Sri Lankan Central Bank Moots Recast of Pension Funds, haircut on Sovereign Bonds

Friday 28 July 2023, by SRINIVASAN Meera (Date first published: 30 June 2023).

Sri Lanka's Central Bank has proposed restructuring the beleaguered nation's debt by recasting the outgo on the country's pension funds and offering international sovereign bondholders a repayment plan that entails a 30% haircut.

Addressing a media briefing in Colombo Thursday morning, Central Bank Governor Nandalal Weerasinghe unveiled the Ranil Wickremesinghe government's domestic debt restructuring plan that seeks to protect local banks, while effectively transferring the burden to superannuation funds, including the Employees' Provident Fund (EPF). The Central Bank will convert treasury bills and exchange superannuation funds' treasury bonds to longer-term maturity treasury bonds at a lower interest rate.

On the decision to exclude local banks from the restructuring plan, he said: "It is vital to protect the banking sector, as a collapse [of it] would have a catastrophic consequence for some 57 million depositors."

The plan for domestic debt restructuring, cleared by the Cabinet on Wednesday, will be debated in Parliament the coming weekend, ahead of a vote. Amid some speculation of a bank run, the government announced a five-day banking holiday beginning on Thursday. "The holiday is mainly to prevent any market-panic [around the parliamentary debate]," Mr. Weerasinghe said, as he sought to allay fears.

Sri Lanka to restructure domestic debt amid challenges

The government's latest move is part of its efforts to restructure both its foreign and domestic debt, in line with the expectations of the International Monetary Fund (IMF) that extended a nearly-$3 billion External Fund Facility in the wake of Sri Lanka's painful economic crash last year. As of March 2023, the crisis-hit country's foreign and domestic debt were estimated at about $41.5 billion and $42.1 billion, respectively. Earlier this week, President Wickremesinghe said his government hopes to restructure $17 billion of its foreign debt in five years. After indiscriminate borrowing for years, and spending beyond its means, Sri Lanka is now aiming to reduce its public debt to GDP ratio from 128% to 95% by the year 2032.

Key bilateral creditors, India and Japan, along with the Paris Club group of creditors, have set up a common platform to jointly evolve a debt restructuring plan for Sri Lanka, based on the principle of creditor parity. All eyes are on China, Sri Lanka's largest bilateral creditor, which is yet to officially join in the process and remains an observer, although Beijing has assured Colombo of cooperation.

Meanwhile, Mr. Weerasinghe said Sri Lanka would ask its private creditors, holding International Sovereign Bonds and the largest chunk of the island nation's foreign debt, to take a 30% haircut. "It is still under discussion," he said.

‘Massive blow to workers’

The government expects its Domestic Debt Restructure programme to offer an impetus to its ongoing foreign debt negotiations. However, the decision to have pensioners bear the cost of the country’s domestic debt restructuring, that too during a persisting crisis, has sparked criticism, despite the Governor assuring that the existing EPF funds will remain untouched, and guaranteeing a minimum 9% interest.

Sri Lanka’s economy has contracted by 11.5% in the first quarter of 2023, even as ordinary citizens struggle to cope with stagnant incomes and stubbornly high living costs. “People’s retirement funds have already suffered a huge fall in real value, amounting to over 40%, due to the drastic currency depreciation and sharp price hikes last year. Further cuts to the interest earnings from the superannuation funds, of about 0.5% of the GDP each year over the next 15 years, will be a massive blow to the retirement funds of formal sector workers, from tea pluckers to garment workers,” said Ahilan Kadirgamar, a senior lecturer at the University of Jaffna. In other words, Sri Lanka’s domestic debt restructuring over the next 15 years will amount to people’s retirement funds declining by 30%, he pointed out.

Ground Zero: In Sri Lanka, a long and rocky road to economic recovery

“Instead of cutting the interest rates of treasury bonds held by superannuation funds, the government could have raised additional wealth tax amounting to 3.3% of total tax revenue to address the gap in Gross Financing Needs,” he contended.

FR petition

H.M. Wasantha Samarasinghe, President of the Inter Company Employees Union, termed the reprofiling of superannuation funds a “violation of the fundamental rights of the workers”. According to the Central Bank data, the government has borrowed about 26% of its domestic debt from superannuation funds. “Now, they are threatening superannuation funds unwilling to be part of the plan with a higher tax of 30% instead of the 14% special treatment charged now. This is absolutely unfair, and targets millions of workers’ hard-earned pension savings,” he said.

Recently, the union with about 80,000 members across the private sector and affiliated to the leftist Janatha Vimukthi Peramuna (JVP) filed a Fundamental Rights petition at the Supreme Court challenging any attempt to restructure superannuation funds. The case is yet to be taken up.

Meera Srinivasan

P.S.

International Development Economics Associates

https://www.networkideas.org/news-analysis/2023/06/sri-lankan-central-bank-moots-recast-of-pension-funds-haircut-on-sovereign-bonds/