Fiscal Strategy Statement – 2026

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Content

PART I

Fiscal Strategy Statement 2026
(FSS 2026)

Fiscal Strategy Statement 2026 (FSS 2026)

1. Introduction

Sri Lanka's economy has made a remarkable transition from crisis response to reform and recovery. Following the unprecedented economic collapse in 2022, the country has demonstrated notable progress in restoring macroeconomic stability and rebuilding confidence. The economy recorded a 5 percent real growth in 2024, the strongest since 2014. This signals a renewed momentum and rebuilding of confidence of investor and people in the future, helped by disciplined fiscal consolidation, effective monetary policy, and structural reforms implemented in line with the International Monetary Fund – Extended Fund Facility (IMF-EFF) programme.

These gains were supported by Sri Lanka's successful near completion of key debt restructuring milestones in 2024, including agreements with official creditors and high participation in the sovereign bond exchange. In parallel, the government maintained its commitment to the IMF-EFF programme, demonstrating strong policy discipline. This continuity signaled credibility to international partners and capital markets, contributing to credit rating upgrades by Fitch and Moody's and improving investor sentiment.

The Parliament enacted two landmark fiscal laws in 2024, the Public Debt Management Act, No. 33 of 2024, and the Public Financial Management Act, No. 44 of 2024 (PFMA). The PFMA includes an updated Fiscal Responsibility Framework, which seeks to reestablish a rules-based approach to setting and achieving fiscal targets. The Fiscal Responsibility Framework underpins and modernizes fiscal governance in Sri Lanka. It mandates the preparation of an annual Fiscal Strategy Statement (FSS) and accompanying Fiscal Risk Statement (FRS), including the setting of new quantitative targets on fiscal aggregates to provide binding constraints over each budget process.

The macroeconomic stability restored in 2023 and 2024 has laid the foundation for longer term prosperity: Inflation declined into negative territory; the rupee appreciated by over 10 percent; and gross official reserves increased to USD 6.3 billion by end-May 2025. The external current account remained in surplus for a second consecutive year, supported by tourism and foreign workers' remittances. Despite these positive signs, challenges remain. Vulnerabilities stemming from global trade tensions, subdued external demand, and high poverty levels require a continued focus on inclusive development, resilience-building, and structural reforms.

As the country enters the next phase of its reform journey, the Fiscal Strategy Statement 2026 (FSS 2026) sets out a clear roadmap for safeguarding Sri Lanka's journey of macroeconomic stability. The pillars of the strategy are to pursue sustained debt reduction over the medium-term, targeting at least a 2.3 percent of GDP primary surplus, lifting government revenues to above 15 percent of GDP, and keeping close control over expenditure growth, while boosting investment in infrastructure and productive capacity of the country.

The preparation of the FSS is mandated in Section 11 of the Public Financial Management Act, No. 44 of 2024 (PFMA), which requires the Minister of Finance to prepare the FSS annually.

Objectives of the Fiscal Strategy Statement

The purpose of the FSS is as follows:

- Provide the Parliament and the public with a formal statement of the Government's fiscal strategy before the annual budget is prepared;
- Provide Ministries with strategic guidance as they develop proposals for the upcoming annual budget;

- Establish the basis upon which fiscal performance shall be evaluated objectively;
- Strengthen Parliamentary oversight of performance against the Government's fiscal strategy; and
- Enhance fiscal transparency and accountability.

The fiscal responsibility provisions enacted under the PFMA establish specific requirements regarding the content of the FSS and Medium-Term Fiscal Framework (MTFF). The minimum content of the FSS as specified by the PFMA is summarized in Annexure I.

2. Fiscal Goals and Priorities of the Government

The overarching goals of fiscal policy over the next five-year period 2026–30 are to control and reduce public debt to sustainable levels by increasing revenue, controlling expenditure growth, and thereby reducing gross financing needs while supporting efforts to restore macroeconomic growth and stability. The objective of reducing public debt is to be pursued with vigour, and efforts will need to be sustained over many years.

Fiscal policy is also being shaped by various other commitments the government has made under the IMF-EFF programme, which covers the fiscal years from 2023 to 2027. The Government's MTFF now extends three years beyond the programme from 2028 to 2030. Fiscal policy also takes into account commitments entered into with other development partners, including the World Bank and the Asian Development Bank (ADB).

The PFMA requires the government to ensure its fiscal policy is consistent with the objectives of responsible fiscal management including to:

- Ensure that **public debt** is reduced to, and maintained at a sustainable level;
- Create and maintain **fiscal buffers** that secure against future shocks;
- Manage and mitigate **fiscal risks** in a prudent manner;
- Ensure **discipline, transparency, and accountability** in fiscal management;
- Lengthen the time horizon of **fiscal planning** through the development and publication of an annual **fiscal strategy statement** and rolling five-year **medium-term fiscal framework**; and
- Facilitate **effective scrutiny** of the fiscal performance of the Government.

The FSS and the details published within it will now become the key vehicle through which the Government establishes its fiscal goals and priorities. In particular, the PFMA requires that the FSS include specific and measurable plans in relation to a number of related fiscal variables:

- **A debt reduction objective**: specifying the time frame over which the Government is planning to reduce and then maintain public debt at sustainable levels;
- **A primary balance target**: the government's targeted level of primary surplus (total revenue minus non-interest expenditure) for the upcoming budget year and for each of the following four fiscal years, determined to be consistent with its debt reduction objectives; and
- **A primary expenditure ceiling**: the total value of primary expenditure (i.e, excluding interest) that the government will observe in formulating and executing the upcoming annual budget, consistent with its debt reduction objectives and primary balance target. The PFMA requires that the primary expenditure ceiling be no higher than 13 percent of GDP for the first five years of its operation.[1]

The choice of these three fiscal variables as the central focus of the Fiscal Responsibility Framework is quite deliberate. They are also interrelated.

The primary expenditure ceiling reflects what the Government can most directly control through its budgetary decisions.

Primary expenditure must be calibrated to be consistent with the primary balance target, which requires explicit and credible assumptions and projections to be laid out for macroeconomic parameters and the outlook for revenue while taking any new policy measures into account.

1 The maximum allowable primary expenditure ceiling can then be reviewed and recalibrated for successive five – year periods, but must remain consistent with the debt reduction objective and associated primary balance target.

The primary balance target is itself related to the desired pace of debt reduction, although other external factors and shocks outside the government's direct control may also influence debt levels (e.g. interest rates, inflation, currency movements, triggering of government guarantees or contingent liabilities).

Debt Reduction Objective

Reducing and then maintaining public debt at sustainable levels lies at the heart of fiscal responsibility. High levels of public debt represent a significant vulnerability, increase borrowing costs across the economy, divert scarce budgetary resources towards debt servicing costs, and limit future policy choices. Strong progress has been made under the IMF-EFF programme in bringing public debt under control.

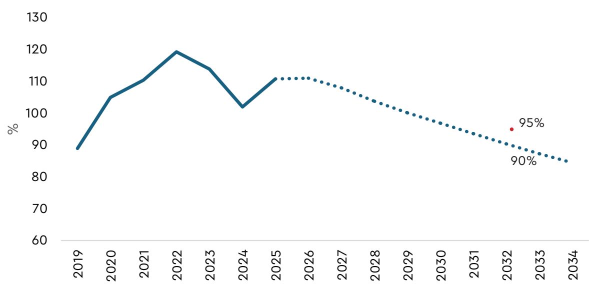
To achieve a sustained reduction in debt towards much lower and safer levels, and to restore fiscal buffers, prudent fiscal settings will likely need to be sustained over the next 20 years or more. This clearly goes well beyond the rolling five-year horizon of the Government's Fiscal Strategy. The debt reduction objective must therefore be understood as a long-term anchor for fiscal policy. Reducing the public debt to GDP ratio to below 95 percent of GDP by 2032 was one of the quantitative milestones contained within the IMF-EFF programme. This will continue to serve as an interim debt target.

With the continued successful implementation of the IMF-EFF programme, including the recent near conclusion of associated debt restructuring, the latest IMF projections are for public debt to be reduced from 95 percent to around 90 percent of GDP by 2032. There is therefore a modest buffer between the target and projections, which is prudent given the significant uncertainty around economic and fiscal developments over the coming years. These projections will be updated regularly, and fiscal settings can be recalibrated as needed to ensure the achievement of this goal.

Public debt will need to be reduced to even lower levels if Sri Lanka is to restore its fiscal buffers and be better prepared to face future risks, uncertainties, and challenges. Further debt reduction would need to be pursued before public debt can be sustained at much safer levels of below 60 percent of GDP. Extrapolating the latest debt projections, this would likely take until the early 2040s to achieve.

The latest public debt projections are taken from the debt sustainability analysis (DSA) contained in the IMF-EFF Programme. This follows the successful conclusion of debt restructuring negotiations for the vast majority of Sri Lanka's public debt. The Ministry of Finance is developing its capabilities to undertake DSA which is to be published by the Minister of Finance annually and form the basis for rolling updates of the fiscal strategy.

Figure 1 | Public Debt (% of GDP)



Source: Central Bank of Sri Lanka & IMF – EFF Programme

As stipulated in the PFMA, the Government has established a revised limit on the stock of government guarantees, lowering it from 15 percent of GDP[2] to 7.5 percent and implementing a new framework for managing the issuance of guarantees. It is expected that this policy change can help reduce the likelihood and impact of guarantees being triggered in the future.

Primary Balance Target

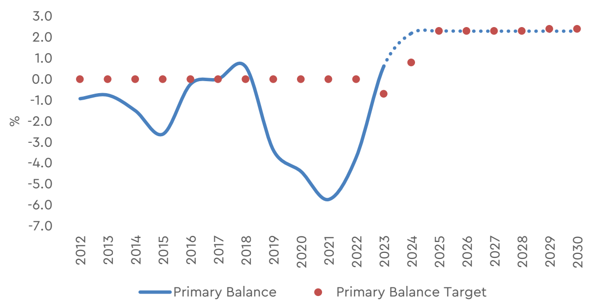
The Primary Balance Target (PBT) must be set in consistent with the debt reduction objective and will therefore serve as the main practical guardrail for fiscal policy until debt sustainability is restored.

2 Average GDP of the relevant financial year and two preceding financial years.

As per the PFMA, the Government is required to monitor its actual and expected compliance with this target, advise Parliament if circumstances arise that put its achievement at risk in any year, and if necessary, devise appropriate remedial measures to get the situation back on track. For example, if further major shocks are experienced, it would likely prove necessary to recalibrate the MTFF and primary balance target to ensure continued alignment with the debt reduction objective.

The Government adopted a primary surplus target of 2.3 percent of GDP from 2025 to 2027 under the IMF-EFF programme and will maintain at least this target to cover the remaining three years of the MTFF period, 2028 to 2030. Based on the latest DSA, targeting a primary surplus of at least 2.3 percent over the 2026–30 MTFF period is consistent with reducing public debt to below 95 percent of GDP by 2032.

Figure 2 | Primary Balance (% of GDP)



Source: Department of Fiscal Policy

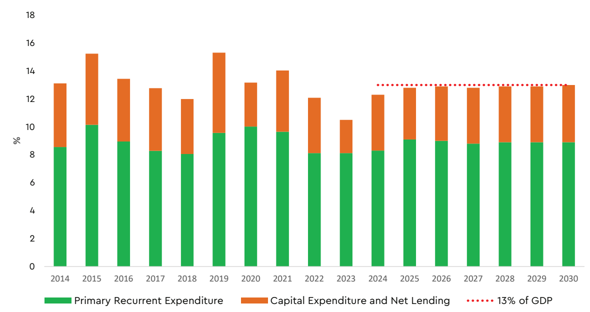
Primary Expenditure Ceiling

Consistent with the primary balance target, and the latest outlook for revenues agreed under the IMF-EFF programme, the primary expenditure ceiling for the 2026 budget is set at 12.9 percent of GDP. The indicative ceiling for the 2028–2030 fiscal years is for primary expenditure to be maintained around 13 percent of GDP.

This profile sits around the 13.0 percent limit in the PFMA to ensure consistency with the primary balance target, given the latest revenue projection of 15.2 percent of GDP for 2026.

Based on the latest economic outturn and updated outlook this translates into a nominal ceiling on primary expenditure of Rs. 4,470 billion for the 2026 Budget, which must be observed in all stages of budget development and adoption as well as in terms of actual budget execution.

Figure 3 | Primary Expenditure



Source: Department of Fiscal Policy

The primary expenditure ceiling for future years will be recalculated in each annual update of the FSS to reflect the latest economic statistics and revised outlook for the main macroeconomic and fiscal variables. This annual update will also be guided by a formal assessment of performance against the MTFF targets.

Additional Fiscal Targets

The government has a number of complementary fiscal targets which provide additional granularity to its strategy, while ensuring consistency with the main requirements of the PFMA and commitments under the IMF Programme.

The government's shorter to medium-term fiscal policy objectives are all guided by the overarching objective of debt reduction and securing and sustaining the gains made toward greater fiscal sustainability. Other specific targets that the government has established are as follows:

- Increasing government revenue as a percentage of GDP to over 15 percent in 2026 and beyond;
- Rationalizing government expenditure to maintain it at a sustainable level;
- Gradually increasing and maintaining public investment at over 4 percent of GDP from 2027 and beyond; and
- Containing budget deficits gradually to be less than 5 percent of GDP from 2028 and beyond.

Medium-Term Fiscal Framework (MTFF)

The FSS sets out the government's MTFF for the upcoming financial year and the four succeeding financial years, as required by Section 12 of the PFMA. Table 1 below provides the 2025–2030 MTFF, which prescribes key parameters for the upcoming 2026 Budget and presents the latest projections for the period through to 2030.

The projections imply that the various requirements of the Fiscal Responsibility Framework are expected to be satisfied. The MTFF will be updated each year to maintain a rolling five-year horizon and the PFMA requires the government to undertake ongoing monitoring of performance against this plan and to manage any actual or expected deviations if they occur.

Table 1 | Medium-Term Fiscal Framework: 2025–2030

As a percentage of GDP (Unless othewise noted)

Indicator	2024 Provisional	2025 Budget	2025 Revised Projections	2026 Estimates	2027 Projections	2028 Projections	2029 Projections	2030 Projections
Total Revenue and Grants	**13.7**	**15.1**	**15.1**	**15.2**	**15.3**	**15.3**	**15.4**	**15.4**
Tax Revenue	12.4	13.9	13.9	14.0	14.1	14.1	14.2	14.2
Non-Tax Revenue	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Grants	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total Expenditure	**20.5**	**21.8**	**21.6**	**20.8**	**20.4**	**20.0**	**19.4**	**19.2**
Recurrent Expenditure	**17.9**	**17.8**	**17.9**	**17.0**	**16.3**	**15.8**	**15.3**	**14.9**
Non-Interest Recurrent Expenditure	8.9	8.9	9.1	9.0	8.9	8.8	8.8	8.8
Interest Expenditure	9.0	8.9	8.8	8.0	7.4	7.0	6.5	6.1
Capital Expenditure and Net Lending	**2.6**	**4.0**	**3.7**	**3.8**	**4.0**	**4.2**	**4.2**	**4.3**
o/w Public Investments	**2.7**	**4.0**	**3.7**	**3.8**	**4.0**	**4.2**	**4.2**	**4.3**
Primary Balance *(excluding interest)*	**2.2**	**2.3**	**2.3**	**2.3**	**2.3**	**2.3**	**2.4**	**2.4**
Budget Balance	**-6.8**	**-6.7**	**-6.5**	**-5.6**	**-5.1**	**-4.6**	**-4.0**	**-3.7**
Nominal GDP (Rs. billion)	*29,899*	*33,000*	*32,036*	*34,754*	*37,664*	*40,779*	*44,163*	*47,826*
Nominal GDP (growth rate)	*9.0*	*10.4*	*7.1*	*8.5*	*8.4*	*8.3*	*8.3*	*8.3*
Real GDP (growth rate)	*5.0*	*3.0*	*3.5*	*3.1*	*3.1*	*3.1*	*3.1*	*3.1*
GDP deflator (percent change)	*3.8*	*6.7*	*3.6*	*5.3*	*5.1*	*5.0*	*5.0*	*5.0*
Primary Expenditure (as a % of GDP)	*11.5*	*12.8*	*12.8*	*12.9*	*12.9*	*13.0*	*13.0*	*13.0*
Primary Expenditure (Rs. billion)	*3,441*	*4,240*	*4,100*	*4,470*	*4,876*	*5,301*	*5,731*	*6,241*

Source: Department of Fiscal Policy

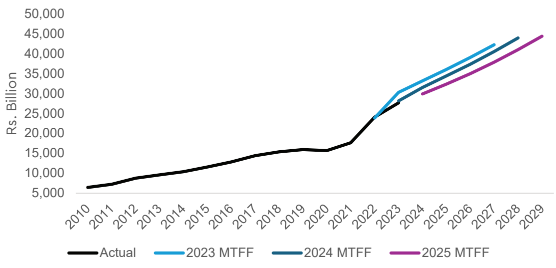
Macroeconomic Assumptions

The fiscal targets and projections in the MTFF are expressed as ratios, calculated by dividing the relevant fiscal aggregates by projections for nominal GDP (GDP in current prices). The assumptions that sit beneath the nominal GDP projections are presented in Table 1. This comprises projected real GDP growth of 3.1 percent per annum and assumed growth in the GDP deflator (an estimate of economy-wide inflation) of 5 percent per annum.

Figure 4 illustrates the nominal GDP projections that have been used (but not previously published) in preparing the 2023, 2024, and 2025 MTFF vintages. Each update of the MTFF will involve an updated set of macroeconomic projections, reflecting recent actual outcomes in the relevant economic variables and an assessment of whether the forward-looking assumptions remain reasonable. As can be seen, the latest set of projections is for the trajectory of nominal GDP to be lower over the medium-term than previously projected. This is consistent with recent inflation outturns, which have been lower than previously assumed in each of the past few years.

The Fiscal Risk Statement contains a section examining the performance of recent macroeconomic and fiscal forecasts and the main factors that have driven deviations between forecasts and outcomes.

Figure 4 | Nominal GDP



Source: Department of Fiscal Policy.

Consistency of the Fiscal Strategy with the Objectives of Responsible Fiscal Management

The Government's fiscal targets and policies are closely aligned with the objectives of responsible fiscal management, as follows:

(a) Debt Sustainability: The government aims to reduce public debt to a sustainable level and maintain it within those bounds. This objective is reflected in its fiscal targets, which embed a sustained and significant debt reduction over the long term. By actively managing debt levels, the government will ensure the financial stability of the country and minimize the burden on future generations.

(b) Fiscal Buffers: Creating and maintaining fiscal buffers is another key objective served by the fiscal strategy. This entails setting aside reserves to cushion against future economic shocks or emergencies. The government's fiscal policies include provisions for building up these buffers, thereby enhancing the country's resilience to adverse events and reducing the need for drastic measures during crises.

(c) Discipline, Transparency, Accountability and Scrutiny: Ensuring discipline, transparency, and accountability in fiscal management is fundamental. The government's fiscal targets and policies are clear, with additional mechanisms for performance monitoring and accountability. By adhering to transparent reporting practices and inviting independent scrutiny of fiscal performance, the government enhances trust and confidence in its management of public finances.

(d) Long-Term Planning: Lengthening the time horizon of fiscal planning is being achieved through the development and publication of annual fiscal strategy statements and rolling five-year medium-term fiscal frameworks. By setting out clear fiscal strategies and priorities over the medium to long term, the government promotes stability, predictability, and effective allocation of resources. This will be particularly beneficial for supporting a sustained lift in the rate of public investment for Sri Lanka.

3. Assessment of Performance against the Fiscal Strategy

Forward-looking Assessment of the Fiscal Strategy over the Medium-Term

Based on the fiscal targets outlined in Section 2, the fiscal strategy focuses on achieving the targeted primary surpluses consistent with the objective of reducing public debt, while promoting economic growth and stability. The fiscal strategy of the government is particularly focused on the following aspects:

- **Reducing public debt**: The strategy is consistent with reducing public debt to below 95 percent of GDP by 2032, with the latest IMF projections indicating an expected value of around 97 percent of GDP by 2030 and 90 percent of GDP by 2032.

- **Achieving the Government Revenue Target**: By targeting an increase in the Revenue to GDP ratio from 13.7 percent in 2024 to over 15 percent of GDP from 2025 and beyond, the fiscal strategy seeks to permanently enhance Sri Lanka's fiscal capacity, enabling governments to fund a greater proportion of operations, services, and investments while reducing reliance on borrowing.

- **Controlling Government Expenditure**: Planning for primary expenditure to remain below the newly legislated limit of 13 percent of GDP from 2025 and beyond indicates an enduring commitment to efficient resource allocation and cost control. Close control of expenditure ensures that government spending remains sustainable and is aligned with the highest priorities.

- **Boosting Public Investment**: Within the overall limit on primary expenditure, increasing and maintaining the budget allocation to public investment of around 4 percent of GDP from 2027 onwards underscores the importance of infrastructure development and investment for Sri Lanka's future. Well-executed public infrastructure investment stimulates economic growth, enhances productivity, and lays the foundation for long-term prosperity.

- **Delivering Primary Surpluses**: Building on recent gains and maintaining a primary surplus of at least 2.3 percent from 2025 and over the medium-term is designed to deliver fiscal sustainability. A primary surplus indicates that government revenues exceed non-interest spending, which is a necessary step to achieve debt reduction and the rebuilding of fiscal buffers.

- **Containing Budget Deficits**: Gradually reducing budget deficits to less than 5 percent of GDP from 2028 onwards also demonstrates a commitment to fiscal discipline and intergenerational equity. The risk premia and costs of servicing Sri Lanka's public debt will continue to decline if the fiscal strategy is achieved, creating further headroom for addressing other priorities. Containing deficits is a crucial step to stabilize public debt levels and restore investor confidence in the economy.

Accordingly, the government's fiscal strategy aims to strike a balance between efficient revenue generation, sound expenditure management, investment promotion, deficit containment, and achievement of a surplus in the primary balance target. By adhering to the various fiscal targets, the government seeks to ensure sound fiscal management, promote economic growth, and safeguard the long-term financial health of the country.

Fiscal Performance in 2024

Fiscal operations in 2024 showed a significant further improvement, with the preliminary outturn of a primary surplus of 2.2 percent of GDP compared to the 2024 budget forecast of a primary surplus of 0.8 percent (Table 2). This represents a favorable variance of 1.4 percentage points of GDP compared to the 2024 Budget, and a 1.6 percentage point increase over the 2023 outcome of 0.6 percent of GDP primary surplus.

The outturn for the overall budget in 2024 was a deficit of 6.8 percent of GDP compared to a forecast deficit of 7.6 percent of GDP, a solid improvement from the 8.3 percent of GDP deficit reported in 2023.

Nominal GDP growth of 9.0 percent in 2024 was weaker than the forecast 12.1 percent, primarily due to economy-wide inflation being significantly less than expected. Growth in real GDP of 5.0 percent in 2024 exceeded the Budget forecast of 1.8 percent growth reflecting a stronger-than-expected recovery in the manufacturing, constructions, and tourism sectors.

Total revenue and grants in 2024 of Rs. 4,091 billion was slightly behind the budget forecast of Rs. 4,127 billion, but represents 13.7 percent of GDP, well above the Budget forecast of 13.1 percent of GDP. Taxes on income and profits and external trade were generally in line with their respective forecast shares of the economy, with taxes on goods and services stronger than forecast.

Total expenditure of Rs. 6,131 billion in 2024 was kept well below the initial budget forecast of Rs. 6,528 billion, representing an outturn of 20.5 percent of GDP against the forecast of 20.7 percent of GDP. This result was largely due to managing the execution of capital investment in line with available cash flows and financing with recurrent expenditure on salary and wages also less than budgeted. Expenditure on subsidies and transfers and interest were each around 0.5 percent of GDP higher than expected as a share of the economy.

Table 2 | Performance Assessment 2024

Indicator	Rs. Billion			% of GDP	
	2024 Budget*	2024 Provisional	Variance with Budget	2024 Budget	2024 Provisional
Total Revenue and Grants	**4,127**	**4,091**	**(36)**	**13.1**	**13.7**
Total Revenue	**4,107**	**4,031**	**(76)**	**13.0**	**13.5**
Tax Revenue	**3,820**	**3,705**	**(115)**	**12.1**	**12.4**
Taxes on Income and Profit	1,080	1,026	(54)	3.4	3.4
Taxes on Goods and Services	2,235	2,201	(34)	7.1	7.4
Taxes on External Trade	505	477	(28)	1.6	1.6
Non-Tax Revenue	**287**	**326**	**39**	**0.9**	**1.1**
Grants	**20**	**60**	**40**	**0.1**	**0.2**
Total Expenditure	**6,528**	**6,131**	**(397)**	**20.7**	**20.5**
Recurrent Expenditure	**5,277**	**5,340**	**63**	**16.8**	**17.9**
Non-Interest Recurrent Expenditure	**2,626**	**2,650**	**24**	**8.3**	**8.9**
Salaries and Wages	1,127	1,066	(61)	3.6	3.6
Goods and Services	341	351	10	1.1	1.2
Subsidies & Transfers	1,158	1,234	76	3.7	4.1
Interest Expenditure	2,651	2,690	39	8.4	9.0
Capital Expenditure and Net Lending	**1,251**	**791**	**(460)**	**4.0**	**2.6**
o/w Public Investments	1,260	817	(443)	4.0	2.7
Current Account Balance *(includes interest, excludes public investment and net lending)*	**-1,170**	**-1,309**	**(139)**	**(3.7)**	**(4.4)**
Primary Balance *(excludes interest)*	**250**	**650**	**399**	**0.8**	**2.2**
Budget Balance	**-2,401**	**-2,040**	**361**	**(7.6)**	**(6.8)**
Nominal GDP (LKR billion)	*31,500*	*29,899*	(1,601)		
Nominal GDP (growth rate)	*12.1*	*9.0*	(3.1)		
Real GDP (growth rate)	*1.8*	*5.0*	3.2		
GDP deflator (percent change)	*10.1*	*3.8*	(6.3)		
Primary Expenditure (LKR billion)	*3,877*	*3,441*	(436)		
Primary Expenditure (As a share of GDP)	*12.3*	*11.5*	*(0.8)*		

* *Excluding bank recapitalization of Rs. 450 billion*
Source: Department of Fiscal Policy

Expected Fiscal Performance in the 2025 Fiscal Year

The assessment of expected compliance with the fiscal targets for the current financial year is based on year-to-date estimates for the period January – April 2025 (Table 3).

The preliminary year to date results indicate the targeted primary surplus of 2.3 percent of GDP in 2025 remains on track. The primary surplus over the first four months of 2025 is estimated at Rs. 533 billion against the full year target of Rs. 750 billion.

In the first four months of 2025, all heads of tax revenue have been growing broadly in line with the rates assumed in the budget. Non-tax revenue and grants which both reflect relatively small shares of total revenue have been growing less strongly than anticipated, but also tend to materialize later in the fiscal year.

Budget execution remains contained, with total expenditure in the four months to April reflecting 23.9 percent of the full year estimate, and primary expenditure just 21.7 percent of the full year estimate. Recurrent expenditure over the first four months is growing ahead of budget estimates, reflecting stronger-than-forecast growth in salaries and wages and subsidies and transfers. Expenditure on interest and capital expenditure are tracking below the budget estimates. While providing some positive signals, caution is warranted in extrapolating this result as usual patterns of government expenditure in Sri Lanka tend to involve faster growth later in the year.

With the achievement of 29.2 percent of the 2025 revenue estimate in the first four months of 2025, the estimated revenue yield of 15.1 percent of GDP is considered to be on track considering higher revenue expectation falls in the remaining eight months of 2025. Total revenue and grants in the first quarter of 2025 amounted to 12.9 percent of quarterly GDP.

Table 3 | Performance Assessment 2025

Rs. Billion

Indicator	2024 Annual*	2024 Jan-Apr	2025 Annual	2025 Jan-Apr (a)	Budgeted Growth %	Growth %	Achievement (As a % of Budget)
Total Revenue and Grants	**4,127**	**1,218**	**4,990**	**1,455**	**20.9**	**19.4**	**29.2**
Total Revenue	**4,107**	**1,216**	**4,960**	**1,453**	**20.8**	**19.5**	**29.3**
Tax Revenue	**3,820**	**1,118**	**4,590**	**1,349**	**20.2**	**20.7**	**29.4**
Taxes on Income and Profit	1,080	244	1,167	274	8.1	12.3	23.5
Taxes on Goods and Services	2,235	724	2,772	881	24.0	21.6	31.8
Taxes on External Trade	505	149	651	194	28.9	30.2	29.9
Non-Tax Revenue	**287**	**98**	**370**	**104**	**28.9**	**6.1**	**28.2**
Grants	**20**	**2**	**30**	**1**	**50.0**	**(32.6)**	**4.6**
Total Expenditure	**6,528**	**1,579**	**7,190**	**1,716**	**10.1**	**8.7**	**23.9**
Recurrent Expenditure	**5,277**	**1,419**	**5,886**	**1,603**	**11.5**	**13.0**	**27.2**
Non-Interest Recurrent Expenditure	**2,626**	**693**	**2,936**	**809**	**11.8**	**16.7**	**27.6**
Salaries and Wages	1,127	302	1,230	361	9.2	19.7	29.4
Goods and Services	341	100	416	102	21.9	2.6	24.6
Subsidies & Transfers	1,158	291	1,290	345	11.4	18.5	26.8
Interest Expenditure	**2,651**	**726**	**2,950**	**794**	**11.3**	**9.4**	**26.9**
Capital Expenditure and Net Lending	**1,251**	**160**	**1,304**	**113**	**4.3**	**(29.4)**	**8.7**
o/w Public Investments	1,260	165	1,315	115	4.4	(30.3)	8.8
Current Account Balance *(includes interest, excludes public investment and net lending)*	**-1,170**	**-203**	**-926**	**-150**			
Primary Balance *(excludes interest)*	**250**	**365**	**750**	**533**			
Budget Deficit	**-2,401**	**-361**	**-2,200**	**-262**			
Primary Expenditure (LKR billion)	*3,877*	*853*	*4,240*	*922*	9.4	8.1	21.7

**Excluding bank recapitalization of Rs. 450 billion*
(a) Provisional
Source: Department of Fiscal Policy

Expected Fiscal Performance over the 5-year MTFF Period

Taking account of the recent fiscal developments, the fiscal indicators projected for the next five years are considered realistic but are clearly subject to significant uncertainties surrounding the economic climate and ongoing success in executing major reforms.

Expected compliance with the fiscal targets for the 2026 financial year and the four succeeding years is premised on the timely implementation of revenue policy measures envisaged for 2025 and sustaining this revenue enhancement over the medium term, enhancing tax compliance and other tax administration measures.

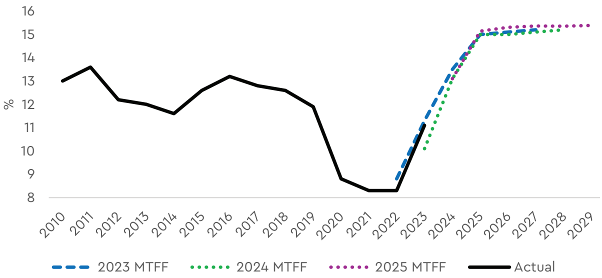
Delivering against these plans will also require actively controlling recurrent expenditure growth, which would provide the headroom necessary for public investment to increase and imply ongoing consideration of relative priorities.

Continuation of relatively benign macroeconomic conditions will be required to support a period of sustained and stable growth and recovery that generates confidence and conditions that support private investment. The resumption of private sector credit growth is a very positive sign in this respect.

Revenue

The MTFF projects a further step up in total revenue and grants from 13.7 percent of GDP in 2024 to 15.1 percent of GDP in 2025, gradually rising to 15.4 percent by 2030 on the basis that recent and planned reforms are fully executed with robust improvements in revenue collection and administration.

Figure 5 | Total Revenue to GDP



Source: Department of Fiscal Policy

By the time of the 2022 crisis, Sri Lanka's revenue to GDP ratio had fallen to one of the lowest in the world. Significant policy steps have been taken to reverse this situation and return the Revenue to GDP ratio towards previous levels. The assumed upward trend reflects enhanced efficiency in tax administration and a range of specific reforms to reduce tax expenditures.

Delivering this sustained uplift in revenue will be challenging, but the breadth of depth of supporting policy reforms underway and achievements throughout 2023 and 2024 which surpassed expectations provide some reassurance that targets are within reach.

Expenditure and the Primary Expenditure Ceiling

The projected gradual decline in total expenditure from 20.5 percent of GDP in 2024 to 19.2 percent of GDP in 2030 is predicated on effective expenditure management and the continuation of fiscal consolidation efforts.

Recurrent expenditure is expected to decline from 17.9 percent of GDP in 2024 to 17.0 percent in 2026 and further to reduce 14.9 percent of GDP by 2030. This is led by the anticipated reduction of interest expenditure from 9.0 percent of GDP in 2024 to around 6.1 percent of GDP in 2030 based on successful debt restructuring, lower borrowing needs and more favourable terms.

Capital expenditure and net lending is projected to increase from 2.6 percent of GDP in 2024 to 4.0 percent in 2027 and reach 4.3 percent of GDP by 2030 in line with the Government's strong focus on infrastructure development and long-term investments.

Primary (non-interest) expenditure is projected to increase from 11.5 percent of GDP in 2024 to 12.9 percent of GDP in 2026 and be held around these levels, slightly below the legislated ceiling of 13 percent of GDP for the duration of the first five years of the new Fiscal Responsibility framework.

Primary balance

Based on the above projections for revenue and primary expenditure, the primary surplus target of at least 2.3 percent of GDP would be achieved and maintained from 2025 onwards.

The MTFF projections sit slightly above the target because the Government has decided to include a small buffer to help deal with uncertainty surrounding the short-term outlook for growth, inflation and revenue.

This is done by keeping primary expenditure slightly below the level that would otherwise be consistent with exactly matching the primary balance target. That is, policy will be set to deliberately aim for a slightly stronger primary balance, to increase the probability of observing the target in practice. Some recalibration of this buffer may be appropriate in future years in light of observed outcomes.

The projections are therefore broadly for the target to be satisfied over the remainder of the IMF-EFF programme period to 2027 and medium-term projection period to 2030. The Government currently envisages it would continue to target primary surpluses of at least 2.3 percent of GDP until much lower levels of public debt are reached.

Fiscal balance

A significant reduction in the overall budget deficit from 6.8 percent of GDP in 2024 to 5.6 percent in 2026, and further improvement to 3.7 percent by 2030, would follow from the anticipated decline in interest payments and the successful implementation of the government's fiscal policies.

This comprehensive approach is aimed at restoring fiscal sustainability and to position the Sri Lankan economy for stable growth and development.

Public debt

The latest IMF projections for Sri Lanka's public debt see a reduction from around 119.2 percent of GDP in 2022 to around 94.5 per cent of GDP by 2030, which is consistent with debt falling below the initial target of 95 percent of GDP by 2032. Adherence to the primary balance target and primary expenditure ceiling will support the attainment of this goal in the absence of major external shocks.

4. Specific Policy Measures to Support Achievement of the Fiscal Strategy

Through its ongoing response to the 2022 crisis, the Government has implemented corrective macroeconomic policies, including revenue-based fiscal consolidation measures as outlined below and explained in greater detail in Annexure II. These policy reforms have been designed to help reach the fiscal targets stipulated above.

Over the past three years, Sri Lanka has undertaken a series of fiscal consolidation measures that have significantly impacted its macroeconomic landscape. These measures have helped to stabilize the economy, manage public debt, and promote sustainable growth, yielding more positive outcomes as outlined below.

- Economic growth rebounded to an impresive 5 percent in 2024 following to consecutive years of contraction. This was the strongest annual growth recorded since 2014. Continuing this positive trend the economy grew by 4.8 percent in the first quarter of 2025.

- Year-on-year Inflation as measured by the Colombo Consumer Price Index (CCPI), reached the historically highest peak of 69.8 percent in September 2022. However, efforts to stabilize inflation proved successful, with the inflation rate reaching a single-digit level in July 2023 and remaining at that level ever since. Inflation reached a negative territory in September 2024, recoding -0.5 and reaching -0.7 in May 2025.

- Fiscal discipline and prudent management led to significant improvements in the fiscal sector. A primary surplus of Rs. 650 billion or 2.2 percent of GDP was recorded in 2024, along with a reduction in the overall budget deficit to 6.8 percent of GDP. This was driven by the increase in government revenue. A primary surplus of Rs. 532.7 billion was recorded in the first four months of 2025.

- Total government revenue including grants surpassed Rs. 4,000 billion in 2024. Parallel to the substantial nominal increase, government revenue including grants as a percentage of GDP, increased to 13.7 percent in 2024 from 11.2 percent in 2023. Total revenue and grants in the first quarter of 2025 amounted to 12.9 percent of GDP.

- In terms of the external sector, Sri Lanka experienced positive momentum, with a current account surplus of USD 1.2 billion recorded in 2024 due to the sharp increase in tourism earnings, steady rising of workers remittances and strengthening overall external sector stability.

- Gross Official Reserves (GOR) increased substantially to USD 6.3 billion as at end April 2025 owing to the purchase of the historic high of foreign exchange by CBSL domestically and receipts from multilateral institutions, namely the International Monetary Fund (IMF), World Bank and the Asian Development Bank.

- The exchange rate appreciated for the second consecutive year recording an annual appreciation of 10.7 percent at the end of 2024 compared to the annual appreciation of 12.1 percent at the end of 2023, mainly due to current account surpluses, and a steady net inflow of foreign currency into the domestic foreign exchange market.

To achieve these milestones, the Sri Lankan government implemented various policy measures and structural reforms. These included changes to tax policies, such as reducing tax-free thresholds, revising tax rates, and increasing corporate income tax rates. Additionally, adjustments to VAT rates and Excise Duty contributed to revenue growth and fiscal consolidation.

In line with the revenue enhancement measures, expenditure rationalization measures will also be sustained over the medium term. This includes a reduction of transfers to the SOEs and other public institutions as a result of ongoing SOE reform/ divestment process, prudent investments in development projects as supported by the PFMA, rationalization of cadre of the public sector.

Further, efforts to contain expenditures and enhance cash flow management played a crucial role in improving fiscal performance. The government successfully managed its cash flow, with a significant portion of the budget deficit financed from domestic sources.

PART II

Fiscal Risk Statement 2026

(FRS 2026)

1. Introduction

Under Section 11(5)(f) of the Public Financial Management Act, No. 44 of 2024 (PFMA), the Fiscal Strategy Statement (FSS) is required to specify the main sources of fiscal risks to the attainment of the objectives specified in Section 10 and the estimate of the fiscal impact of such fiscal risks. This is the first such Fiscal Risk Statement to be published under the requirements stipulated in the PFMA.

Sri Lanka's population, economy, and fiscal and financial position have been profoundly impacted by shocks in recent years, including natural disasters, the 2019 Easter Sunday attack, the COVID-19 pandemic and the deep-rooted, multifaceted socio-economic crisis that erupted in 2022.

Overall, the levels of risk remain elevated, but are subsiding. This is due to extensive policy efforts implemented by the Government and the support of all development partners, including the successful debt restructuring negotiations with Sri Lanka's creditors.

Our contemporary approach to fiscal responsibility is founded upon transparency.

The Government is now required to establish explicit targets that will guide its approach to fiscal policy and manage the inherent risks within a rolling five-year fiscal planning horizon. In setting targets, it is expected that they will be abided by. Progress is to be closely monitored by the Parliament.

This means being objective and candid about progress, including about whether the relevant targets have in fact been achieved each year and that they remain realistic in a forward-looking sense. Remedial policy responses must be developed if required.

Sri Lanka has taken great strides over recent years in restoring economic and budget stability and that has created strong foundations for a recovery and renewed confidence in the future. Continued vigilance is warranted and further progress must be made to consolidate these recent gains and to bring risks down to even lower levels.

The dividends from today's efforts will be enjoyed by generations to come, with more stable growth, more abundant opportunities, and greater policy flexibility. A more stable and less risky fiscal position, particularly sustained debt reduction, will free up scarce resources for other priorities, including public investment.

The Fiscal Risk Statement (FRS) is a crucial element of modern fiscal governance. The coverage of risks will be expanded over time, and the depth and sophistication of analysis will grow. The assessment must be dynamic and move with a rapidly changing world.

2. Fiscal Risks

Fiscal risks are factors that can cause the fiscal position to deviate from forecasts and expectations.

Evaluating fiscal risks considers the nature of potential shocks or events that would create unexpected costs or cause revenues or debt to differ materially from their estimated levels.

In the Sri Lankan context, both internal and external economic shocks, the performance of state-owned enterprises, risks from Public-Private Partnerships (PPPs), unexpected movements in foreign exchange rates and interest rates, and the impacts of natural disasters are all pertinent examples of the kinds of risks that have resulted in the unexpected changes in fiscal outcomes in the recent past.

The fiscal risks emanating from these sources have been evaluated in the following sections of this document. Even as the recovery from the 2022 economic crisis gathers strength, Sri Lanka remains vulnerable to further shocks. These cannot be avoided but they can be better understood and better managed.

It is prudent to assume that further shocks will be encountered, but also to be encouraged that overall levels of risk are assessed to be subsiding. Fiscal risk assessment will be undertaken and published on an annual basis making it possible to gauge changes in the overall situation and the contributions that policy can make to a more resilient nation.

A summary of the assessments made in this document is presented in the heatmap below.

Summary of Findings

		Likelihood of realization		
		Remote (<10%)	Possible (10–50%)	Probable (>50%)
Potential fiscal impact	High (>1% of GDP)			Macroeconomic
	Medium (0.1–1% of GDP)		State-owned Enterprises Debt, guarantees & on-lending	Natural disasters
	Low (<0.1% of GDP)		Public-private partnerships	

In future versions of the FRS, coverage will be expanded to potential risks arising from the financial sector, climate change, subnational governments and legal claims.

3. Anticipated Fiscal Pressures

Recent data from the World Bank's Sri Lanka Development Update (April 2025) highlights the broader economic challenges facing the country. While macroeconomic indicators show signs of recovery, household income, employment, and the standard of living for vulnerable groups remain well below pre-crisis levels. The poverty rate, measured at the purchasing power parity threshold of USD 3.65 per person per day, stood at 24.5 percent in 2024, highlighting persistent social vulnerabilities.

These socioeconomic pressures increase the likelihood of higher future government spending on social safety nets to support affected populations. At the same time, the rapidly growing elderly population is driving up pension and elderly support payments, further compounding fiscal pressures. If unaddressed, the combined impact of a non-contributory pension system, rising social protection needs, and demographic shifts pose a substantial risk to fiscal sustainability in the medium to long term.

4. Main Sources of Fiscal Risks

A. Fiscal Risks Arising from Macroeconomic Uncertainty

Economic conditions are a major determinant of fiscal outcomes, though they are also usually the main source of uncertainty surrounding forecasts of the fiscal position. Fluctuations in global markets, commodity prices, and domestic economic activity can cause actual revenue and expenditure outcomes to markedly diverge from forecasts.

For instance, tax receipts may fall short of expectations due to weaker-than-anticipated activity or lower prices, while unforeseen expenditure pressures, such as emergency response or social assistance, can emerge rapidly in the wake of a disaster or shock.

Other variables such as inflation, interest rates, and exchange rates, which directly affect borrowing costs and fiscal sustainability, are likewise influenced by volatile and unpredictable economic forces.

Recognising that uncertainty and forecasting errors are a reality is essential for formulating resilient and adaptive fiscal policy. Like any economy, Sri Lanka has its own unique set of vulnerabilities to potential shocks.

The country's relatively narrow export base and heavy reliance on tourism, workers' remittances, and oil imports increase its vulnerability to both external and domestic disruptions. Sri Lanka's geographical location is thought to heighten its exposure to certain natural disasters and may ultimately result in disproportionate impacts from climate change.

Several severe shocks have been experienced in recent years, including the 2019 Easter Sunday attack, the COVID-19 pandemic, major droughts and floods, and energy price volatility, all of which have meaningfully affected the domestic economy.

The factors that might cause fiscal outcomes to diverge from expectations include:

- Major random events or 'tail risks' that materialize which were either considered too unlikely or overlooked in the central case forecasts presented in the budget;
- Errors or biases in the models and judgments that are adopted when preparing economic forecasts, including judgments about the impact of policies; and
- Policy changes that produce a different outcome from what was forecast (e.g. if a new expenditure program is devised or a new tax policy is not implemented).

To illustrate how these sources of uncertainty can impact fiscal performance, this section examines the accuracy of the main economic and fiscal forecasts for Sri Lanka over the past decade. It also discusses the main sources of uncertainty that could materially impact projected fiscal outcomes over the medium term.

Analysis of Forecast Performance

Macroeconomic Forecasts

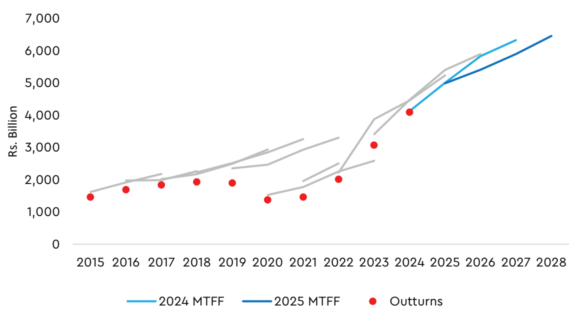
Forecasts of the overall size of the economy tend to perform well in periods of stability but fail to predict major turning points. In fact, through the period 2015 to 2019, successive Budget projections of nominal GDP tended to under-predict the size of the Sri Lankan economy to a small degree (Figure 6).

The sharp spike in inflation, which occurred during 2022, driven by supply-side disruptions including notable price hikes in food commodities, global energy prices, sharp depreciation of the Sri Lankan rupee, and aggregate demand pressures due to the lagged impact of monetary accommodation during the past few years, was clearly not foreseen. In the two years since this shock, inflation has moderated more quickly than anticipated and therefore, nominal GDP has in fact turned out to be somewhat smaller than that had been projected. This is reflected in successive revisions to the medium-term projections.

A string of shocks in 2019, 2020, and 2022 (the 2019 Easter Sunday attack, COVID-19 and economic and debt crisis, respectively) arrived on the back of an economy that was already slowing from 2018, with real GDP growth outturns well below the relevant budget forecasts for these years (Figure 7). The contraction in real GDP during 2022 was unprecedented and even greater than the impact of COVID-19 observed in 2020. The 5.0 percent real GDP growth observed in 2024 was more than twice the pace of recovery initially forecast when the Budget forecast was prepared in late 2023.

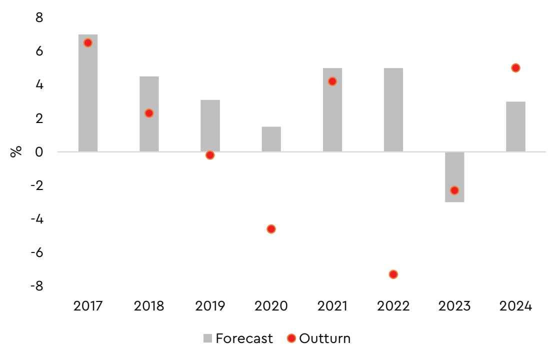
Macroeconomic Forecast Performance

Figure 6 | Nominal GDP



Source: Department of Fiscal Policy (projections), Department of Census and Statistics.

Figure 7 | Real GDP Growth



Source: Department of Fiscal Policy (projections), Department of Census and Statistics.

The average projection error for nominal GDP over the past decade was an under-prediction of around 5.5 percent. Around 2.5 percentage points of this decade-average error can be traced to the inflationary shock in 2022 alone.

Over the period since 2017, forecasts for real GDP growth, which has been volatile, have tended to over-predict actual growth by an average of 2.5 percent. Again, the impacts of the 2019 Easter Sunday attack, the COVID-19, and the 2022 economic crisis have been the main drivers of this deviation.

Fiscal Forecasts

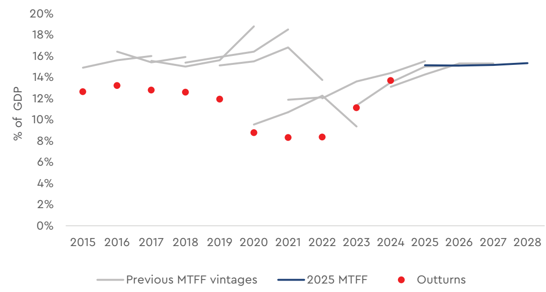
Revenue

A similar analysis of forecasts for total revenue reveals that there had been a clear tendency to over-predict revenue for much of the past decade (Figure 8).

This was not so much due to errors in forecasting the overall size of the economy, but a serial bias in the sense that of repeatedly forecasting revenue to represent a larger share of the economy than it ever actually did, and such overestimation also reflected the non-implementation of certain policy measures. On average, over the past decade, successive revenue projections exhibited an optimistic bias of 2.2 percent of GDP.

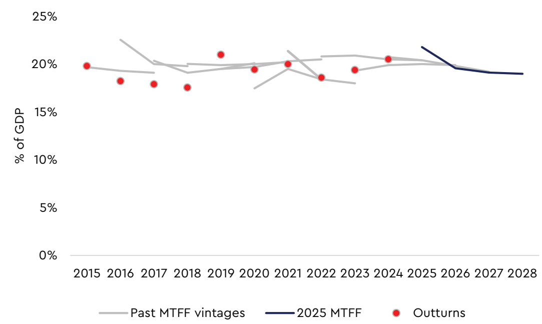
In the past few years, this bias has been corrected, and the outturns for 2023 and 2024 were in line with or exceeded budget forecasts, even with the significant lift in the revenue to GDP ratio due to extensive tax policy measures. Total revenue has returned to its highest levels in over a decade and the three-year average forecast error has been reduced to 1.1 percent of GDP.

Figure 8 | Total Revenue and Grants



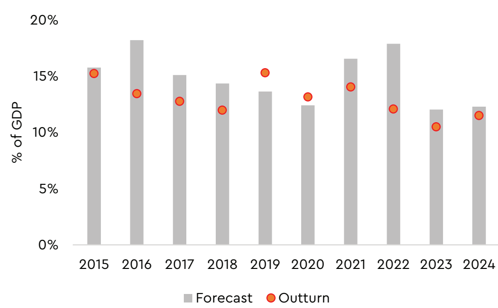
Source: Department of Fiscal Policy

Figure 9 | Total Expenditure



Source: Department of Fiscal Policy

Figure 10 | Primary Expenditure



Source: Department of Fiscal Policy

Expenditure

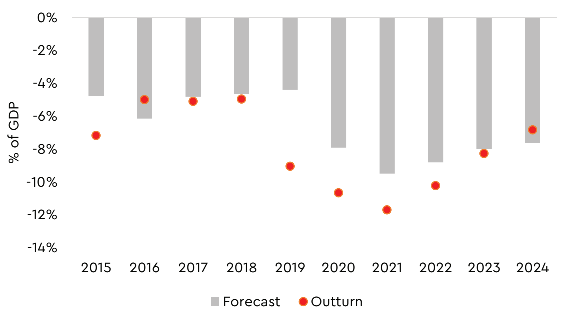
Projections for total expenditure have tended to be more stable, and outturns are typically either in line with or less than forecasts with variability attached to interest payments. Budget execution has been managed within the year to compensate for underperforming revenues and availability of grants and sources of finance to broadly keep track with budget targets. In such cases, much of the adjustment burden tends to fall on capital expenditure.

Since 2021, primary expenditure has been maintained within the envelope envisaged in the relevant budget (Figure 10), albeit with compositional variances. For example, in 2023 and 2024, the execution of capital investment was significantly lower than forecast.

Budget Balance and Primary Balance

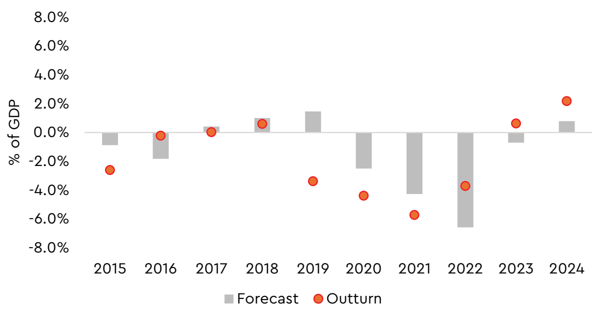
Forecasts for the overall budget balance represent the net effects of the factors discussed above with the outturn weaker than anticipated for most of the past decade (Figure 11). On average, over the past 10 years, the budget balance was just over 1 percent of GDP weaker than forecast with the greatest deviations observed during the successive shocks between 2019 and 2022. Since 2022, forecast performance has improved significantly and the average forecast error has been just 0.3 percent of GDP. Again, this recent improvement in forecast performance is primarily due to having addressed the bias in revenue forecasts.

Figure 11 | Fiscal Balance



Source: Department of Fiscal Policy

Figure 12 | Primary Balance



Source: Department of Fiscal Policy

The primary balance (Figure 12) excludes interest expenses, which reflecting movements in both exchange rates and interest rates, tend to be more difficult to forecast. The 10-year average forecast error for the primary balance is an overestimate of 0.3 percent of GDP. Overestimates in some years have been balanced by underestimates in others. For each of the years 2022, 2023 and 2024 the primary balance outturn has been stronger than forecast in the respective budgets.

Sensitivity and Scenario Analysis

As the above discussion highlights, unexpected economic events have a major bearing on the budget position and the nature and severity of random shocks are impossible to predict with perfect foresight.

Regular assessment of forecast performance helps to validate and improve the underlying assumptions that are made. Upgrading the underlying models and capabilities of staff is a crucial ingredient in managing fiscal risks.

In future versions of the FRS, the Government intends to present additional analysis that considers the sensitivity of fiscal forecasts to changes in economic variables and to supplement the central case projections with additional alternative scenarios.

Potential Sources of Risk and Uncertainty over the Medium-Term

The Budget forecasts represent a central case scenario that balances a range of judgments about many competing factors.

Some of the more significant factors likely to have a bearing on the economic and fiscal position in the coming five years include:

- Geopolitical instability – the ongoing uncertainty about the nature and scale of conflict across several regions and the impacts this might have on global growth and sentiment, capital markets, global trade flows, and energy prices.

- Trade policy issues – the uncertainty regarding US trade policy and the impacts this might have on Sri Lankan export sectors together with the impacts on global trade flows and inflation more generally.

- Demographic change – whether recent patterns of outward migration, declining marriage and birth rates will continue in Sri Lanka, which would tend to lower the growth rate of the economy; or alternatively improve the prospects for economic growth, they showed signs of reversal as stability and confidence return.

- The pace of the recovery from the 2022 economic crisis – which could be faster or slower than anticipated and affected by external events impacting sentiment in emerging markets or conditions in financial markets.

Steps Being Taken to Manage Macro-Fiscal Risks

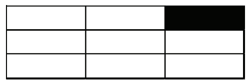
The Government has made significant progress in restoring stability and continues to take important steps to help manage the main risks to the economy and fiscal position.

As explained in the Fiscal Strategy Statement, the primary focus of fiscal policy is to reduce public debt to sustainable levels which will lower the country's overall level of vulnerability to shocks, free up resources for alternative uses and provide greater policy flexibility in the future.

The Government is striving to pursue wider structural reforms to create favourable conditions for business investment and private sector growth. Broader-based economic growth and a focus on lifting productivity will be key to realising Sri Lanka's economic potential and ensuring buoyancy in revenue into the future.

The Ministry of Finance is improving its technical capabilities and resources devoted to economic forecasting and monitoring of fiscal risks. A Macro-Fiscal Unit was established in 2021 and new forecasting tools are being created with the support of development partners.

An annual assessment of forecasting performance as part of the wider analysis of fiscal risks is intended to increase the scrutiny of the official forecasts and lead to improvements in their accuracy over time.

Summary Assessment: *Probable, High Potential Impact.* Macroeconomic shocks could be expected to impact the Sri Lankan economy with a relatively high probability (greater than 50 percent likelihood in the coming 5 years). The nature and severity of such shocks are difficult to predict but, like past events, could readily involve a material impact on the fiscal position (greater than 1 percent of GDP impact). Vulnerabilities to such shocks are being actively managed and reduced. Risk mitigation strategies include significant debt reduction to create some flexibility and additional buffers and implementing policy responses as needed to keep track with the fiscal strategy's targets.	**Rating** 

B. Fiscal Risks Arising from State Owned Enterprises (SOEs)

Fiscal risks may arise from the State-owned Enterprise (SoE) sector for a variety of reasons.

SOEs face operational risks and exposure to broader market forces that can impact their profitability and solvency.

Some state-owned enterprises (SOEs) may be required to address market failures, implement policies or assume risks on behalf of the government without adequate compensation (known as undertaking quasi-fiscal activities). This can affect their ability to generate commercial returns.

SOEs often undertake long-term investments in capital intensive sectors and therefore carry significant levels of debt, creating vulnerabilities if profits decline.

Government regulation and policy decisions can directly impact the profitability and solvency of commercial entities (e.g. if the prices they may charge are regulated).

Governments ultimately determine the levels of tax, dividend and other income they receive from SOEs together with any financial support provided to SOEs (e.g. subsidies or debt guarantees).

Overview of Sri Lanka's Major SOEs

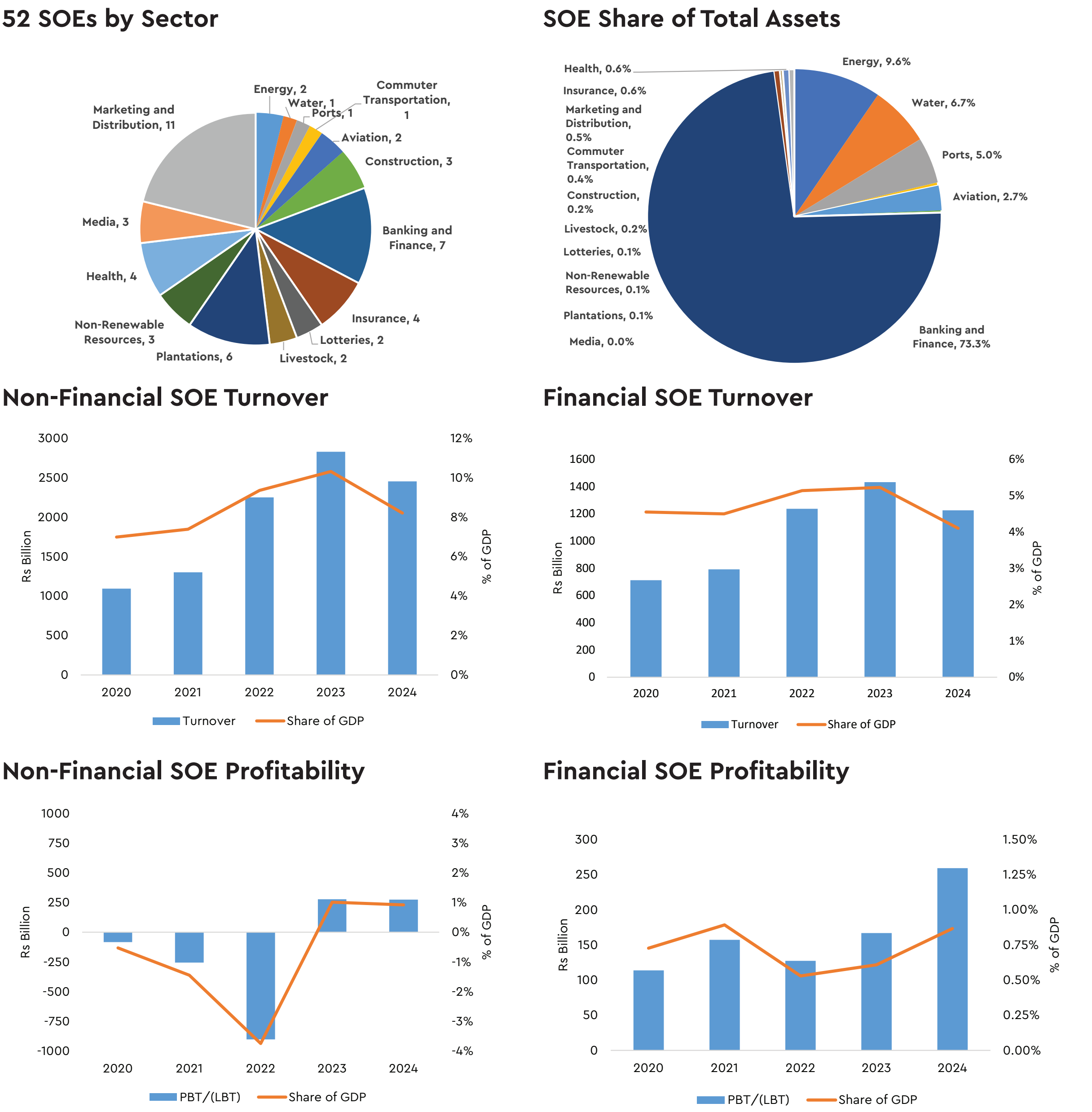
SOEs enjoy a significant presence in the Sri Lankan economy (Figure 13).

- There are nearly 350 public corporations comprising 41 commercial corporations, 40 government owned companies and 197 statutory boards.
- SOEs may have their own separate legal status (commercial corporations) or be governed by the Companies Act (government owned companies). They are all either fully or almost fully owned by the government.
- 151 SOEs operate in the non-financial sector and 11 are financial sector entities.
- Statutory boards undertake non-commercial activities typically with direct budget funding and their operations tend to pose limited fiscal risks.

The following analysis of Sri Lanka's SOE sector captures the 52 most strategically important enterprises (41 non-financial sector and 11 financial sector).

This subset of entities is considered to represent those of strategic importance, and are subject to the most extensive oversight by Government and the most likely to present material fiscal risks.

Figure 13 | SOE Sector Dashboard



Source: Department of Public Enterprises

Financial Performance

The financial performance of Sri Lanka's main SOEs was severely impacted throughout the recent crisis, with the impacts most pronounced in the non-financial sector.

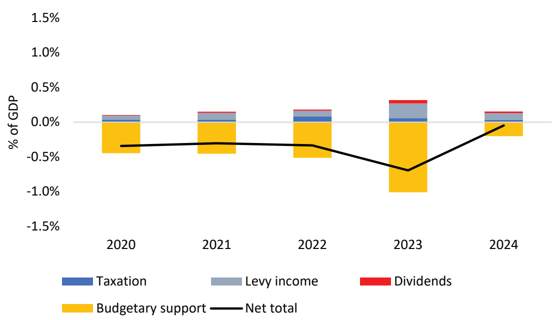
In aggregate, the 41 non-financial SOEs recorded successive years of losses from 2020 to 2022, culminating in aggregate operating losses of around 3.5 percent of GDP. Significant reforms and restructuring have now taken place and the sector returned to profitability in 2023 and 2024. In 2024, 24 of the 41 non-financial SOEs recorded profits and 17 recorded losses (an increase from 13 in 2023). Significant budgetary support has been provided to the sector over the past five years.

Over the same period, the 11 financial sector SOEs (6 banks, 4 insurers and 1 fund) remained profitable in aggregate. Total profitability was noticeably impacted by the 2022 crisis, but has exhibited an upward trend since then, driven by the relatively stronger performance of the banking sector. Conditions in the insurance sector remain more challenging, driven by volatility in investment income. State-owned financial institutions' exposures to government and SOE debt restructuring have been significant and budgetary support was extended to two state banks in 2024 (see below). One of the 11 financial sector SOEs recorded a loss in 2024.

Budgetary Impacts: SOE Sector

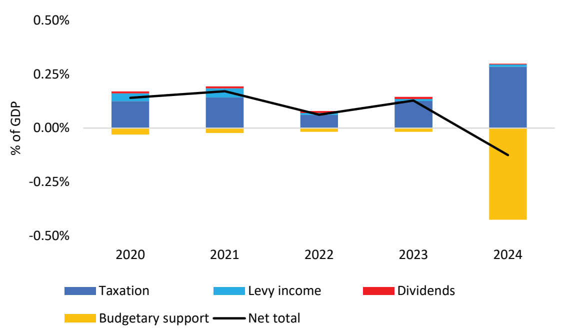
SOEs make contributions to the budget through their payment of tax, levies and dividends. A well-performing SOE sector, generating profits from operations, would be expected to make net financial contributions to the Government over time. Governments may make financial contributions to SOEs to subsidise them for loss-making activities or otherwise ensure their financial viability.

Figure 14 | Non-Financial SOEs – Net Cash Flows to Government



Source: Department of Public Enterprises

Figure 15 | Financial SOEs – Net Cash Flows to Government



Source: Department of Public Enterprises

Non-financial SOEs have required significant ongoing budgetary support in recent years, with the typical contribution from the Government averaging around 0.4–0.5 percent of GDP. This doubled to 1.0 percent of GDP in 2023.

Financial SOEs received small amounts of budgetary support over the period 2020 to 2023 (e.g. for subsidised savings and insurance products), but in 2024 a significant financial contribution was made to two major state-owned banks as part of the broader restructuring of government and non-financial SOE debt.

Sri Lanka's major SOEs have come through a very difficult period in the aftermath of the 2022 crisis and, in aggregate, their vulnerabilities appear to be reducing. Within the overall portfolio there are a significant number of entities that remain high risk and ongoing reforms and restructuring will likely be required.

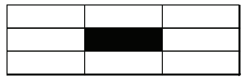
In future versions of the FRS, the Government intends to publish the results of financial viability and risk analysis of the 41 non-financial sector SOEs using the IMF SoE Health Check Tool. This will allow a risk rating to be assigned to each entity and for the financial health of the portfolio of SOEs to be evaluated over time. The 11 financial sector entities are already subject to independent prudential supervision by the Central Bank of Sri Lanka (CBSL) and Insurance Regulatory Commission (IRC), which explains why they would not be covered by this analysis.

Risk Mitigation Measures

Over the past two years, significant policy reforms have been pursued by the Government to improve the operational performance of SOEs and to address underlying vulnerabilities. Areas of focus include:

- Cost-reflective Pricing Policies
  - Electricity and fuel prices restructured based on cost-recovery principles.
  - Water tariff formula introduced to ensure pricing reflects actual service costs.
- Balance Sheet Restructuring
  - Transfer of legacy debts of key SOEs to the Government balance sheet.
  - Settlement of cross-liabilities among SOEs and related government entities.

- Institutional Improvements
    - Measures taken to strengthen governance and operations of 52 key SOEs.
- Electricity Sector Reform
    - Electricity Act, No. 36 of 2024 enacted to:
        - Grant more operational and financial autonomy to CEB (Ceylon Electricity Board).
        - Allow private sector participation in generation, transmission, and distribution.
        - Improve efficiency, transparency, and accountability.
    - An expert committee was appointed to review and propose amendments to the Electricity Act.
- Petroleum Market Liberalization
    - The number of market players increased from 3 in 2023 to 5 in 2024.
    - Reform intended to enhance competition and boost productivity.
- SriLankan Airlines Restructuring
    - The revised business plan approved in December 2024 (without privatization).
    - Government exploring alternate restructuring models.
- Water Sector Reform
    - Water tariff policy and formula approved by Cabinet.
    - Statement of Corporate Intent (SCI) signed by National Water Supply and Drainage Board in July 2024.
    - SCI includes Key Performance Indicators (KPIs) for monitoring.
- SOE Restructuring Policy
    - Activities of the State-Owned Enterprises Restructuring Unit (SOERU) paused pending review and approval of the overall restructuring policy.

Summary Assessment: *Possible, Medium Potential Impact.*	**Rating**
Despite recent policy changes that have boosted profitability and lowered debt risks, there remains a moderate likelihood of Sri Lanka's SOEs requiring additional budgetary support in the coming five years. If this risk materializes, the expected budgetary impact falls within the 0.5 to 1.0 percent of GDP range. To mitigate these risks, strategies include improving SOE profitability through regulatory reforms, modernizing management and governance, and restructuring entities with higher risks.	

C. Fiscal Risks Arising from Public Debt, Guarantees and On-lending

Fiscal risks arise in the context of governments issuing debt to finance recurrent deficits, raise funds for public investment, or guarantee loans raised by state-owned enterprises, provincial governments or local councils. The overall level of indebtedness is a function of historical fiscal performance, including the incidence of fiscal risks.

Governments make choices about the portfolio structure of the debt that they raise, including the term structure, whether borrowing is done in local or foreign currencies, and whether interest rates are fixed or variable, among other factors. These portfolio choices are made in the context of balancing the overall costs and risks of borrowing.

When borrowing on behalf of or guaranteeing other government entities, governments inherently assume some of the risks of these entities by promising to repay or service their debt if necessary.

Debt Reduction

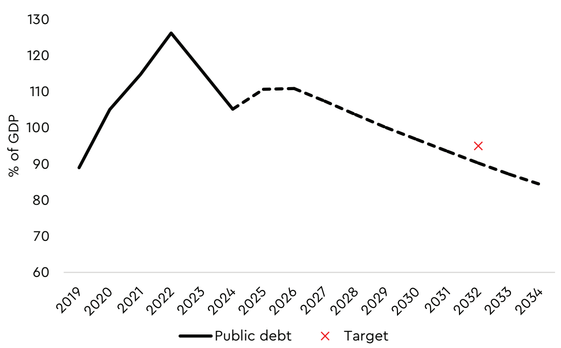
Reducing the risks and vulnerabilities from Sri Lanka's high levels of public debt has been a central focus of the IMF – EFF programme as described in the 2026 Fiscal Strategy Statement and various programme documents. The steps taken to restore macroeconomic stability and to restructure Sri Lanka's public debt will prove to be instrumental in Sri Lanka regaining a sustainable debt trajectory.

The latest projections indicate that the objective of reducing public debt to below 95 percent of GDP by 2032 is well on track (Figure 16). As the fiscal strategy describes, sustained debt reduction will be required over many years to achieve much lower and safer levels and restore policy flexibility.

IMF debt sustainability analysis has been conducted and updated regularly as part of the existing programme. The Ministry of Finance is also developing internal capabilities to conduct debt sustainability analysis and this will be published each year.

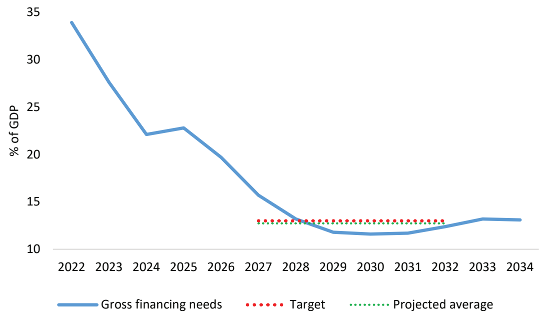
Other than the objective of reducing debt, one of the key targets relating to debt sustainability is to ensure the annual gross financing need (broadly the amount of debt required to cover new borrowing plus refinancing) remains manageable. Sri Lanka's agreement under the IMF program is that this should remain below 13 percent of GDP, on average, over the period 2027–32. The latest projections reveal Sri Lanka is expected to observe this target with the projected average of 12.7 percent coming slightly below the target (Figure 17).

Figure 16 | Public Debt



Source: Central Bank of Sri Lanka and IMF – EFF Programme

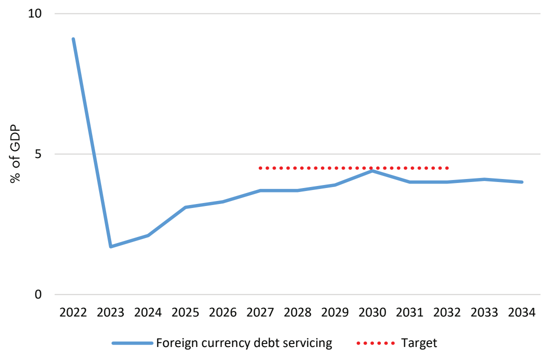
Figure 17 | Gross Financing Needs



Source: IMF – EFF Programme

A third program target relating to public debt seeks to manage exposures of the debt portfolio to foreign currency risk. The objective is to ensure that the foreign-currency debt servicing does not exceed 4.5 percent of GDP in any year during the period 2027–32. The latest projections again show that this target is expected to be observed (Figure 18).

Figure 18 | Foreign Currency Debt Servicing



Source: IMF – EFF Programme

Reforms to Support Debt Sustainability

A range of institutional and policy changes are being implemented in Sri Lanka to reduce vulnerabilities and strengthen risk management and oversight for the public debt portfolio. These include:

- Broad ranging macroeconomic reforms to stabilise the economy and strengthen the budget position;
- For the purpose of achieving a sustainable level of public debt, a primary balance target of 2.3 percent has been determined, consistent with the debt reduction objectives;

- The successful near completion of debt restructuring negotiations has contributed significantly to the outlook for debt sustainability;

- Establishment of the Public Debt Management Office in December 2024 which will be fully operational by the end of 2025;

- Passage of the Public Financial Management Act and Public Debt Management Act which have modernized fiscal governance in Sri Lanka;

- Publication of the first Fiscal Strategy Statement (FSS) covering 2026–30 which establishes a revised fiscal responsibility framework with numerical targets;

- Publication of the first Medium-Term Debt Management Strategy (MTDS) 2025–29;

- Publication of the Quarterly Debt Bulletin to enhance transparency and accountability with frequent reporting on progress implementing the MTDS.

Annual updates to the MTDS will be published alongside each Budget and will consider the progress made against the various debt portfolio targets and metrics. Quarterly bulletins will provide higher-frequency analysis of key portfolio metrics and greatly enhance the information that is made publicly available.

Fiscal policy settings imply that the borrowing requirement and, in time, debt repayments will become more manageable and should result in stronger credit ratings and a lower cost of borrowing.

The government debt portfolio will also be gradually recalibrated over time to reduce the dependence on foreign-currency denominated debt and the risks associated with exchange rate volatility, and strive to lengthen the average term to maturity of the portfolio which will lower annual refinancing needs.

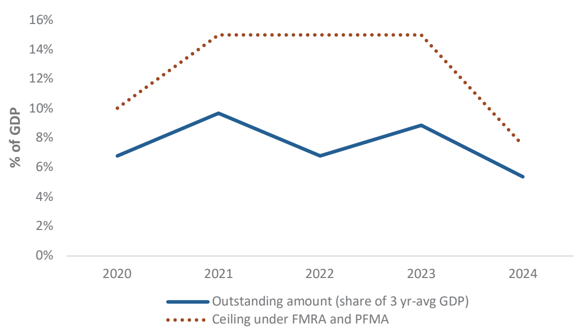
Treasury Guarantees

The outstanding value of debt of SOEs that is guaranteed by the Government of Sri Lanka stooded at approximately USD 4,896 million at the end of 2024, or approximately 5.36 percent of average GDP of pass three years (Figure 19). This balance is counted within total public sector debt for the purposes of the Government's debt reduction objective under the fiscal strategy.

There is also a separate limit under the PFMA that restricts the outstanding balance of government guarantees to less than 7.5 percent of the average GDP for the relevant financial year and the preceding two financial years. A new policy framework is being developed to ensure appropriate scrutiny of requests for new guarantees and an assessment of the financial health and creditworthiness of the requesting entities (typically statutory bodies or SOEs).

Beyond certain guarantees provided to the Central Bank of Sri Lanka, the largest outstanding commercial guarantees are to the Road Development Authority (USD 1,068 million), National Water Supply and Drainage Board (USD 747 million), and Sri Lankan Airlines (USD 504 million). Collectively these arrangements account for approximately 80 percent of the outstanding guarantee portfolio.

Figure 19 | Outstanding Debt Guarantees



Source: Department of Fiscal Policy, Public Debt Management Office

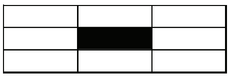
In 2024, two new guarantees with an estimated value of Rs. 8,104 million (less than 0.03% of GDP) were issued to Bank of Ceylon and People's Bank on behalf of Ceylon Electricity Board and Sri Lanka Insurance Corporation, respectively.

During 2024, the Treasury fulfilled guarantee obligations amounting to Rs. 2,200 million on behalf of the Sir John Kotelawala Defence University Hospital and Rs. 2,400 million on behalf of Sri Lankan Airlines.

On-lending

The Government of Sri Lanka also borrows on behalf of a range of Government entities, typically because this is the preferred institutional arrangement for development partners supporting infrastructure development and other programs or policy initiatives.

The outstanding value of on-lending at the end of 2024 was approximately Rs. 195 billion, or around 0.7 percent of GDP. The largest single exposure is to the Sri Lankan Ports Authority, with a loan of around Rs. 57 billion. Some 94 percent of the on-lending portfolio relates to foreign aid projects and programs, with the remaining 6 percent reflecting borrowing from domestic sources on behalf of public sector entities.

Summary Assessment: *Possible, Medium Potential Impact.*	**Rating**
It is considered that there is a medium likelihood of risks materializing in the coming five years that would impact on the costs of servicing Sri Lanka's debt, in particular, movements in exchange rates and interest rates. Some of these market developments could be favourable, such as continued a strengthening of the LKR/USD exchange rate. The potential impact is considered medium, in the context of the steps being taken to ensure debt reduction, restructuring of the debt portfolio, improvements in SOE performance and profitability, and policy limits on guarantee issuance supported by financial viability analysis.	

D. Fiscal Risks Arising from Natural Disasters and Climate Change

The fiscal risks from natural disasters typically arise from meeting the unexpected costs of disaster coordination, relief and recovery arrangements, and the reconstruction or rehabilitation of damaged public assets.

Other significant indirect costs include the loss of government revenue and the additional expenditure required on risk management and mitigation, including purchasing or providing insurance cover, and building resilient infrastructure.

Economic impacts can arise through damage to the economy's capital base, and lost production and income foregone following a major disaster.

Natural disasters tend to translate into fiscal risks when existing provisions and contingencies (within the budget) and risk transfer and contingent financing strategies (beyond the budget) are insufficient to cope with major events.

Contingent liabilities could also be triggered following a major event (e.g. if an SOE is temporarily unable to service debt, or a revenue guarantee is activated under a public-private partnership (e.g. for a toll road that is severely damaged).

Climate change is increasing the frequency and impact of natural disasters, driving an urgency to establish stronger natural disaster risk management and mitigation practices. The more adverse climate change scenarios could have profound impacts on Sri Lanka's labour productivity, reducing potential economic growth and requiring a sharper focus on the longer-term implications for fiscal sustainability.

Sri Lanka's Exposure to Natural Disasters

Sri Lanka is exposed to a range of natural disaster hazards, with floods, landslides, cyclones, and drought among the most significant regularly occurring events (Figure 20).

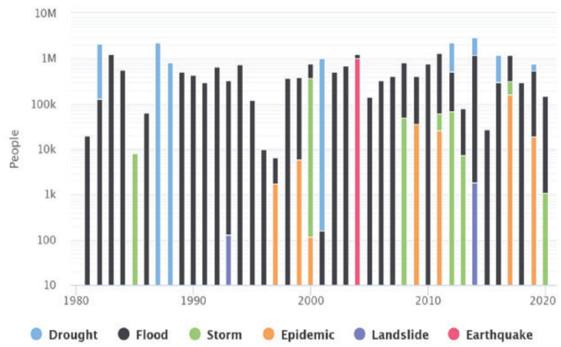
The scale and significance of individual events varies quite significantly, not just due to the random severity of events but also the extent to which they affect more densely populated areas or according to the resilience of infrastructure in place.

Among the low-frequency, more costly natural hazards, the 2004 Indian Ocean Tsunami was the single largest loss event (over USD 2 billion in 2023 terms) with catastrophic impacts felt in large parts of the country and associated loss of life and livelihoods.

In recent years, extensive flooding and landslides have presented significant challenges (the combined economic loss from floods in 2016 and 2017 was around USD 2.3 billion in 2023 terms).

Droughts have had serious and sustained impacts on agricultural production and incomes. Significant dengue fever outbreaks have occurred with a moderate frequency.

Figure 20 | Incidence of Natural Disasters (persons affected, by peril, log scale)



Source: Sri Lanka Nationally Determined Contributions Implementation Plan 2021–2030.

Estimated Costs of Natural Disasters and Climate Change

There are currently no centralized official estimates of the historical costs of natural disasters for Sri Lanka. However, a number of estimates have been prepared by development partners over the past decade following major events.

In 2016, the World Bank and Global Facility for Disaster Reduction and Recovery (GFDRR) prepared estimates of the costs associated with natural disasters in Sri Lanka[3].

This found the annual average economic loss[4] from natural disasters to be around 1.5 percent of GDP, leaving aside the catastrophic impact of the 2004 Indian Ocean Tsunami, which itself created losses of over 6.0 percent of GDP.

The study used a range of assumptions about the associated fiscal costs of disasters, focusing on the fiscal costs associated with coordination, relief and recovery costs for housing and roads, with these estimated to average around one-third of the annual average economic loss, or 0.5 percent of GDP.

There is a concern that the frequency and severity of natural disasters may be increasing. More recent estimates of the average economic loss from natural disasters in Sri Lanka are around 2.5 percent of GDP[5].

If the World Bank/GFDRR assumptions discussed above were applied, this would translate into expected annual fiscal costs in the order of 0.9 percent of GDP.

Under alternative climate change scenarios, Sri Lanka's projected annual economic losses from natural disasters increase from 2.5 to 2.8-3.0 percent of GDP; or a fiscal cost of around 1.1 percent applying the above assumptions.

Sri Lanka faces annual climate change adaptation costs of around USD 430 million or 0.5 percent of GDP per annum[6].

Managing Fiscal Risks from Natural Disasters

Given the potential significance of natural disasters as a source of fiscal risks, the Government will pursue the following reforms and reviews with the support of development partners. It is hoped this can provide a stronger foundation for assessing and managing fiscal risks from natural disasters and climate change in the future.

- Consistent with the National Disaster Management Plan, improve the databases and financial records to track actual expenditure on natural disasters and upgrade risk assessment and forecasting tools;

3 World Bank and GFDRR (2016), Fiscal Disaster Risk Assessment and Risk Financing Options.

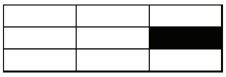
4 Economic loss in the context of natural disasters is understood to broadly capture the value of damage to the capital stock and the value of lost production and income, including through injury and loss of life. In this context it is not meant to correspond to the impact on GDP.

5 UN ESCAP, Risk and Resilience Portal, Sri Lanka Country Profile.

6 UN ESCAP, Risk and Resilience Portal, Sri Lanka Country Profile

- Review the adequacy of budgetary appropriations, contingencies and reserves and develop more detailed plans of how natural disasters, of up to a high severity, would be managed within the fiscal strategy's expenditure ceiling;
- Review the depth, viability and affordability of relevant insurance and reinsurance markets and contingent financing instruments;
- Consider aggregate exposures of the financial sector and government to natural disasters; and
- Model the expected economic and fiscal impacts of alternative climate change scenarios.

Progress against these initiatives will be reported in subsequent Fiscal Risk Statements.

Summary Assessment: *Probable, Medium Potential Impact.* There is a high likelihood of Sri Lanka experiencing material impacts from natural disasters such as floods, landslides and drought within the medium-term planning horizon. While it is difficult to predict the severity of events, historical experience indicates that unexpected fiscal costs might fall into a range of 0.25 to 0.75 percent of GDP, with more costly events also possible. Risk management measures include ensuring debt reduction remains on track and reviewing the adequacy of annual appropriations, contingencies and insurance and reinsurance coverage.	**Rating** 

E. Fiscal Risks Arising from Public-Private Partnerships (PPPs)

Fiscal risks can arise under public-private partnerships (PPPs) when the underlying legal agreements create contingent liabilities for the Government or government entities, such as through revenue or debt guarantees, or potential legal claims for compensation relating to a commercial dispute or policy change.

Overview of Recent PPP Activities in Sri Lanka

In recent years, Sri Lanka has initiated several PPPs, particularly in sectors such as transport, energy, and urban development, to mobilize greater private investment toward improved infrastructure and service delivery. Some of the key sectors in which PPPs have been introduced are:

Power & Energy: Sri Lanka is implementing several PPP energy projects led by Ceylon Electricity Board (CEB), Sustainable Energy Authority (SEA), and Atomic Energy Board (AEB). The key developments include two 350 MW LNG plants at Kerawalapitiya, both renegotiated due to tax and infrastructure changes, with cost increases of USD 37.83 million and USD 35.56 million. A 50 MW solar project in Trincomalee involves a sovereign guarantee, and 50 percent of CEB's equity contribution (USD 12.5 million) is still outstanding.

Other major projects include a 700MW solar plant in Poonakary, a 50MW wind project in Thambapawani, and large solar parks in Siyambalanduwa and Hambantota. Most projects are funded by private investors and have not triggered government guarantees.

Water & Sanitation: Under the Public-Private Partnership (PPP) framework, the National Water Supply and Drainage Board is initiating a large-scale Non-Revenue Water (NRW) reduction project in Galle starting in 2025, with a planned duration of eight years. Currently in its initial stages, the project involves an estimated investment of Rs. 3,337 million and is aimed at enhancing water service efficiency by minimizing water losses through private sector collaboration.

Port Development: The West Container Terminal-I (WCT-I), a USD 700 million project, has been operational since February 2022 and will continue until February 2027. The Galle Port Development Project, estimated at USD 200 million, is currently in the procurement phase, with seven Expressions of Interest (EOIs) received in May 2024; six have been shortlisted, and the RFP deadline is set for June 12, 2025. The South Asia Commercial and Logistic Hub, a USD 150 million project, has been awarded and is planned to be implemented over 42 months. These initiatives aim to strengthen Sri Lanka's port infrastructure through strategic partnerships with the private sector.

Analysis of Fiscal Risks from PPPs

There is currently no official register of PPP projects for Sri Lanka nor any central coordinating body that monitors performance and risks. This is a weakness that is being addressed with a complete list of projects to be published as part of the 2026 Budget.

The Government recognizes the potential fiscal risks associated PPPs, particularly in light of past experiences where poorly structured PPPs and unsolicited proposals contributed to contingent liabilities and created long-term fiscal exposures.

While the country makes less widespread use of PPPs compared to regional peers, the absence of a strong legal and institutional framework previously hindered consistent risk evaluation.

Under the Public Finance Management Act (PFMA) and with support from the IMF and development partners, steps are being taken to introduce more rigorous fiscal risk assessments for PPPs. A draft PPP Law has been prepared, and a centralized PPP Unit is being established within the Ministry of Finance.

PPP-related risks such as guarantees, minimum revenue commitments, and other forms of contingent liabilities are being mapped more systematically, although the depth and frequency of this analysis still need improvement.

Risk Reduction Strategies

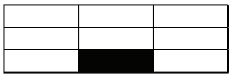
To mitigate fiscal risks from PPPs, several institutional and policy reforms are underway.

These include the development of standardized guidelines for value-for-money analysis, risk allocation matrices, and mandatory fiscal impact assessments as part of the project approval process.

A key mitigation tool being implemented is the establishment of a centralized contingent liability register, which will include any PPP-related obligations. The PFMA mandates improved disclosure of contingent liabilities, and this will enhance visibility and oversight. Moreover, risk-sharing arrangements in new PPP contracts are being designed with clearer ceilings on government exposure, including caps on guarantees and viability gap funding. Technical assistance from multilateral partners is also being mobilized to strengthen capacity in PPP structuring and contract management.

Collectively, these measures aim to ensure that PPPs can be appropriately utilized to deliver public value without undermining fiscal sustainability. Further, a forthcoming Public-Private Partnership Bill is intended to establish the National Agency for Public-Private Partnerships and to promote and facilitate PPPs in Sri Lanka, along with addressing all related and incidental matters necessary for their effective implementation.

It emphasizes transparency, competition, fiscal responsibility, and adherence to environmental and social standards, while also encouraging knowledge transfer and capacity building in the public sector. The Bill aims to provide legal certainty and institutional clarity, thereby improving investor confidence and aligning PPP governance with international best practices.

Summary Assessment: *Possible, Low Potential Impact.* Sri Lanka's use of PPPs accounts for a relatively small proportion of national infrastructure projects, but there have been instances within the past decade of material fiscal risks arising from this source. There are gaps in the current monitoring and evaluation framework that need to be addressed. As an interim assessment, the potential impact of contingent liabilities being realised under existing PPP contracts is considered relatively low. Risk management measures include establishing a national legal framework and coordinating body to ensure appropriate risk analysis and oversight of all existing and new projects.	**Rating** 

Required contents of the FSS

The PFMA specifies the minimum content of the FSS, which includes:

I. Government's fiscal targets and the policies being implemented to ensure achievement of such targets;

II. Proposed timeframe for the reduction of public debt to a sustainable level;

III. Government's strategic priorities to ensure responsible fiscal management

IV. Explanation of how the Government's fiscal targets and policies are consistent with the objectives of responsible fiscal management;

V. The medium-term fiscal framework;

VI. An assessment of performance against the fiscal strategy, including

- an assessment of compliance with the fiscal targets for the preceding financial year, including an explanation of any non-compliance with such targets;
- an assessment of expected compliance with the fiscal targets for the current financial year;
- an assessment of expected compliance with the fiscal targets for the next financial year and the four succeeding years; and
- an assessment of risks of non-compliance with the fiscal targets for the current financial year and the next financial year;

VII. The main sources of fiscal risks against the attainment of the objectives underlying responsible fiscal management; and

VIII. The macroeconomic impact of fiscal decisions taken over the past three years.

Specific Policy Measures to Support Enhanced Fiscal Sustainability

1. A New Legal Architecture for Fiscal Discipline

- Enactment of Public Debt Management Act, No. 33 of 2024 (PDMA) in June 2024.
- Enactment of Public Financial Management Act, No. 44 of 2024 (PFMA) in August 2024.
- Establishment of Public Debt Management Office on December 02, 2024.
- Publication of Tax Expenditure Statement.

2. Major Tax Policy Reforms: Broadening the Base, Indexing the Rates

With effect from January 01, 2024;

- Increase the standard Value Added Tax (VAT) rate from 15 percent to 18 percent.
- Removal of the vast majority of VAT exemptions applicable on major items.
- Reduction of VAT registration threshold to Rs. 60 million per annum from Rs. 80 million per annum.
- Reduction of the registration threshold applicable for the Social Security Contribution Levy (SSCL) to Rs. 60 million per annum from Rs. 120 million per annum.
- Revision of excise duty of all excisable articles with unit rates of excise duty by 14 percent based on inflation-adjusted indexation.
- Increase excise duty on all varieties of liquor by 14 percent based on an annual inflation-adjusted indexation.

With effect from January 11, 2025;

- Increase excise duty for all excisable articles with unit rates of excise duty by 5.9 percent based on an annual inflation-adjusted indexation.
- Increase excise duty on all varieties of liquor by 5.9 percent based on an annual inflation-adjusted indexation.

With effect from April 01, 2025;

- Increase personal income tax relief of an individual from Rs. 1,200,000/- per annum to Rs. 1,800,000/- per annum and revise the tax rates applicable on the taxable income of an individual.

Amendments to the Personal Income Tax (PIT) structure

	Annual Taxable Income (Rs.)	
Marginal Tax rate (%)	**Previous Regime**	**Current Regime**
0	Up to 1.2 Mn	Up to 1.8 Mn
6	1.2 – 1.7 Mn	1.8 – 2.8 Mn
12	1.7 – 2.2 Mn	-
18	2.2 – 2.7 Mn	2.8 – 3.3 Mn
24	2.7 – 3.2 Mn	3.3 – 3.8 Mn
30	3.2 – 3.7 Mn	3.8 – 4.3 Mn
36	Over 3.7 Mn	Over 4.3 Mn

3. Tax Administration and Institutional Re-tooling

Inland Revenue Department

- Establishment of the Criminal Investigation unit.
- Introduced a Simplified Individual Income Tax Return form for the Year of Assessment 2023/2024 for individuals with only employment and interest income.
- Expanded the risk management unit.
- Initiated an exporter refund unit to expedite VAT refunds for exporters following the abolition of the SVAT system in October 2025.
- Establishment of an Internal Affairs Unit.

Sri Lanka Customs

- Launched a Strategic Plan for 2024–2028.
- Established an Internal Affairs Unit.
- Launched the "80-Day Excellence" programme with weekly KPI score cards.
- Revamped risk rules and container-exam hit rate.
- Implementation of the ASYHUB system.

Excise Department

- Initiated the preliminary activities required to implement the Revenue Administration System for the Excise Department.
- Enhanced supervision of licensed excise premises across the country.
- Implemented a 100-day special enforcement program (from 20.05.2024 to 27.08.2024).
- Launched the 24-hour hotline 1913.
- Established a central laboratory to uphold stringent quality controls on alcoholic beverages.
- Established a risk management unit to identify, assess, and mitigate risks associated with excise revenue collection.
- Established a Financial Intelligence Unit (FIU).
- Introduction of a new mobile application designed to identify legally manufactured alcoholic beverages through a secure labelling system.