United Nations

A/HRC/40/57/Add.4

General Assembly

Distr.: General
6 February 2019

English only

Human Rights Council
Fortieth session
25 February–22 March 2019
Agenda item 3
Promotion and protection of all human rights, civil, political, economic, social and cultural rights, including the right to development

Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of human rights, particularly economic, social and cultural rights on his mission to Sri Lanka

Comments by the State*

* The present document is being issued without formal editing.

Comments/Observations of the Government of Sri Lanka (GoSL) on the advance unedited Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, on his visit to Sri Lanka, 3-11 September 2018

1. The Government of Sri Lanka (GoSL) wishes to express its gratitude to the Independent Expert for inviting the GoSL to comment on 'any errors of fact or law' in the advance unedited Report.

2. Specific observations on each area are submitted as follows:

I. Debt and Macroeconomic Stability and the Current Economic Reform Programme

(paras 13 – 32)

Comment:

3. On the fiscal front, the GoSL has continued to achieve a sustainable reduction of fiscal deficit and outstanding public debt assisted by enhanced revenue mobilization. As such, the fiscal deficit was curtailed at 5.5 percent of GDP in 2017 which was marginally high compared to 5.4 percent in 2016. The budget deficit will contain at 3.5 percent of GDP over the medium-term, which will enable lowering the outstanding balance of government debt to an estimate of 76.6 percent of GDP by end 2018, compared to 78.8 percent of GDP as at in 2016. With the prudent deficit curtailment measures, outstanding government debt would fall to a level of about 66 percent of GDP by 2022. Such progressive path will also be ensured without compromising on the expenditure on social and capital budgets which drive long-term growth prospects of the economy.

4. On the social spending front, the GoSL has continued to invest heavily on development of sectors such as health and education, while ensuring adequate funds for social safety net programmes such as *Samurdhi,* fertilizer subsidy and school uniforms etc. The policy has been directed to empower the 'poor' and safeguard vulnerable groups through social safety net programmes and ensure that the country's development is equitable and sustainable over the long-term. The GoSL ensures that the concerns of multiple strata of the society would be adequately and effectively addressed through targeted fund allocations. In particular, social groups such as women, pensioners, public servants, overseas workers, estate employees, students and school leavers etc., are receiving prominence in government's policy formulation. Meanwhile, socio-economic sectors which are given greater emphasis including agriculture (farming, plantation, fishing etc.), higher education, health, labour market etc. Measures have been taken to ensure that an adequate space is provided for social and capital spending within the overall spending envelop, thereby maintaining growth prospects as robust and inclusive.

5. On the debt management front, the newly enacted Active Liability Management Act will provide an opportunity to address part of refinancing requirements ahead of time by reducing rollover risks and extending the maturity duration of debt obligations. In support of the use of active liability management operations, the GoSL is reinforcing the Medium-Term Debt Management Strategy (MTDMS) with an overarching objective of containing the exposure of foreign outstanding liabilities at manageable level. The MTDMS enables the GoSL to identify and quantify the main risks of public debt portfolio, thereby helping to specify an appropriate currency and maturity composition of the debt issuance strategy. Accordingly, future government borrowings would be carried out in accordance with an Annual Borrowing Plan (ABP) which forms an integral part of the government's efforts towards bringing the public debt to prudent level.

6. On the macroeconomic front, the economy is expected to gradually pick up thereby moving the economy toward the potential level to about 4.5 percent in 2019 and to about 5.5 percent in 2022 from 3.1 percent in 2017. This will be assisted by the government's development agenda which places great emphasis on the private sector participation as well as its own initiatives to ensure rapid development in rural, urban and estate sectors, and infrastructure development in thrust areas while ensuring social protection programmes. Unemployment rate is expected to stabilize at around 4.0 percent. Further, the government's efforts to increase women labour participation would help enhance production capacity in the economy.

7. Attracting more FDIs through the development of Port City, inflows into public investment projects and export promotion would also strengthen foreign currency flows, which would partly meet the foreign currency requirements for debt servicing obligations of the Government. Such foreign currency inflows to the financial account would reinforce the level of official reserves while containing any depreciation pressure.

II. Monetary Policy

Page 9, Para 34, sentence 2 on depreciation of the rupee

"Depreciation of the rupee was observed over 2018.This has increased the value of foreign currency denominated debt; increased the cost of imports into Sri Lanka including foods; and reduced the purchasing power of wage-earners…"

Comment:

8. Depreciation of the rupee increases the value of foreign currency denominated debt in rupee terms. Although the depreciation of the Sri Lankan rupee would be reflected as an increase in the government foreign currency debt stock in rupee terms, the accumulated debt stock denominated in foreign currency would remain unchanged in terms of foreign currency, irrespective of such depreciation. As this debt stock denominated in foreign currency would be serviced using foreign currency inflows to the government, the impact of its increase in rupee terms will be negated. Therefore, the change in the value of debt stock in rupee terms due to depreciation or appreciation of the rupee can neither be considered as an additional real expenditure nor be considered as a real savings on net basis for the government.

9. Preliminary studies have shown that the passthrough effect of the exchange depreciation on inflation is not very significant in the Sri Lankan context, particularly to those near the poverty line as the major portion of their consumption basket are domestically produced food and other consumables. However, purchasing power of middle income earners may be affected by the passthrough effect of higher cost of imports.

10. It should be noted that the depreciation of the rupee is not disadvantageous to all segments of the population. The depreciation could be beneficial for some segments of the population, including those in tourism sector, businesses and workers in the export sector as well as the Sri Lankan workers in Middle East and other regions who remit money to Sri Lanka.

III. Reform of State Owned Enterprises

(Paras 35 – 37)

Comment:

11. The GoSL adopted the pricing formula for the pricing of fuel except kerosene. Kerosene is being provided at a subsidized price enabling to reduce the burden of market-based mechanism to the livelihoods of fishermen, farmers and rural households. Further, the GoSL has also recently implemented the fertilizer subsidy to improve the living standards of farmers while enhancing agricultural productivity.

IV. Project Financing and International Development Assistance

(paras 60 – 66)

Comment:

12. The GoSL mobilizes foreign financing for infrastructure projects mainly from multilateral and bilateral development partners under the legal system of Sri Lanka. There are many accepted procedures that have to be followed to mobilize foreign financing for a particular project such as fact-finding, pre-feasibility and feasibility studies, project designing, obtaining Cabinet approval and obtaining legal clearance from the Attorney General's Department etc. Any citizen can make any complaint during this process as the government always looks for wider stakeholder consultation including the general public during the process.

13. Even after the commencement of the project, as per our legal system, the public is free to complain to the Development Partner, line Ministry or the Treasury, or even go to the Human Rights Commission or courts for any violation of human rights, involuntary resettlements or any other form of grievances. Apart from that, Multilateral Development Partners have a well- established internal justice system to seek redress for citizen's grievances. Any adversely affected person can directly write to multilateral funding agencies and make a complaint. According to the records, the External Resources Department (ERD) has not received any complaint on human rights relating to infrastructure project issues during the last 10-12 years due to the stakeholder consultation process in place for all infrastructure projects during project preparation and implementation. The GoSL has recognized the importance of streamlining and strengthening current practice in a well-coordinated manner in order to ensure social inclusion and equity.

V. Microcredit and Human Rights

(paras 71 – 89)

Comment:

14. The GoSL being acutely aware of the of issues associated with microfinance, especially the difficulties faced by women in poor and former conflict areas, has implemented a policy from August 2018 to provide debt relief for women in the Districts of Trincomalee, Ampara, Batticaloa, Jaffna, Mulaitivu, Kilinochchi, Vavniya, Mannar, Kurunegala, Puttalam, Anuradhapura, Polonnaruwa, who have availed themselves of micro-finance loans from Micro Finance Institutions (MFIs) as registered with Lanka Micro Finance Practitioners Association (LMFPA) and Finance Companies (FCs) registered with the Central Bank of Sri Lanka (CBSL). Those who have loans where the initial capital is less than or equal to Rs.100,000 (initial capital) and outstanding for at least 3 consecutive months as at 30th June 2018 will have their debt written off under this policy. For further information, please see at **Annex 'A',** the Development Finance Circular No.1/ 2018.

15. In paragraph 81 of the report, it is stated that licenses have to be requested by institutions. This is inaccurate, and licensing is a mandatory obligation. As per Section 32 of the Microfinance Act, No.6 of 2016 (the Act), no person other than a licensed microfinance company, a microfinance NGO or an institution exempted from the application of the provision of the Act under Section 2, shall carry on microfinance business. Section 32 of the Act defines Microfinance Business as accepting deposits and providing financial accommodation in any form and/or other financial services. Therefore, it is mandatory for any person who carries on Microfinance Business as defined in the Act and who is not exempted from the application of the provisions of the Act to obtain a licence under the Act to carry on Microfinance Business. As per Section 35(1) of the Act any person carrying on Microfinance Business in contravention of the aforesaid requirements commits an offence and punishable by imprisonment and/or a fine.

16. With regard to customer protection, banks are required to comply with the Banking Act Directions No. 8 of 2011 on Customer Charter issued on 05.10.2011, where harassing of customers and using abusive debt collection procedures are not permitted.

17. Enhanced access by banks to finance in rural areas has been encouraged by requiring to open 2 branches outside the Western Province for each branch set up in Western Province, by the Circular dated 26.05.2008.

18. Central Bank has requested all licensed banks, by Circular issued on 01.02.2017, to take appropriate measures to implement budget proposals on providing credit facilities: to women not less than 5% of the total credit portfolio, and to grant credit of more than 15% of the deposits mobilised by bank branches for business development in the respective area.

19. The Bank Supervision Department of the Central Bank continues to monitor compliance with the above requirements.

20. With regard to the interest rate caps on various credit products, even though there are no caps applicable at present for banks, the interest rates offered by banks are closely monitored on a continuous basis to see whether there are significant movements in interest rates and if necessary, caps would be re-introduced.

21. Three Regional Indebtedness Review Programmes were held at Killinochchi (2017), Nuwara-Eliya (April 2018) and Trincomalee (May 2018) for public and bankers, aimed at providing awareness about the indebtedness issues with the participation of Gramaniladhari officers and bank officials. During these programmes, the difficulties faced by customers in accessing banking facilities, recoveries carried out at abnormal hours and creating debt traps by giving loans to settle other loans, were highlighted and bankers were requested to examine and address these issues.

VI. Illicit Financial Flows and Human Rights

(paras 44 – 59)

A. Impact of illicit financial flows on human rights

Comment:

22. In response to the European Union Directive, it is to be noted that at the Financial Action Task Force (FATF) plenary held in October, 2018, Sri Lanka was upgraded to Complaint and Largely Compliant in 27 of the 40 FATF recommendations. These include the regime on anti-money laundering and countering of terrorist financing. It is also noted that during the three decades long period of terrorist conflict in Sri Lanka, measures taken to combat terrorist financing was stringent and it has been taken cognizance of at the Asia Pacific Group on money laundering, in which Sri Lanka is a member. Sri Lanka also enacted U.N. Regulations 1267 and 1373 in accordance with the resolutions of the United Nations Security Council in imposing sanctions on Terrorist Groups and their illicit financial dealings.

B. Legal framework and international commitments

Comment:

23. Prevention of Money Laundering Act No. 05 of 2006 has incorporated:

- Section 3(1)(a) – any person directly or indirectly involved in transactions in relation to property which is derived directly or indirectly from any unlawful activity.

- Section 3(1)(b) – receives, possesses, conceals, disposes of or brings into Sri Lanka transfers out of Sri Lanka, or invests in Sri Lanka any property which is derived or realized, directly or indirectly from any unlawful activity of from the proceeds of any unlawful activity.

- *Note:* The Amendment No. 40 of 2011- (1A) – The assets of any person found guilty of the offence of money laundering under this section shall be liable for forfeiture in terms of Part II of the Act.

- Unlawful activity – does not cover tax related offences. (interpretation section)

24. Paragraph 54 (last line) states that in 2018, new guidelines were put in place by the Central Bank with a view to ensuring a better management of suspicious transactions reports. Guidelines on suspicious transaction reports were issued to financial institutions (FIs) and designated non-financial business and professionals (DNFBPs) by the Financial Intelligence Unit (FIU).

VII. Conclusions and Recommendations

Para 97 (f): "add tax fraud to the list of suspicious transactions that financial and non-financial entities and professionals must report to competent authorities;"

Comment:

25. Financial Transaction Reporting Act No. 6 of 2006 stipulates the following:

- Section 7 of Act imposes obligations on institutes that where there are reasonable grounds to suspect a transaction, to report such to the Financial Intelligence Unit.
- Section 8 of the Act imposes obligations to the Institutions to disclose to the Financial Intelligence Unit
- Every Institution shall, in relation to any person conducting transactions with such institution, forthwith disclose to the Financial Intelligence Unit-

a. the existence of any property in its possession or control, which to its knowledge is, or which it reasonably suspects is, property derived from the commission of any terrorist activity in terms of any law for the time being in force;

b. the existence of any property in his or her possession or control, owned or controlled by or on behalf of a specified entity or for which there are reasonable grounds for suspicion that it is owned or controlled by or on behalf of a specified entity;

c. any information regarding a transaction or proposed transaction in respect of property derived from the commission of any terrorist activity in terms of any law for the time being in force, or

d. any information regarding a transaction or proposed transaction and there are reasonable grounds for suspicion that such transaction may involve property derived from the commission of any terrorist activity in terms of any law for the being in force.

Para. 97 (e): "Make tax evasion and providing assistance for tax evasion a criminal offence under the Penal (Criminal) Code, not solely an administrative or fiscal contravention;"

Comment:

26. Institutional Framework in this regard includes the functioning of the Financial Intelligence Unit of the Central Bank of Sri Lanka and the Financial Crime Investigation Division of the Police.

VIII. Corrections of Errors in the Report

Page 5, para 14

"Between 2000 to 2009 foreign debt doubled and it has continued growing ever since. At the end of 2017 it amounted to US$ 28.7 billion, a boost of 13 percent in comparison to 2016, the debt amounting to 25.3 billion at the end of the year 2017."

Comment:

27. It should be noted that "between 2000 to 2009 foreign debt doubled" in rupee terms. Although foreign debt showed an increase in rupee terms, foreign debt as a percentage of GDP has dropped to 35.5 percent in 2017 from a high of 43.1 percent in 2000. The second sentence in the same paragraph, the foreign debt for 2017 should be in USD terms.

Page 5, para 15, sentence 1

"While debt to GDP ratio has declined from 86.2 per cent in 2009 to 77.4 per cent in 2017, the more onerous composition of the debt needs to be carefully considered, impacting debt servicing given the repercussions interest to be paid."

Comment:

28. Debt to GDP ratio for 2017 should be corrected as 77.6 percent, not 77.4 percent.

Page 8, para 29, last sentence

"…As a result, a significant reduction in the number of households receiving *Samurdhi* cash transfers is to be expected as the intention was to reduce the number of beneficiaries by 10 per cent in 2017."

Comment:

29. There is no reduction in number of *Samurdhi* beneficiaries. For instance, the GoSL added another 150,000 beneficiaries to the *Samurdhi* programme in 2018 totaling of 1,400,000 recipients with an annual cost of Rs.44 billion.

Page 8, para 32, first sentence

"Social spending should not be cut in order to repay increasing debts if less harmful policy options are available."

Comment:

30. Social spending has not been cut in the event of the accumulation of government debt. For instance, welfare expenditure on the education sector such as school uniforms, text books, insurance and nutrition food programme etc., has increased by 146.4 percent to Rs. 4.9 billion in 2017, compared to Rs. 2.0 billion in 2016.

Page 8, paragraph 28

"Trying to achieve fiscal adjustment by reducing public expenditure in education, health and social transfers actually hinders long-term development and may have negative effects on social and economic stability..."

Comment:

31. The government expenditure on healthcare has increased by 6 percent to Rs. 204 billion in 2017. Total investment in general education increased by 8 percent to Rs. 201 billion while total government investment for university systems was Rs. 48.7 billion in 2017.

Page 9, para 33, First sentence

"Sri Lanka's letter of intent to the IMF of 2016 highlights that the Government intends to maintain inflation within a range of 3% of the projected path."

Comment:

32. The Central Bank of Sri Lanka intends to maintain inflation within range of 4-6% over the medium term, and not within a range of 3%.

Page 9, reference no. 39

"Central Bank of Sri Lanka, Monetary Policy Review No. 6, 2 October 2018, available at: https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/press/pr/press_20181002_Monetary_Policy_Review_No_6_2018_e.pdf"

Comment:

33. Please change the reference to Road Map 2018 – Monetary and Financial Sector Policies for 2018 and Beyond, available at https://www.cbsl.gov.lk/sites/default/files/press_20180103_Road_Map_2018_e.pdf

page 14, para 61, sentence 4

"…Furthermore, as they have somehow consequences on public spending, information received by the Independent Expert indicate that funds allocated to mega development project such as the loan-funded Colombo Port City, may collaterally impact the realization of human rights while not necessarily ensuring shared benefit in promoting social inclusion or equity for instance.”

Comment:

34. Colombo- Port City project is a foreign direct investment project and not a loan-funded project as stated in the report.

Page 12, para 51, last sentence

“In addition, customer due diligence is embedded in section 24(1) of the Financial Transactions Reporting Act, prohibiting financial institutions to open, operate or maintain anonymous accounts.”

Comment:

35. The provision pertaining to the Customer Due Diligence (CDD) is embedded in Section 2(1). However, the report refers to the section as Section 24(1).