetary sovereignty, allowing for policy tools such as domestic borrowing and currency management (if carefully used).

## Weaknesses

**Policy Instability and Governance Failures:** Inconsistent leadership, poor fiscal planning, and corruption have eroded public trust and worsened debt management.

**Over-dependence on Imports and External Loans:** A narrow export base and reliance on foreign borrowing make the economy vulnerable to external shocks.

**Weak Technological Infrastructure:** Low investment in R&D and digital systems limits productivity and economic diversification.

**Institutional Fragmentation:** Lack of coordination among ministries and weak regulatory oversight undermine implementation of reforms.

## Opportunities

**South-South Cooperation and Regional Integration:** Strengthening ties with neighbouring countries and regional blocs can provide alternative sources of finance and trade.

**Debt Restructuring and Domestic Finance:** Renegotiating external debt restructuring agreement and using SL rupee for economic development.

**Technological Leapfrogging:** Adoption of digital tools, green energy, and innovation in sectors like agriculture and services could boost resilience and competitiveness.

**Global Demand for Ethical and Sustainable Goods:** Shifting consumer preferences offer an opportunity to position Sri Lankan exports in ethical, organic, and fair-trade markets.

## Threats

**IMF and External Conditionalities:** Structural adjustment programmes may lead to austerity, further social unrest, and loss of policy autonomy.

**Currency Volatility and Inflation:** Global commodity price fluctuations and domestic monetary challenges could increase inflation and the real burden of debt.

**Global Economic Uncertainty:** External shocks (e.g. pandemics, geopolitical tensions) could disrupt remittances, tourism, and foreign investment.

**Pressure from Creditors and Strategic Rivals:** Competing interests from bilateral creditors may limit Sri Lanka's ability to negotiate favourable terms or assert economic sovereignty.

# 14. CRITICAL SUCCESS FACTORS

To secure a fair and lasting resolution to Sri Lanka's external debt crisis, the government must build the institutional capacity, political resolve, and strategic partnerships necessary to assert national interests and protect public wellbeing.

- **Capable and Resourced Debt Office**  
Establish a skilled and well-funded Debt Management and Restructuring Office with technical expertise and political backing.
- **People-Centred Task Force**  
Form a multidisciplinary task force—including legal, financial, and negotiation experts—focused on national development and citizen welfare.
- **Progressive International Advisors**  
Engage independent, pro-Global South financial and legal experts to support negotiations and challenge creditor-driven frameworks.
- **Strong Political Will**  
Demonstrate commitment to prioritising social wellbeing and economic justice over creditor pressures.
- **Transparent and Inclusive Process**  
Conduct a full audit of external debt, legal reviews of loan contracts, and development impact assessments, while ensuring active public and stakeholder engagement.
- **Foreign Exchange Growth Strategy**  
Implement a coherent strategy to grow dollar earnings—such as a development bank to fund value-added industries, export diversification, and sustainable FDI.
- **Credible Alternative “Plan B”**  
Prepare for collective negotiation through a Global South Debtors' Coalition, offering a platform for coordinated action and structural reform of the international financial system.
- **Progressive Taxation** Enhanced domestic spending on a social safety net and public services.

# 15. STRATEGIC OPTIONS AND CHOSEN STRATEGY

## OPTION 1

Continue with current IMF Agreement

*(Not sustainable in the long run)*

## OPTION 2

Completely exit the IMF Agreement

*(High risk of financial & social instability)*

## OPTION 3

Reopen IMF Debt Restructuring Negotiation before another potential debt defaults or social unrest

***(Preferred Option, to avoid future default and seek fairer terms)***

# 16. RISK ASSESSMENT AND MITIGATION

## IMF may Reject Renegotiation

- Continue dialogue, show public support for mandate and commitment to national priorities.<sup>20</sup>
- Strengthen ties with bilateral partners and seek concessionary loans
- Co-ordinate and share information and possible strategies with other debtor countries.

## Macroeconomic Risks

(Credit rating downgrade, inflation, interest rate hikes, rupee depreciation)

- Strengthen the domestic economy through industrialisation and import substitution
- Non-essential import control and credit control, including direction of credit

## Political Risks

(Future government change, pressure from creditors)

- Develop non-partisan strategies and maintain policy continuity
- Build public support and ensure transparency to mitigate risks

## Social Unrest

- Prioritise essential services, public communication, and inclusive policy responses

## Legal risks from private creditors

- Conduct a full debt audit to identify unjust or odious debts
- Build legal cases and reduce overseas exposure of public assets

## External Shocks

(Wars, climate events, tariffs, commodity prices, global recession)

- Manage reserves carefully with credit controls and a diversified reserve policy
- Use import prioritisation and export retention schemes

## Short-term Foreign Exchange Risk

- 37.5% of total debt is in foreign currency, exposing Sri Lanka to exchange rate volatility
- 29.2% of foreign reserves are tied to short-term FX debt (Dec 2024); this rises to 25% in 2029<sup>22</sup>
- Conduct regular impact assessments to manage FX volatility

## Mitigation through Domestic Financing

- Shift towards a Domestic-Oriented Financing Strategy (based entirely on future ability to generate forex, and current forex requirements)
- Issue more medium- to long-term treasury bonds to lower refinancing and borrowing risks
- Reduce reliance on external commercial loans; limit external borrowing to concessional bilateral/multilateral sources
- Higher progressive direct tax and new wealth tax, with plugging of loopholes and reduction / elimination of exceptions.
- Manage rupee money supply in circulation (taxes) to control inflation.

## 17. MONITORING AND REVIEW

The purpose of **monitoring and reviewing the progress** of the strategy is to ensure that it remains effective, responsive, and aligned with its stated objectives. This process is essential for evidence-based decision-making, accountability, continuous improvement and public support.

- **Transparent Key Performance Indicators**
  - Debt sustainability metrics
  - Human development indicators
  - Economic resilience measures
- **Accountability Mechanisms**
  - Parliamentary oversight
  - Civil society monitoring
  - International reporting
- **Periodic communication and publication of progress**

## 18. DATE TIMELINE AND KEY MILESTONES

- **2025:** Foreign Currency Revenue Generation Strategy
  - Investment mobilisation
  - Structural transformation
  - Sustainable debt levels
- **2025:** Build Domestic Economy Plan (Industrialisation, agricultural revival, energy sovereignty and Import Substitutions)
- **2026:** Debt Audit Commission (CSO experts) & Independent Sovereign Debt Audit
- **2027:** Draft Alternative DSA
- **2027:** New IMF Restructuring Proposal (and renegotiation with Bi-lateral and Private creditors)
- **2026:** Join Global South Debtors' Coalition

# 19. CONCLUSIONS

This strategy—anchored in aligning Sri Lanka’s debt servicing obligations to its foreign export earnings—presents a credible and comprehensive alternative to the current IMF-led austerity framework. It offers a sovereign, equitable, and enforceable pathway for resolving the external debt crisis, one that prioritises national ownership, protects public welfare, and supports long-term economic stability.

Sri Lanka has the potential to achieve lasting economic sovereignty, financial independence, and economic justice for its people. To realise this, there is a compelling case for reopening negotiations with the IMF to revise the terms of debt restructuring. Without such revision, the risk of further default, economic deterioration, and social unrest remains high. A critical element of this new approach involves targeting debt repayment against a fixed share of foreign exchange earnings rather than GDP, which more accurately reflects the country’s real repayment capacity and eases pressure on domestic resources.

In asserting its economic sovereignty, Sri Lanka must also resist IMF oversight of its domestic economy—particularly performance benchmarks that constrain fiscal and monetary policy space. Instead, policymaking should be rooted in local priorities and democratic accountability.

Strengthening foreign exchange revenues is also essential. This requires an integrated strategy to finance essential imports, development projects, reserve accumulation, and debt servicing obligations in a sustainable manner.

Finally, Sri Lanka should actively participate in emerging platforms for Global South cooperation, including a Global South Debtors’ Coalition. Such collective engagement can support more coordinated negotiations, enable shared policy learning, and contribute to the transformation of the global financial architecture toward greater equity and justice.

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- <sup>3</sup> [IMF Debt Sustainability Analysis, IMF Country Analysis, Dec 2023](#)
- <sup>4</sup> [Case Against Odious Debts, Committee on the Abolition of Illegitimate Debts, Feb 2025](#)
- <sup>5</sup> Howse, R. (2007). Odious Debt and State Corruption.
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- <sup>7</sup> Campaign for Collective action clauses - UK Government Response, Debt Justice, 2022
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- <sup>19</sup> [TradingEconomics.com](#)
- <sup>20</sup> [Sri Lanka's Debt Restructuring and Lessons towards the Overhaul of a Broken International Financial Architecture, erlassjahr.de and Yukthi, March 2025](#)

# APPENDIX

The IMF's Debt Sustainability Analysis (DSA), which guided Sri Lanka's recent debt restructuring, was based on a scenario that provides only a **50% probability** that the country will not require another default or restructuring under the IMF's own economic models.<sup>[1]</sup> In other words, the DSA implicitly acknowledges a **50% risk of repeat default**.

Following internal criticism regarding the weakness of Sri Lanka's restructuring deal, the IMF has since revised its guidance—now requiring that debt restructurings reduce the risk of recurrence to **no more than 40%**.<sup>[2]</sup>

Crucially, the IMF's analysis also assumes that Sri Lanka will be able—and will need—to issue new international bonds in the coming years to repay the restructured debt as it matures. However, the yield on Sri Lanka's restructured bonds currently exceeds **20%**, reflecting the market's perception of high risk.<sup>[3]</sup> Such a yield implies prohibitively expensive borrowing costs, making it **unlikely** that private lenders will be willing to finance new bond issuances.

As a result, despite undergoing restructuring, **Sri Lanka may still be unable to refinance its debt**, heightening the risk of another default and further restructuring in the near future.

[1] Debt Justice UK conversations with IMF staff.

[2] <https://www.imf.org/en/Publications/Policy-Papers/Issues/2024/11/18/Guidance-Note-On-The-Financing-Assurances-And-Sovereign-Arrears-Policies-And-The-Fund-s-557389> page 53 “Given the overarching objective to restore sustainability, in the normal access context the debt targets should be consistent with a probability of sustainable debt that exceeds 50 percent by a sufficient buffer (normally at least 60 percent probability), to avoid the need for subsequent restructurings in the face of moderate shocks. In exceptional access cases, debt targets should be consistent with a probability of sustainable debt that exceeds 80 percent (consistent with how thresholds of the SRDSF are calibrated).”

[3] [https://markets.businessinsider.com/bonds/dl-governlkd\\_bds2434-35regs-bond-2035-xs2966242179](https://markets.businessinsider.com/bonds/dl-governlkd_bds2434-35regs-bond-2035-xs2966242179)

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