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## **REPORT**

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**From:** General Secretariat of the Council  
**To:** Asia-Oceania Working Party

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**Subject:** Sri Lanka: Update by the EU Delegation on the political and economic situation

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Delegations will find attached the update by the EU Delegation in Colombo on the political and economic situation in Sri Lanka.

## Subject: SRI LANKA – ‘pre-emptive’ default declared amidst political stalemate

### *Summary:*

With ‘next to nothing’ foreign reserves remaining, SL has suspended all of its foreign debt servicing and is negotiating with the IMF and the World Bank how to avert a humanitarian crisis.

This default is disorderly as not preceded by an understanding with main creditors. It could become a ‘hard default’, if there is a run on the Sri Lankan banks that hold most of the Government’s bonds (ratings agencies have put the main Sri Lankan banks on watch), and a collapse of SL’s financial system.

The key would be to agree swiftly on terms of bridging finance and IMF plan, but that needs to be built on political credibility. This currency is quite low at the moment as the Rajapaksas do not seem open to accept the opposition’s conditions (PM to step down and constitutional amendment to limit President’s powers) to work together for a solution.

Largely peaceful anti-government protests continue but the Rajapaksas are betting that the movement will tire out, and are trying to encourage this by offering carrots (engagement with protesting youth) and sticks (threat of “restoring public order”).

### Assessment:

What this means for the country is that with no financial space, there will be several months of worsening humanitarian conditions as electricity, fuel, cooking gas, food, and medical supplies will not be available for a certain part of the population, making it particularly vulnerable.

What this means for EU-SL relations is that the immediate objective is to avoid violence that could come from demonstrators, possibly triggered by further shortages, or from the army. The needs are obviously too big for the EU and could only be addressed by India and/or China. Yet, the EU messaging, the Member States votes in the IMF, the specific support for areas crucial for forex (exports - cumulation, migrants’ remittances, tourism) and the EU’s program and humanitarian actions will be useful.

### Detail:

#### Economic developments

1. After months of denial, recent weeks had seen significant **change in GoSL’s economic decision-making**. Exchange rate was floated, policy rates have been increased, technical discussions with the IMF are ongoing, new Finance Minister, Treasury Secretary and Central Bank governor have been appointed alongside an advisory team of three reputed economists to support multilateral engagement, and GoSL has begun the process of appointing legal and financial advisors to support its debt restructuring negotiations with international creditors.
2. Yesterday’s (12 April) announcement of **suspension of all Sri Lanka’s foreign debt servicing** came without a warning and appears to have been decided on in the past three days. Positioned by Minister Sabry in a briefing to foreign diplomats as a ‘pre-emptive moratorium’, it is a last resort move to divert any remaining reserves to fuel, cooking gas, food, and medicine instead of interest payments. With (only) USD 78mn of debt servicing due next week, Sri Lanka appears to have completely depleted its usable foreign reserves.

3. In Sabry's own assessment, negotiations will take 3-9 months, during which SL will be in need of short term financing, credit lines, and humanitarian assistance for the provision of essential goods. Any budgetary support from multilateral institutions (WB), will not be forthcoming until a debt restructuring plan is agreed with the IMF, which in turn requires **political stability and credible assurances of reform continuity** by GoSL.

#### Political landscape

4. Currently, SL finds itself far from political stability. Protests against the current SLPP-led government and Rajapaksa family in particular continue across the island, including 'Occupy'-like permanent tents near the Presidential Secretariat on Galle Face. SJB, the main opposition party led by Sajith Premadasa, are organising for a **no-confidence motion** against the Government, while also collecting lawmakers' signatures for an **impeachment procedure** against the President. Their initial position that the President should step down as a prerequisite for any interim government remains unchanged.

5. In an attempt to iron out party differences on the way forward, on 11 April former President Chandrika Bandaranaike Kumaratunga called for a meeting with parties of the opposition, which included the leader of the 43 Brigade Champika Ranawaka, SJB leader Sajith Premadasa, the Sri Lanka Muslim Congress and the Tamil National Alliance. Premadasa left before the meeting ended.

6. Non-SLPP government coalition parties and newly independent breakaway SLPP MPs have proposed that Prime Minister's resignation would be required to give way for an interim government, but are unwilling to back a no-confidence motion. Their proposal to pass a 21<sup>st</sup> amendment to the Constitution **curtailing the President's executive powers** presents a potential wedge to break the categorical stalemate between interlocutors.

7. **An all-party government seems in these circumstances not feasible.** In any case, no political solution is likely to be reached before Parliament reconvenes next week. Against the backdrop of social discontent, the current popular mobilisation island wide, non-ideological in nature but calling for radical change, cuts across gender, class and age groups. At this stage, whether the protests will remain peaceful is uncertain. Attempts by agitators to instigate violence have been thwarted so far but the situation remains extremely volatile.

#### Humanitarian risks

8. Sri Lankans are currently experiencing the dire consequences of GoSL's short-sighted chemical fertiliser ban last year, which has led to an estimated 30-40% reduction in the current harvesting season (Maha) and unprecedented food inflation, reaching 30% in March 2022. Ongoing power cuts and fuel shortages are aggravating the situation further by disrupting supply chains. **Food insecurity** risks are compounded by the potential of a second consecutive disrupted harvesting season (Yala), currently estimated to reduce in production by up to 50%. Although the ban on chemical fertilisers has been lifted, the lack of foreign reserves and financial capacity means importers are unable to afford purchasing the fertiliser required for the upcoming Yala season.

9. Following an appeal last week by the Sri Lanka Medical Association that the country's healthcare system is "weeks if not days" away from not being able to carry out emergency treatments, Ministry of Health has called for assistance with **essential medical devices and pharmaceutical drugs** not produced in Sri Lanka. World Bank, Asian Development Bank, and India are in the process of providing some of the needed supplies. WHO has been asked by UNRC to coordinate support to avoid duplication among Development Partners. On the Sri Lankan side, a Co-ordinator of Health Care Donor Activities has been appointed. WHO has noted that attention must be paid to channelling support to private not just public healthcare providers given the dynamics of Sri Lankan healthcare delivery.