Keynote Speech by Mr. K. M. Mahinda Siriwardana, Secretary to the Treasury and the Ministry of Finance, Planning and Economic Development, at the "Softlogic Stockbroker's Investor Forum", held at Shangri-La Colombo on 25th February 2025

1. Background

As we all know, in 2022, Sri Lanka faced its deepest ever and most complex economic crisis since gaining independence in 1948, reflecting the culmination of the negative implications of long standing structural issues, exogenous factors and most importantly, the misguided economic policies followed at the heart of the country's problems by the then senior economic administrators. The crisis shattered the innocent dreams of the entire population of 22 million, and had a serious impact for the generations to come. The poor and the vulnerable were the most affected due to the crisis. In resolving the crisis, stringent and painful measures were required. Accordingly, the government had to undertake a carefully designed, comprehensive reform programme, with the assistance of the International Monetary Fund (IMF) and other international stakeholders, to take the country out of the deep crisis.

Since then, Sri Lanka continues to make good progress on its road to recovery from the deep crisis. The 2025 Budget speech was the most recent landmark on this journey, and the next milestone will be later this week when the IMF Executive Board takes up the third review of Sri Lanka's Extended Fund Facility (EFF) on the 28th of February.

The road to recovery has been a long and challenging one. It has required tough and often painful policy decisions, particularly at the outset of the reform efforts in mid-2022. This includes increases in tax rates, rationalisation of exemptions, implementation of cost reflective energy pricing, and interest rate increases early on in the process.

The results of the comprehensive reform programme put in place since mid-2022 have been very encouraging. As the Honourable President mentioned in the budget speech, most countries that go through a sovereign default typically endure a lost decade. In Sri Lanka's case, we have seen a robust recovery in the fiscal accounts with a preliminary estimated primary budget surplus of 2.2% of GDP in 2024, a significant improvement considering that we had a primary budget deficit of 5.7% of GDP in 2021. Interest rates have declined from around 30% to single digit levels as inflation was tamed from 70% in 2022 to negative inflation at present.

More importantly, these macroeconomic indicators have translated into a GDP growth of close to 5% in 2024, which in turn has enabled the reversal of the trend of rising poverty. The World Bank estimated that poverty doubled to 25% in 2022 and increased further to 25.9% in 2023. The World Bank's preliminary estimate for 2024 indicates a poverty rate of 23.4%[1], an important reversal in the rising trend. As the economy continues to recover, it is expected that the reduction in poverty levels will gather momentum.

Whilst we have made a very good progress in this journey, we are not quite at the destination as yet. Stabilisation of the economy has now been meaningfully anchored, supported by crucial legislative and institutional reforms. The focus now shifts to the acceleration of growth, building on 6 successive quarters of positive GDP growth since the second half of 2023. Economic growth must also continue to support the reduction of poverty, by ensuring that economic gains are inclusive across all strata of society. The 2025 budget speech is structured towards achieving these very objectives – consolidating stability and driving inclusive, sustainable economic growth.

2. Is this an "IMF Budget"?

There has been a lot of post-budget debate on whether the 2025 budget is an "IMF budget". To answer this question, it is important to reflect on Sri Lanka's past. Since independence, Sri Lanka has been engaged in 17 IMF programmes, including the present one. In none of these instances did the IMF come to the Sri Lankan authorities and compel us to take on a programme. In this 17th instance as well, it was the Sri Lankan government that requested an IMF supported programme through a letter dated 18th March 2022, followed by a second letter on the 7th of April 2022, both signed by the then President Gotabaya Rajapaksa. This request was made because Sri Lanka's then home-grown policy package led to a devastating economic crisis. In most of the previous 16 IMF programmes, Sri Lanka's track record has been bleak. Every time the country reached a degree of stability following reform implementation, those reforms were replaced with populist measures which sent the country back into a spiral of instability.

[1] World Bank Sri Lanka Development Update October 2024 - https://www.worldbank.org/en/country/srilanka/publication/sri-lanka-development-update-2024

At present, we are experiencing one of the very rare instances in the history of Sri Lanka's political economy where a change in the political cycle has not been accompanied by a drastic change in macroeconomic policy discipline. We saw very clearly what happened with the change in economic policies that accompanied the change in political leadership in end 2019. It is indeed unfortunate that whilst today we are experiencing a rare instance of mature and pragmatic macroeconomic policy continuity through an election cycle, there is criticism on this good outcome.

Sri Lanka requested the support of the IMF and negotiated the programme structure since mid-2022. Every 6 months at the programme reviews, adjustments are made to the reform programme. The EFF programme is indeed Sri Lanka's economic reform programme that is supported by the IMF. Yes, there are tough reforms and challenging policies that have to be adhered to – but those are the very measures that are needed to address the root causes of macroeconomic vulnerability in the country. The outcomes of the reform measures put in place since mid-2022 speak for themselves. Some may have forgotten the state of the country 3 years ago when we did not have fuel, medicines, fertilizer, essential foods, and electricity. The journey to get to where we are today has not been easy – in fact it has been one of the most challenging tasks to navigate this plethora of complex reforms. The 2025 budget ensures that Sri Lanka stays the course on the macroeconomic reform path that is necessary to ensure a sustained recovery. If that is something that warrants criticism and displeasure, that is indeed an unfortunate position to take.

If the important question today is "*economic independence*", the solution should be found through better and improved economic management itself. If we consider the experience in Jamaica, which is seen as a success story in terms of macroeconomic reforms undertaken in the last decade, the remarks by Nigel Clarke, Jamaica's Ambassador of Economic Affairs at the time, are revealing. *"The primary surplus that we have decided to pursue is not arbitrary; it is designed to achieve a larger objective, which is the reduction in Jamaica's debt to levels that are sustainable. Let me remind you that the 7 percent primary surplus target is merely an intermediate goal. It is a means to an end. The substantive goal is the achievement of real economic independence, where Jamaica has the policy space to address its opportunities and challenges, without reliance on the multilateral community, in a manner that sustains and even enhances that independence*[2]".

[2] https://www.imf.org/en/News/Articles/2017/05/09/na051017-jamaicas-economic-reform-and-growth-interview-with-nigel-clarke

So, in my view, it is very unfortunate that we Sri Lankans, over the years, have not been able to *"put our house in order"*. Now, after learning a bitter lesson from the deep economic crisis, we all should *use this crisis as an important opportunity* to correct the past mistakes and to put the country in a more sustainable path. For that, we need the ongoing IMF programme which brings discipline in economic management process and we should push for better and disciplined economic management culture in the country by using the same. If we can succeed, I am sure that this will be the last IMF reform programme and we can continue as any other normal country in the world rather than being a frequent "customer" of the IMF. In fact, this should be the last IMF programme and there shouldn't be an 18th programme, in my view. But, we will be able to achieve that only if we pursue in this direction with a strong commitment and focus to strengthen our economic levers and buffers. By now, with the difficult and painful reform process have already been frontloaded and completed, what is remaining is to consolidate the reforms while not allowing any serious policy mistakes. Only by then "*we Sri Lankans can achieve our real economic independence and even enhance our economic independence*", going forward.

3. Balancing Government's Priorities with Reform Continuity

Whilst carefully staying within the fiscal limits, the 2025 budget has provided significant resources to key priority areas which are aligned with the mandate of the government. Rs. 749 billion is allocated for social protection. This includes a substantial increase in allocations for *Aswesuma* as the government increasingly focuses on driving its welfare agenda through direct targeted cash transfers. This is important in order to break from past practices of tinkering with the tax structure and administered prices in order to provide public welfare. Going forward as well, it is important for the government to use targeted direct cash transfers to achieve its welfare objectives.

Rs. 604 billion is allocated for public health services. Rs. 619 billion is allocated for the education sector. Substantial attention is paid to addressing pressing issues such as child nutrition, pre-school education, and other areas that require focus as developmental objectives. Rs. 483 billion is allocated for public transportation and transport related infrastructure, another key driver of inclusive economic expansion. The budget allocates 4% of GDP for capital expenditure from 2.7% of GDP capital expenditure executed in 2024. This is a clear signal of the shift from stabilisation to growth.

The 2025 budget also introduces a number of policy related initiatives of the government. The enhanced focus on developing the cooperative mechanism of organising production is an important new direction which helps create citizens' engagement in economic activities and commercial ventures. The new model for public bus transportation, including a proposed new corporate structure and the expansion of low floor buses to improve inclusivity of public transport, is another new feature. Inclusivity is a recurring theme in this budget. The attention to disadvantaged groups such as children with autism, people with disabilities, the elderly, rehabilitation of drug related offenders, among others, is a significant shift in policy focus that is signalled through this budget. Therefore, in my view, the government has struck the appropriate balance between setting the platform to implement key policies articulated in the government's manifesto, whilst ensuring macroeconomic reforms can continue to deliver a stable economy which sets the foundation for growth.

4. Budget Realism

There has also been some debate as to whether the budget is realistic and whether the proposed revenue measures are sufficient to meet the revenue and primary budget balance targets.

From the outset of the EFF programme, revenue enhancement has been one of the primary fiscal objectives. Most revenue measures were front loaded in as progressive a manner as feasible. For 2023, the major revenue enhancement was through the increase of corporate and personal income tax rates and elimination of sectoral exemptions. For 2023, the government revenue was 11% of GDP which was in line with what was projected by the IMF at programme initiation. In 2024, the major revenue measures were the elimination of VAT exemptions and adjustment of VAT thresholds and rates. In fact, there has been some recent media coverage of revenue loss through tax exemptions. Much of this revenue leakage was prior to the rationalisation of VAT exemptions. In 2024, the government's provisional projection is for revenue and grants to have reached 13.6% of GDP, which is again in line with the IMF baseline projection for 2024 as of the 2^{nd} review. Therefore, it is clear that Sri Lanka has thus far been on track with regard to revenue growth.

Since most of the core revenue measures were frontloaded in the programme, for 2025, the bulk of revenue gains were expected to be realised from taxes on motor vehicle imports. For standard passenger vehicles, there haven't been major changes in the tax structure. Excise taxes, which is the major vehicle tax item, have remained largely the same except for regular annual indexation. VAT exemptions were previously eliminated in January 2024 like with other VAT exemptions. Luxury tax threshold was increased which would entail a tax reduction for lower cost vehicles. The only substantive change was the introduction of a 30% customs import duty, which was necessary given the large and potentially de-stabilising pent up demand for vehicles following 5 years without imports[3].

The government has been carefully monitoring vehicle import data on a daily basis since the 1st of February when all restrictions were lifted. Thus far, I am happy to note that the vehicle import trend is very much in line with expectations. Accordingly, there is no reason to make any adjustments to the existing vehicle import policy framework, including tax structure, at this stage. I am confident that the 2025 budget revenue projections are well grounded in analysis and will likely be met, much like the previous 2 years.

Here, I wish to emphasize the importance of sharing the tax burden and improving the tax compliance. As you are well aware, there are some sectors in the society which have shouldered much of the tax burden after the economic crisis, including the personal income tax payers. However, there is a need to reduce their burden as early as possible but it is difficult to do so until the tax net in the country in expanded. It is only when everyone pays their fair share to the government as taxes that the tax burden would be shared fairly. So, I urge everyone in the country, it is your responsibility to pay your taxes in a fair manner to facilitate the domestic resource mobilisation efforts and to strengthen macroeconomic management process. In this regard, one concern that has been highlighted by many is whether there is effective usage of tax payers' money. In fact, with the improvement in the expenditure management with stringent controls etc., and the strong commitment of the government to eliminate bribery and corruption vulnerabilities, the utilisation of the hard-earned tax money will be strengthened further.

[3] During the 5 years from 2015-2019 before the vehicle import ban, the average annual value of vehicle imports was USD 1.2 billion (before taxes). In 2018, USD 2 bn worth of vehicles were imported, if we exclude that year, the 4 year average during that period was USD 962 million.

5. Concluding Remarks

In conclusion, I wish to highlight that the 2025 budget aligns well with Sri Lanka's macroeconomic reform path. The key macroeconomic buffers; the primary budget surplus and foreign exchange reserve build up, are well addressed in the policy measures articulated in the budget. These are the key indicators required to ensure that Sri Lanka's debt service obligations can be managed, as capital repayments gradually resume from 2028. The Honourable President very correctly stated that there need not be any fear that the country would revert to a crisis in 2028. As long as Sri Lanka maintains the present reform path and macroeconomic discipline, such fears will not materialise. The IMF has independently confirmed that Sri Lanka's debt restructuring agreements collectively ensure the country's debt is sustainable, as evidenced by its Debt Sustainability Analysis (DSA). As it stands, Sri Lanka has been over-performing many of the IMF's projections, such as real economic growth, forex trajectory, interest rate decline, and the primary budget surplus, among others. If Sri Lanka continues this momentum of over-performance, the country has the potential to significantly improve upon the IMF's DSA targets.

In my view, the reform efforts implemented over the last almost 3 years have put Sri Lanka on the right track. As we remain on this path, fiscal space will continue to improve, and this will continue to enhance Sri Lanka's negotiating leverage which was minimal at the time the reform programme began. As fiscal space is gradually freed up, more relief can be provided to the public in a manner that does not undermine or reverse the overall reform trajectory. We have already seen evidence of this in recent months. Therefore, it is crucial that we remain patient and disciplined, and the rewards will no doubt continue to materialise over a period of time.

Therefore, it is evident that the 2025 budget ensures a firm commitment to the crucial macroeconomic measures necessary to sustain economic stability and debt sustainability, whilst at the same time, providing clear and pragmatic steps towards unleashing growth potential and ensuring an inclusive economic paradigm with a robust safety net to protect the poor and the vulnerable. The 2025 budget has provided the vision and direction on the way forward for the country, and it is up to all stakeholders to work together to convert this vision into a reality which would create a prosperous and inclusive economy that would benefit all Sri Lankans.

Thank you.