Call for Discussion, Debate and Action

The Way Forward on Debt Justice in Sri Lanka

13 May 2024

Introduction

Sri Lanka is facing an unprecedented moment. It has defaulted on its external debt for the first time in its history and going through the worst economic crisis since Independence. The liberal establishment and the Government in Sri Lanka are uncritically following and implementing the IMF solution for debt restructuring and economic recovery. However, the working people in Sri Lanka are being devastated by this very IMF solution, even as the broader development of the country continues to suffer. The path of debt resolution and economic development chosen today will impact the people and the country for decades into the future.

These challenges in Sri Lanka come amidst tremendous political and economic changes both nationally and internationally. Sri Lanka is to face presidential and parliamentary elections over the next year providing opportunities to challenge authoritarian rule and shape the future course of debt resolution and economic development. The global situation is fragile with geopolitical manoeuvres and the escalation of wars, even as over fifty low and middle income countries are in debt distress.

In Sri Lanka, the ongoing austerity measures and policies of further financialisation, trade liberalisation and privatisation claiming to be part of debt resolution are likely to impact the lives of generations to come. Globally, continuing with the broken international financial architecture, with assertions that the current crisis is merely a problem of liquidity (governments lack short-term funds for debt servicing) rather than a problem of insolvency (countries cannot repay the stock of debt), are likely to aggravate and prolong the debt crisis into the foreseeable future.

There is thus an urgency in Sri Lanka to come up with a common debt justice agenda in the interest of the working people and to work with the international debt justice movement. Internationally, the danger for Sri Lanka and other countries that have defaulted or in debt distress is repeated defaults leading to dispossession and the entrenchment of an unequal global economic system.

We outline below the issues, approach and demands towards resolving the debt crisis and ensure economic recovery in Sri Lanka. We call for discussion, debate action on the following ideas to forge a powerful debt justice movement in Sri Lanka.

Approach

This initiative seeks to build a broad consensus of demands to address the debt crisis in Sri Lanka. The demands are meant to engage the working people throughout the country, the Government and other political constituencies at the national level, and the debt justice movement and policymakers at the international level. These demands, some of them articulated as principles, become meaningful only if there are viable strategies to achieve the changes in the lived realities of working people, in national policies and in the international financial architecture. Furthermore, such strategies have to be put into practice with mobilisations and concrete actions. Therefore, the framing of the demands cannot merely be maximalist goals and lofty statements, but should be linked to strategies that can lead to changes in the debt and economic situation.

Positions

1. Debt Restructuring Process and the IMF Program

The ongoing debt restructuring process and the linked IMF program are devastating the working people by its severe austerity measures. ***Unlike the previous sixteen IMF agreements, it is much more difficult to walk away from the current IMF program*** as Sri Lanka has defaulted on its external debt and the IMF is now considered the arbiter of the debt restructuring process. Indeed, the Paris Club of bilateral Western creditors require an IMF program to restructure their debt. Thus Sri Lanka needs to chart a path out of this IMF trap with a clear analysis on what is at stake. Furthermore, there is a need for mobilisations and campaigns to expose the dispossession inherent in the IMF solution designed to merely serve the interests of powerful creditors. In other words, concrete actions that reject the IMF conditionalities like market pricing of energy, cuts to subsidies, rise in indirect taxes, cuts to social welfare etc. Such actions in turn should push the current and future governments to reject the IMF conditionalities.

This resistance can be strengthened through ***analysis illustrating that little is gained by the IMF program:***

a. The IMF program brings in little foreign exchange for essential imports and debt servicing and in fact is an extremely costly loan:
    - The IMF program provides USD 3 billion over four years or just USD 60 million each month. The additional financing of World Bank and ADB over four years is only USD 4 billion or just USD 83 million per month. However, Sri Lanka's foreign earnings are on the order of USD 1.8 billion per month.

- The net flows given that the previous IMF, World Bank and ADB loans continue to be repaid makes this even lower; close to USD 1.4 billion have been repaid to multi-lateral agencies over the last twenty months.
- The IMF interest rates are high with escalating surcharges resulting in annual interest rates likely to increase to 8% in some years. And between 2024 and 2033, Sri Lanka is expected to pay about USD 2 billion in interest and surcharges payment. Therefore, a USD 3 billion IMF loan resulting in USD 2 billion in interest payments.

b. The IMF program undermines growth, recovery and revenues with its conditionalities:
- The primary surplus conditionality for Sri Lanka is 2.3% of GDP is much higher than Sri Lanka's best performing peers. Such a primary surplus target in the interest of creditors, reduces public investment and undermines growth.
- Focus on inflation targeting with high interest rates – the Central Bank policy rate of 16.5% and commercial borrowing close to 29% last year – undermines production and leads to collapse of small businesses and livelihoods.
- Attempting to rapidly increase revenues from flows such as income taxes and VAT are regressive and undesirable with a contracting economy. Furthermore, wealth taxes targeting the stock of wealth are not prioritised.

c. The IMF program leads to lower levels of local production and loss of foreign exchange:
- It demands ending import restrictions and promotes trade liberalization leading to both loss of foreign exchange and undermining local production in the face of cheaper imported goods.
- Under the guise of reforming state owned enterprises, there is likely to be a fire sale of public assets that will further undermine local production and employment.

2. Debt Stock Reduction and Debt Cancellation

There can be many ***justifications for external debt stock reduction and debt cancellation*** including the following:

a. The international system is unjust where countries in the Global South have been exploited through declining terms of trade, higher premiums (interest rates) on debt etc.
b. Much of it is odious debt used to extract funds by both global creditors and local elite, without using it in the interests of the broader citizenry.
c. Inability and unsustainability of debt repayment and the cost of repayment can be devastating for the people and the economy.

We must **demand reduction of the debt stock to sustainable levels in Sri Lanka**. The IMF's Debt Sustainability Analysis (DSA) requires high levels of debt servicing after debt restructuring.

a. External debt servicing or Gross Financing Needs (GFN) should be limited for example to 10% of revenues or even lower (as opposed to the 30% of revenues in the DSA).
b. External GFN of 4.5% of GDP should be much lower such as 1.5% of GDP.
c. There should be a longer moratorium on debt repayment from the current 4 years to say 10 years given the economic recovery time needed.
d. All of the above mean a much larger haircut than the currently working one on the order of 30%, including outright cancellation of debt for high interest loans and odious debt.

Another approach would be to ***divide the creditors and push for repayment of debt to only those who provide future concessionary debt:***

a. This could be an approach to deal with bilateral debt on a case by case country basis or to negotiate with groupings such as the Paris Club and G20.
b. Refuse to repay commercial debt given the interest payments made over the last 15 years on ISBs and other commercial debt.
c. Demand debt restructuring of multi-lateral debt (World Bank and ADB) as Sri Lanka took on non-concessionary loans. Furthermore, such loans undermined sustainable development including with capital market promotion, agricultural modernization affecting small producers, and commercialization of education.

While such strategies for external debt restructuring and cancellation should have been considered, ***the Government to please powerful international actors and the bondholders decided to push through Domestic Debt Restructuring (DDR):***

a. While external debt restructuring is yet to be achieved, the Government rushed through DDR last year even though Sri Lanka did not default on its domestic debt, which can be repaid in rupees.
b. DDR did not touch the banks, the finance companies or the wealthy individual investors, and only reduced the retirement funds of working under the custody of the Central Bank, where working people, including garment and estate workers earning below poverty level wages, have ended up losing a large share of their future retirement earnings.
c. The Government as part of the IMF program only allocates 0.6% of GDP for its social protection program, while the reduction in the retirement funds each year amounts to 0.5% of GDP. Thus over the sixteen year period of DDR the total stock of retirement funds are likely to decline by about 47%.

The principle of redistribution should be at the core of reducing the debt stock. First, from external creditors to countries of the Global South, in this case Sri Lanka. Second, redistribution within the countries affected by the debt crisis from the wealthy to the working people, where any debt payment is to be borne by the wealthy classes including through wealth taxes. However, the Government and the IMF solution as evident from the austerity measures and DDR are doing the opposite in making the working people carry the burden of debt restructuring.

3. Future of Debt and Development Financing

Debt reduction and cancellation will also have ***implications for future flows of debt.*** We can consider the following positions on future debt:

a. No more commercial borrowing due to the high extraction with high interest rates.
b. Only concessionary loans from multi-lateral and bilateral donors
c. Loans to be used for development purposes limited to enhancing livelihoods, employment and sustainable growth. Therefore the uses of external debt should be specified, i.e. not for luxurious consumption and infrastructure that does not provide social and economic returns.

Focus on development policies and financing that reduces the chances of future crisis:

a. Import substitution to ensure self-sufficiency and to reduce chances of external shocks on import prices leading to future crisis.
b. Industrial policies that are locally driven as opposed to donor-led external market enhancing programs.
c. Planning for longer-term growth with a focus on livelihoods and employment generation.
d. A focus on the food system and progressive agrarian change including with land reforms to avoid repeated food crisis.
e. Seek concessionary financing as well as build up reserves to deal with climate shocks that can lead to debt distress.

Collective engagement with actors in the Global South and the global debt justice movement:

a. Work towards a New Financial Architecture that is about development of countries in the Global South and not to serve extraction by creditors.
b. Engage in legal changes in relation to sovereign debt so that future debt restructuring processes are favourable towards debt distressed countries.
c. Form a Debtors Club of debt-ridden countries to negotiate with creditors, including demanding debt cancellation where necessary and possible.
d. Addressing climate change with financing that is redistributive and considers reparations.

Conclusion

This approach and positions put forward by YUKTHI requires considerable discussion, debate and action. We seek to work with a broad range of progressive actors domestically and internationally that are critical of the neoliberal policies ravaging the Global South including Sri Lanka. We believe that the struggles for debt justice should be linked more broadly to the struggles for equality and freedom.

YUKTHI is a plural forum to support working people's movements and struggles for democracy and justice in Sri Lanka.