



Sri Lanka: Keeping the Storm at Bay

Sri Lanka's interlocking economic and political crises remain acute. In this excerpt from the [Watch List 2022 – Autumn Update](#), Crisis Group lays out what the EU and its member states can do to mitigate the risks of needed reforms.

Despite relative calm on the streets since mass protests forced President Gotabaya Rajapaksa to resign in early July, Sri Lanka's interlocking economic and political crises remain acute. Selected by parliament to succeed Rajapaksa, Ranil Wickremesinghe has since secured a preliminary agreement with the International Monetary Fund (IMF) for a \$2.9 billion bailout loan known as an Extended Funds Facility (EFF). The deal is a necessary first step toward addressing its economic woes, but even if Colombo succeeds in convincing its international creditors to reduce its debts – which the IMF requires to disburse its loan – major challenges remain. Rampant inflation, food shortages and rural economic collapse could see hunger and immiseration reach destabilising levels.

Despite promises to cushion the blow for the worst off, Wickremesinghe's plan for quick, sharp economic reforms to balance the books could deepen the suffering – and anger – of many Sri Lankans. Given how much the public resents the Rajapaksa family, Wickremesinghe's reliance on that clan's political party for his parliamentary majority weakens his political credibility with large sections of the public. It will be hard for him to win popular support for painful changes that run counter to widely held beliefs about the state's role in the economy and in

terms of social protection. The lack of transparency around possible reforms – the government has refused calls in parliament to release details of the IMF deal and plans to implement it – can only increase public anxiety and frustration.

On the political front, authorities are cracking down on the protest movement, seemingly in part to signal that they will not tolerate challenges to the president's economic agenda from the street. But the repression risks alienating those protesters who have so far largely kept to peaceful tactics, especially since Wickremesinghe seems disinclined to accede to the movement's demands for deep political reforms.

To help address Sri Lanka's crisis, the European Union (EU) and its member states should:

- Make clear to the Wickremesinghe administration that holding parliamentary elections at the earliest possible date, ending repression of protest leaders and making credible efforts to tackle corruption will be necessary to win EU member states' support for IMF board approval of the EFF loan. In this context, encourage the IMF to press for enactment and implementation of a strengthened anti-corruption legal framework and concrete progress toward criminal accountability for cases of large-scale corruption.

- Urge the government to share the details of its economic reform plans with parliament and to make special efforts to protect the most vulnerable, avoid cuts in education, health and other essential social services, and ensure tax increases are borne principally by those best positioned to weather them.
- Clearly signal to the Sri Lankan government that the continuation of the EU's Generalised Scheme of Preferences Plus (GSP+) tariff benefits depends on a moratorium on arrests under the Prevention of Terrorism Act (PTA) and this law's rapid replacement with a new one that is compliant with international human rights standards. The EU should insist on a clear timetable for passing this new law.
- Publicly endorse the broadened vision of accountability – linking impunity for economic crimes to impunity for human rights violations – laid out in a September report from the UN High Commissioner for Human Rights, and actively support anti-corruption efforts inside and outside the country, as well as the conflict-related Sri Lanka Accountability Project under the High Commissioner's auspices.
- Strengthen support for and efforts to protect Sri Lankan civil society organisations and political activists, particularly those involved in the protest movement, many of whom are facing heightened surveillance and the threat of arrest.
- Generously fund humanitarian appeals on behalf of support to Sri Lanka's most vulnerable people, taking into account that women have disproportionately suffered from the humanitarian crisis, and ensuring that program design involves significant participation of women from different backgrounds.

Calm before the Storm?

Some of the more visible aspects of Sri Lanka's economic crisis have eased since Wickremesinghe assumed the presidency on 20 July, with a new rationing system shortening the queues for petrol and diesel, power cuts becoming less frequent and cooking gas more readily available. But as the burdens on the urban middle class ease somewhat, hardship continues to grow for poorer Sri Lankans, many of whom have had to go deep into debt after suffering major drops in income, aggravating already high levels of debt incurred during the COVID-19 lockdown. Inflation is skyrocketing at more than 70 per cent, with food costs rising even faster, and cuts to kerosene subsidies have put its price beyond the reach of many who rely on it for cooking, lighting and fuelling fishing boats. Women and girls are particularly badly affected, with many facing increased domestic responsibilities with fewer resources. UN agencies now estimate that three quarters of the population are reducing their daily food intake, with more than

one quarter requiring urgent humanitarian assistance. To make matters worse, yields from the August-September rice harvest could be down by as much as half, as fertiliser remains unavailable or too expensive for many farmers, leading many to simply abandon their fields. Similar concerns are already surfacing about the harvest due in early 2023.

On 1 September, the government and IMF finally concluded a long-awaited staff-level agreement for a \$2.9 billion EFF bailout. It is a crucial first step in stabilising Sri Lanka's debt crisis. But the next steps will be just as challenging, if not more so. In order to receive the initial tranche of the IMF loan, Colombo will first need to reach agreements with its international creditors to "restructure" its \$47 billion in foreign debt. It will have to persuade private holders of Sri Lankan sovereign bonds (who hold almost half of Sri Lanka's foreign debt), as well multilateral agencies and bilateral lenders (including China, which is the largest bilateral

creditor, just ahead of Japan), to accept reduced payments in order to lower debt to a level the IMF considers “sustainable”. The IMF has not set a clear figure, however, and in any case, the process will require all Colombo’s creditors to reach consensus on the degree of debt relief. With China traditionally having refused to accept such a “haircut”, and with geopolitical tensions involving China, India and the United States increasingly playing out in Sri Lanka, many observers worry that negotiations will be long and difficult.

The IMF agreement also requires the government to make a series of delicate policy changes, with the aim of reducing, and ultimately eliminating, its chronic budget deficit, correcting its large trade imbalance and increasing its foreign currency reserves. While the government has resisted calls in parliament to release details, the likely outlines of the necessary economic reforms are clear: higher taxes, reduced government expenditure, privatisation of state-owned enterprises, insulation of the central bank and monetary policy from government influence, and elimination of subsidies for fuel and electricity. Wickremesinghe, a long-time supporter of economic liberalisation, has made comments suggesting that he aims to push through these deep changes as fast as possible, in order to “build a highly competitive, export-oriented economy”.

Many outside actors have welcomed Wickremesinghe’s commitment to economic reforms they see as required to stabilise the Sri Lankan economy. But however necessary major reforms may be, they present clear risks, especially given the economic nationalism and suspicion of the IMF that prevails among many Sri Lankans. Reforms will inevitably bring about economic hardships for large sections of the population, with expected cuts in public services likely to affect women particularly badly. The targeted social safety net programs planned as part of the IMF agreement will almost certainly leave many needs unmet. To date, few details have been shared with the public of the politically charged choices about how

government revenue will be increased and costs reduced: which state-owned enterprises will be sold and on what terms; whose government jobs will be cut; how much taxes will be raised and on whom; who will be covered by promised enhancements to social safety net programs and to what extent; and whether the large military budget will be trimmed at all.

Pushing through poorly understood belt-tightening reforms would be difficult under any circumstances but will be all the more so because of Wickremesinghe’s lack of popular support. Having failed to win his own parliamentary seat in the last election in 2020, Wickremesinghe later agreed – after others refused – to work as prime minister under the widely disliked Gotabaya Rajapaksa. When Rajapaksa fled the country amid a protest wave, Wickremesinghe rose to the presidency not by popular vote but through the support of Rajapaksa’s party in parliament. Many Sri Lankans thus consider their new president to lack credibility, seeing him as an obstacle to popular demands for an end to widespread corruption and a new more transparent and representative political culture – demands that have been consistently amplified by the *aragalaya* (“struggle” in Sinhalese) protest movement.

The scepticism about President Wickremesinghe is well founded. His decision to build a government with the Rajapaksas’ backing, as well as that of ministers convicted or credibly accused of large-scale corruption and other serious crimes, raises grave doubts about his capacity to achieve the IMF agreement’s goal of a “stronger anti-corruption legal framework”. It also means there is little chance Wickremesinghe will proceed with the deep political reforms that the months-long protest movement was demanding, at least without major international pressure. **These potential reforms include abolishing the executive presidency, prosecution and recovery of assets in cases of major financial corruption,** and laws to regulate campaign financing. Those political reforms the president does support – a minimalist reduction of presidential powers,

a stronger oversight role for parliamentary committees and a youth parliament – are too modest to fix Sri Lanka’s political dysfunctions. Although Wickremesinghe’s government promised the UN Human Rights Council in September that it will “endeavour to establish” a truth commission to help repair the damage of Sri Lanka’s long civil war, it has given no signals it will take the concrete steps needed to end the rampant impunity for crimes committed by security forces and the politically powerful, thus undercutting the commission’s ability to repair the war’s damage.

Hopes for political reform have fallen further, and tensions increased, in the wake of Wickremesinghe’s aggressive moves to arrest many of the protest movement’s best-known leaders, often for alleged involvement in minor offences. Many of them face intimidation and heightened government surveillance, and in a number of key cases, [suspects were arrested](#)

[under the draconian Prevention of Terrorism Act](#), which allows for detention without charge for up to a year. The president’s 23 September decision to invoke the rarely used Official Secrets Act to ban protests around key public buildings covering large parts of Colombo was revoked a week later after being widely [denounced, including by the National Human Rights Commission](#). Closing down space for non-violent protest amid an economic crisis, while embarking on reforms that will hurt ordinary Sri Lankans’ living standards, risks pushing some toward more violent forms of resistance. Moreover, the effort to demonise the protest movement – particularly the Inter-University Students’ Federation – by labelling it as “terrorist” should sound alarm bells in a country where three separate youth uprisings over the past 50 years have turned into full-blown insurgencies, leaving as many as 200,000 people dead.

Keeping the Window Open for Governance Reforms

The EU has an important role to play in supporting Sri Lanka’s economic recovery while at the same time minimising the associated risks. With key EU member states important members of the Paris Club of bilateral donors, the EU and states should work to facilitate a consensus approach among all donors, taking into account the geopolitical tensions that are likely to play out in the group – particularly between the U.S. and China, which does not participate in the Paris Club process. But while it is crucial that the EU extend economic support to the bankrupt government both through the restructuring process and otherwise, it should not do so without guarantees regarding both current policies and long-overdue political reforms.

The IMF deal presents important leverage. To begin with, the EU and member states should make clear to the Wickremesinghe administration that their support to approve the EFF is contingent on Sri Lanka holding

parliamentary elections at the earliest opportunity and on the government ceasing the clamp-down on protest leaders, as well as credible anti-corruption efforts. Meaningful action on tackling corruption, demands for which have helped drive the protest and popular unrest, would include the passage of legislation significantly strengthening the anti-bribery commission’s powers and resources. It would also include Sri Lanka rejoining the Stolen Asset Recovery Initiative, administered by the World Bank and UN, which can assist the government to restart stalled investigations into a number of high-profile corruption cases. The EU and member states should also actively support anti-corruption efforts outside Sri Lanka that relate to present and former Sri Lankan officials, including, as appropriate, investigations in EU jurisdictions, including with the support of EU judicial agencies.

To decrease the risk of renewed political

instability from reforms seen by many as unfair and imposed from outside – and to cushion the impact of those reforms on the most vulnerable – the EU and member states should also urge the government to share the details of its economic plans with parliament and the public and engage both in a discussion of how most equitably to share the economic pain. The EU and member states should encourage the government to make special efforts to protect vulnerable segments of the population, avoid cuts in education, health and other essential social services and make sure the urgently needed revenue increases are drawn principally by those most able to afford it.

After years of prodding, the EU should also formally notify Sri Lanka that its GSP+ trade preferences, which waive duties on Sri Lankan exports to the EU, will be at risk if it continues using the PTA to make arrests unrelated to terrorism and fails to draft alternative legislation that respects international human rights principles. Government promises to replace the PTA were essential to the EU's decision in 2017 to restore GSP+ privileges to Sri Lanka after removing them in 2010 for failure to effectively implement all 27 international human rights, labour and environmental conventions. The EU should give Colombo a clear deadline to repeal the PTA, while using the GSP+ monitoring process to press for the protection of labour rights and for meaningful action on corruption.

In line with the vision laid out in the UN High Commissioner for Human Rights' September report – which links impunity for economic crimes to impunity for human rights violations and calls for strengthened efforts against both – EU member states should help ensure adequate funding for the Sri Lanka

Accountability Project, an evidence-gathering mechanism focused on civil war-related international crimes and managed by the High Commissioner. European member state authorities should engage with this Project with the aim of using the evidence it gathers to support prosecutions under the principle of universal jurisdiction in European courts, wherever there is a sufficient legal basis.

Meantime, to help keep open space for political debate and popular participation, the EU delegation and member state embassies in Colombo should, in a coordinated way, offer political support and tangible forms of protection to civil society organisations, especially those involved in the aragalaya protest movement. They could, for example, make public statements, attend and monitor court cases, provide humanitarian visas, or accompany activists under threat to and from the airport.

Finally, as another short-term measure, the EU and its member states can also do more to mitigate the humanitarian crisis in Sri Lanka. They should, in particular, step up contributions to UN and Red Cross appeals – which remain underfunded – to aid the country's most vulnerable people through provision of medicine, food, livelihood support and cash assistance. With women and girls disproportionately affected by the economic crisis, special efforts should be made to include women of different backgrounds in the planning and implementation of humanitarian programming. The EU should also use its influence to ensure that agencies design programs based on careful analysis of local conflict dynamics, particularly for agricultural projects in the multi-ethnic Eastern province, where land-related issues are a regular source of conflict.