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# The Role of Gold in Reserve Management

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Gold prices soared to fresh record highs in October 2025, with prices surpassing US$ 4,300 per troy ounce marking an impressive gain over 60% since the beginning of the year. As of December 2025, gold prices remain elevated, trading above US$ 4,200 per troy ounce on average. The surge has been fueled by growing expectations of U.S. interest rate cuts, a weaker dollar, and ongoing geopolitical tensions. Nonetheless, some analysts caution that the metal may be entering the "overbought" territory, raising the possibility of a short-term correction, with pullbacks toward the US$ 4,000 level in 2026. This dynamic behaviour in gold demand and prices calls on reserve managers to revisit the role of gold in international reserves. Hence, this article examines the historical significance and strategic advantages of gold holdings, explores the key factors shaping allocation decisions, and highlights the role of gold in emerging market reserves. It also discusses the challenges faced in managing gold assets and provides an outlook on the future of gold in reserve management.

## 1. Historical Significance of Gold

Gold served as a fundamental element in the international monetary system for many years, particularly during periods when currency exchange rates were tied to the value of gold. From the 1870s to 1914, the world experienced the Classical International Gold Standard, a period during which the most major economies—excluding China—adopted a fixed monetary system based on gold. Under the Gold Standard, most major currencies were pegged to gold at a fixed rate, and for the United States, that rate was set at $20.67 per troy ounce. This framework provided monetary stability and facilitated global trade and investment, as exchange rates were predictable and backed by physical gold reserves.

Following the disruptions of the World War I, there was an attempt to return to the pre-war monetary normalcy. In 1925, the United Kingdom restored the gold standard at its pre-war parity, although the global economy was not yet stable enough to

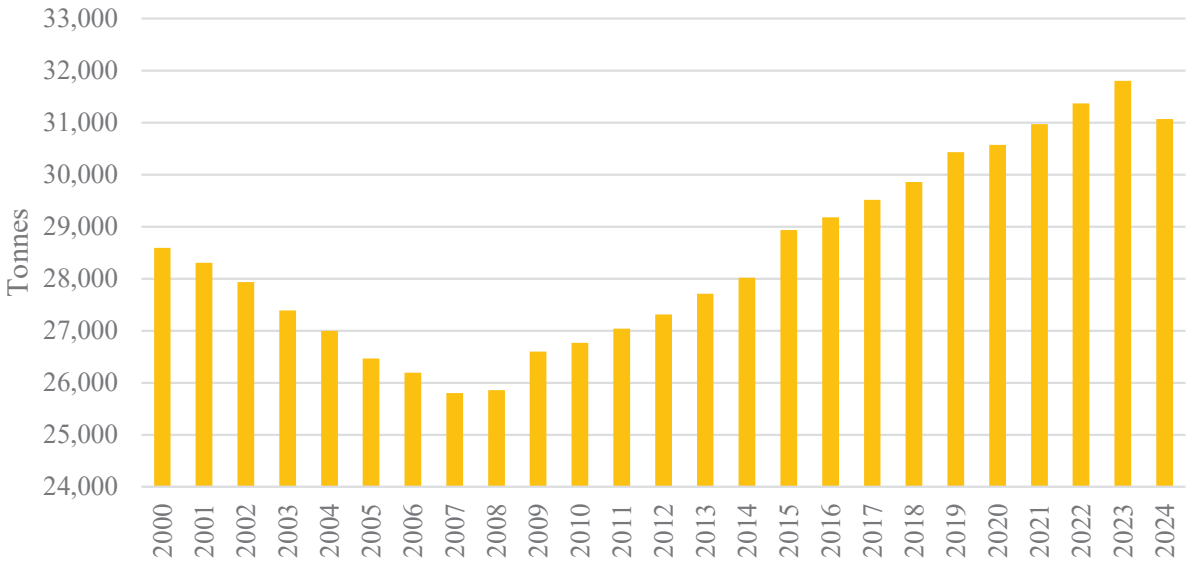
sustain the same. The interwar gold standard faced growing pressure from economic imbalances and eventually collapsed during the Great Depression. In 1933, in response to domestic economic challenges, U.S. President Franklin D. Roosevelt suspended the convertibility of the dollar into gold. Shortly after, in January 1934, the official price of gold was revalued to $35 per troy ounce—a significant devaluation designed to spur inflation and economic recovery.

A more structured and cooperative international monetary system emerged in 1944 with the establishment of the Bretton Woods Agreement. This system introduced the gold exchange standard, under which the U.S. dollar was directly convertible into gold at $35 per troy ounce, while other major currencies were pegged to the dollar. As the post-war global economy expanded, the demand for U.S. dollars and gold rose sharply. To maintain the Bretton Woods framework, a group of central banks formed the London Gold Pool in 1961 to coordinate interventions and stabilize the gold market. However, this cooperation proved unsustainable amid growing imbalances and speculative pressures, leading to the collapse of the Gold Pool in 1968.

By 1971, mounting pressure on U.S. gold reserves and widening trade deficits led President Richard Nixon to take a decisive step as President Nixen suspended the convertibility of the dollar into gold, effectively "closing the gold window". This marked the end of the Bretton Woods system and the gold standard, ushering in a new era of floating exchange rates, where currency values were determined by market forces, i.e. demand and supply of currencies, rather than being tied to a physical commodity.

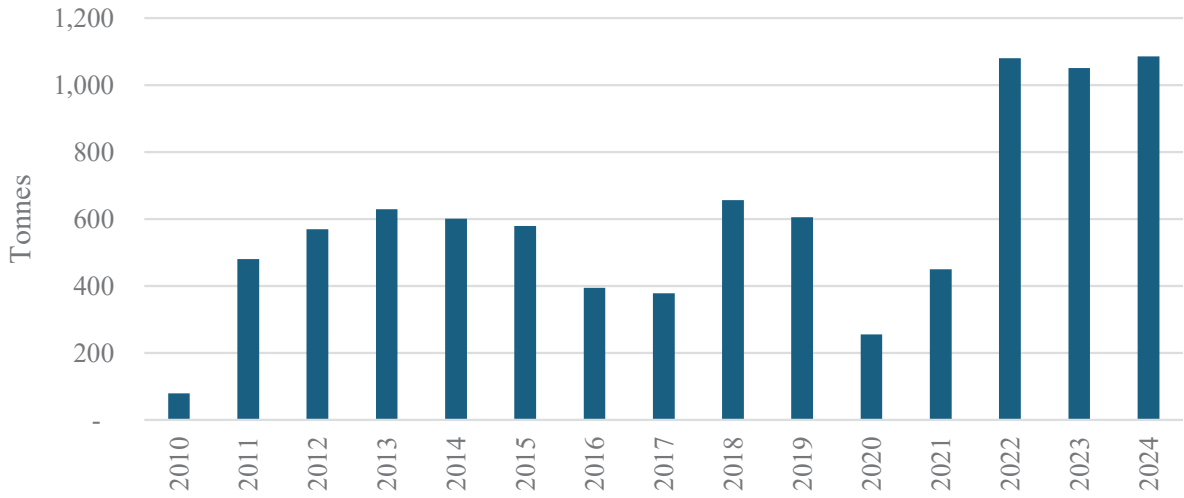
In recent years, gold has regained prominence as a financial asset. Investors increasingly rely on gold to hedge against inflation and market volatility, while central banks and financial institutions continue to hold substantial gold reserves as part of their asset portfolios. Figures 1 and 2 below illustrate the gold holdings and gold purchases of central banks, respectively, highlighting an increasing trend.

**Figure 1: Central Bank Gold Holdings during 2000-2024**




*Source: World Gold Council, IMF*

**Figure 2: Central Bank Gold Purchases during 2010-2024**



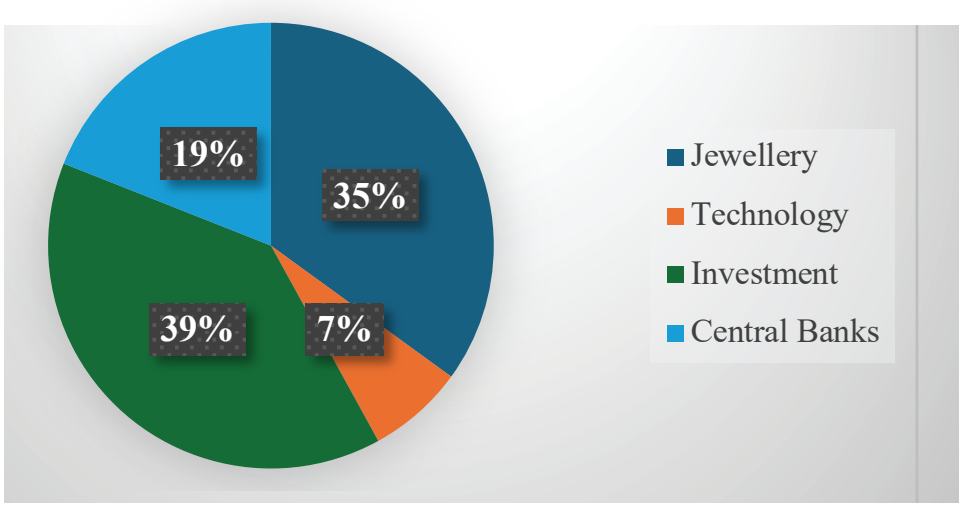

*Source: World Gold Council, IMF*

## 2. Strategic Benefits of Gold in Reserve Management

### 2.1 A long-term source of return

Gold has traditionally been regarded by investors as a reliable asset in times of uncertainty. Moreover, it has consistently delivered positive long-term returns across both strong and weak economic environments. Its broad and diversified demand base lends gold notable resilience and the capacity to generate stable returns under a wide range of market conditions. The demand for gold comes from various sources such as jewellery, technology, investment and central banks. As per the figures published by the World Gold Council (WGC), the composition of demand can be depicted in Figure 3 below.

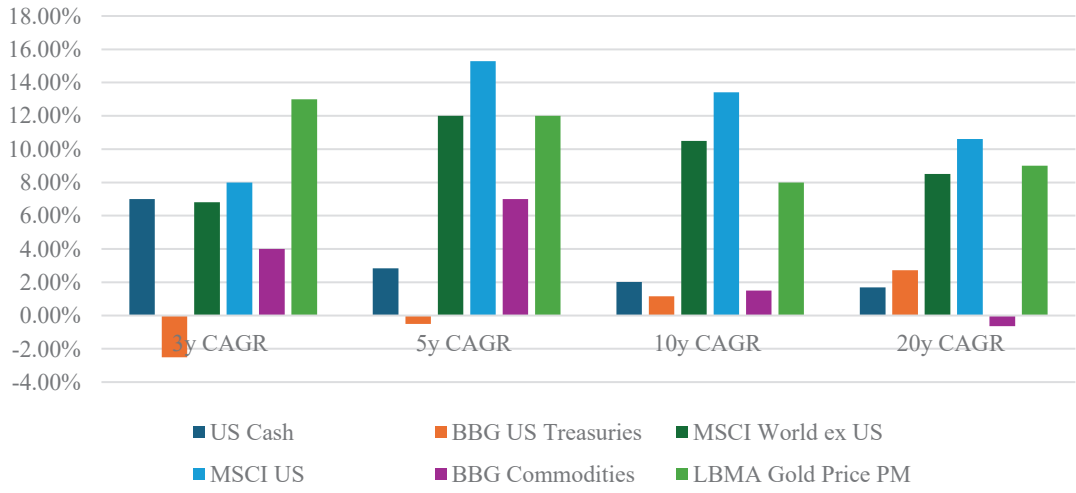
**Figure 3: Sources of Demand**




*Source: World Gold Council*

Since the collapse of the US gold standard in 1971, the price of gold in US dollars has increased at an average annual rate of nearly 8% over the past fifty years. Over this time, gold's long-term returns have been comparable to equities and have surpassed those of bonds. Additionally, gold has outperformed many other major asset classes over the past 3, 5, 10, and 20 years as evident in the following Figure 4.

**Figure 4: Annualized Returns of Various Asset Classes (Returns from 31 December 2004 to 31 December 2024)**




*Sources: Bloomberg, ICE Benchmark Administration, World Gold Council*

In finance, returns are always evaluated relative to the associated risk, with risk typically measured by volatility. According to data from Bloomberg, gold demonstrates lower volatility compared to US stocks and crude oil (commodities). Consequently, when comparing returns relative to risk, gold outperforms both commodities and US stocks.

Moreover, gold generates returns that exceed inflation, making it an effective asset for hedging against inflation risk. Additionally, gold performs particularly well during periods of deflation when global interest rates are low. In such low-interest-rate environments, demand for gold rises, driving up its price and consequently, the return of gold.

**2.2 Diversification**

In reserve management, mainly in portfolio management, the diversification plays a critical role in reducing portfolio risk and optimizing returns for a given level of risk. Constructing portfolios requires combining assets with negative correlations to minimize the overall risk. However, finding effective diversifiers can be challenging, as many assets tend to become increasingly correlated during periods of market uncertainty, increased volatility and often due to risk-on and risk-off sentiments of the investors. This in turn means that many heterogenous diversifiers fail to protect portfolios precisely when they are needed the most. Gold, however, offers a low or a negative correlation with traditional reserve assets such as government bonds and foreign currencies. Including gold in a reserve portfolio thus helps mitigate risks associated with market fluctuations, enhancing overall resilience and stability of the reserve portfolio.

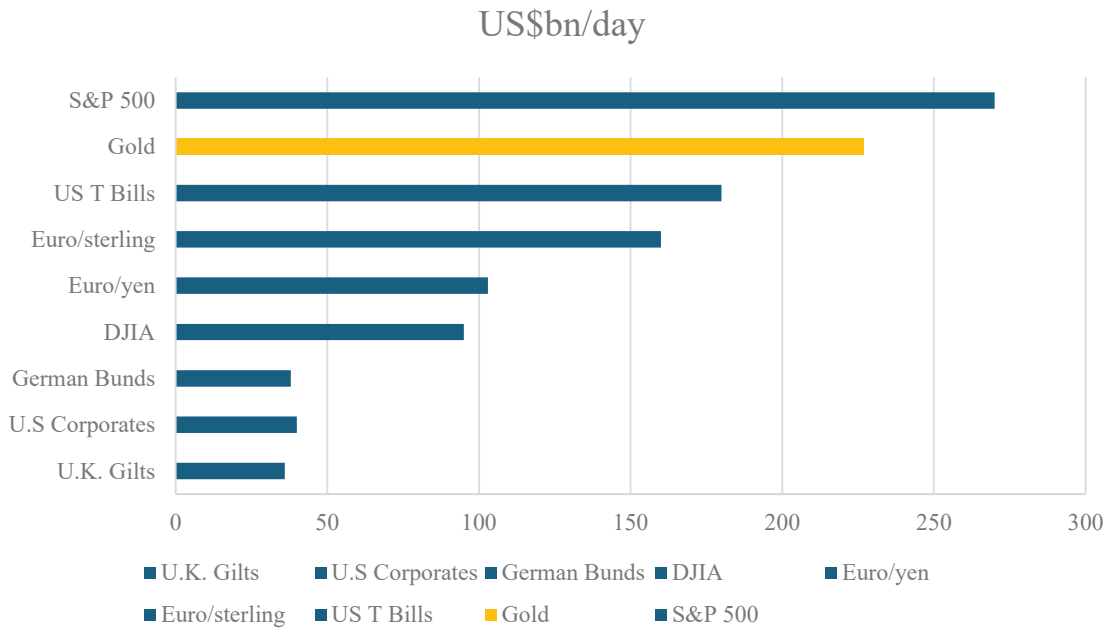
## 2.3 Liquidity

In reserve management, the second key objective is to ensure sufficient liquidity to meet potential foreign currency payment obligations. The global gold market is vast and highly liquid. As per the WGC estimates, physical gold holdings by investors and Central Banks are estimated to be worth approximately US$ 5.1 trillion, with an additional US$ 1.0 trillion in open interest from derivatives traded on exchanges and the over-the-counter (OTC) market. This provides central banks holding gold with the ability to sell it when necessary, ensuring access to foreign currency liquidity during times of need.

Gold is also more liquid than several major financial markets, including euro/yen currency pairs and the Dow Jones Industrial Average (DJIA), with trading volumes comparable to those of US Treasury bills[1] as depicted in Figure 5 below. In 2024, average daily trading volume of gold was approximately US$ 227 billion. Of this, OTC spot and derivatives contracts represented approximately US$ 138 billion in daily trading, while gold futures accounted for around US$ 86.5 billion in daily volume across global exchanges. Additionally, physically backed gold ETFs provided an extra layer of liquidity, averaging US$ 2.6 billion in daily trading volumes.

The vast scale and depth of the gold market make it well-suited to accommodate large, buy-and-hold institutional investors with ease. Unlike many financial markets, gold maintains strong liquidity even during periods of financial stress, providing stability that enables investors to meet liabilities when other less liquid assets

**Figure 5: Average Daily Trading Volumes of Major Asset Classes in US dollars**




*Sources: Bloomberg, IMF, World Gold Council*

1 https://www.gold.org/goldhub/research/relevance-of-gold-as-a-strategic-asset (2025)

in their portfolios become difficult to sell or are subject to mispricing.

### 2.4 Inflation Hedge

Gold has historically preserved its purchasing power, making it a reliable hedge against inflation. In periods of rising inflation, gold typically appreciates in value, helping to preserve the real purchasing power of reserves. Figure 6 below demonstrates that during periods of inflation, gold prices tend to rise, serving as an effective hedge against inflation. Interestingly, in recent months, gold prices have continued to increase despite a decline in inflation. This trend has proven advantageous for gold investors.

## 3. Factors Influencing Gold Allocation in Reserves

### 3.1 Economic Conditions

Central Banks often increase their gold reserves in response to economic instability or when the value of fiat currencies is under pressure. Gold has historically demonstrated resilience during periods of financial turmoil, making it a preferred asset for safeguarding national reserves. Its intrinsic value and limited supply provide a hedge against inflation, currency devaluation, and geopolitical risks.

Moreover, inverse relationship of gold with the US dollar further underscores its importance.

**Figure 6: Gold prices and US Inflation**


*Source: Bloomberg*

### 2.5 Counterparty/Issuer Risk Mitigation

Unlike other reserve assets that involve counterparty and/or issuer risk gold is not dependent on the creditworthiness of any government or institution, making it uniquely resilient in times of sovereign debt crises or systemic banking failures. This attribute enhances its appeal as a reserve asset, particularly in periods of global uncertainty.

When the dollar weakens, gold prices often rise, providing central banks with a buffer against currency fluctuations. This dynamic makes gold an essential component of reserve management strategies, particularly in uncertain economic climates.

### 3.2 Geopolitical Tensions

Geopolitical uncertainties, such as conflicts or trade disputes, often prompt central

banks to increase their gold reserves. Gold's detachment from any single nation's monetary policy makes it a highly valuable asset during periods of instability. The WGC analyzed the performance of various asset classes during periods of geopolitical risk using the Geopolitical Risk Index (GPR)[2]. According to their findings, gold outperformed other asset classes during such events, as illustrated in Figure 7 below.

**Figure 7: Performance of Gold during geopolitical crises**


*Based on average weekly performances between January 1999 and September 2024 due to limitation of certain indices. Figures show when the GPR index during the week soared by 100% or more. Source: Bloomberg, World Gold Council

Figure 8 below illustrates the historical movement of gold prices, clearly showing that during periods of geopolitical tension and uncertainty, gold prices tend to rise, demonstrating effectiveness of gold as a hedge against such risks.

### 3.3 Monetary Policy

Monetary policy, particularly decisions made by central banks regarding interest rates and liquidity measures such as quantitative easing (QE), plays a significant role in shaping the demand for gold.

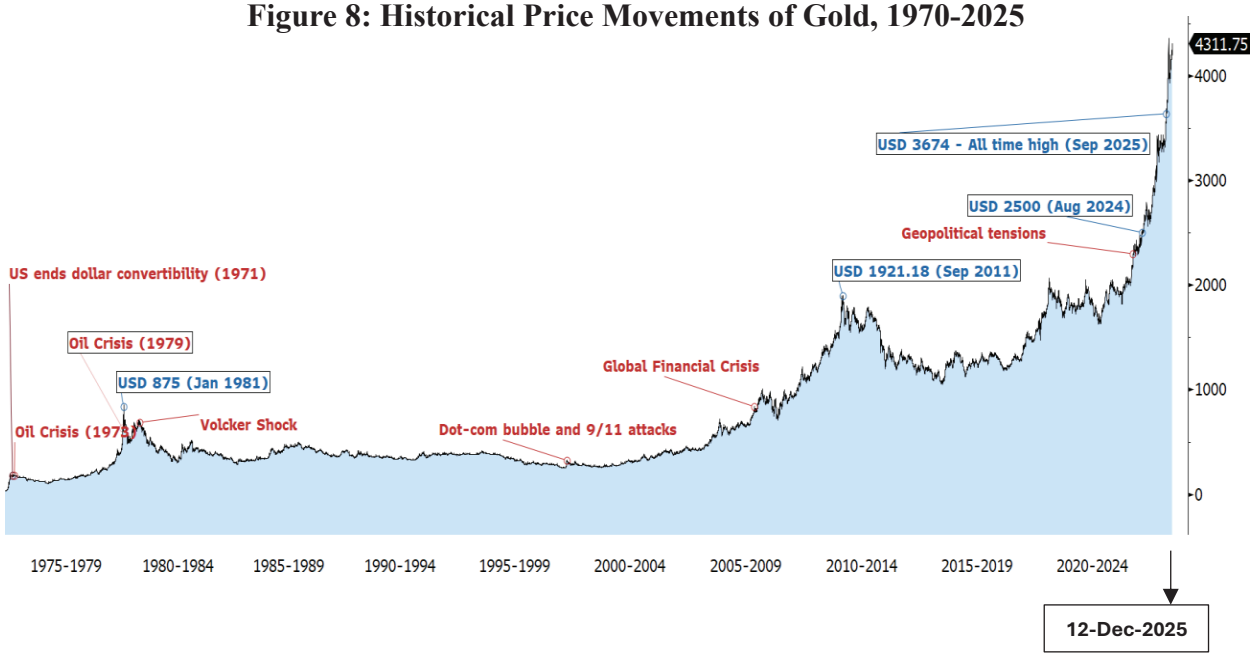
When central banks lower interest rates, returns on traditional interest-bearing assets such as government bonds or savings accounts decline. In some cases, rates may even become zero or negative, especially during periods of economic downturn or deflationary pressures. In such an environment, the opportunity cost of holding gold decreases, making it a more appealing asset for investors. Unlike fixed-income securities, gold does not yield interest or dividends, but in low-rate environments, this disadvantage becomes negligible.

Additionally, during times of economic distress, central banks may implement quantitative easing—a policy involving the large-scale purchase of government securities or other financial assets to inject liquidity into the economy. While QE can stimulate economic activity, it often raises concerns about currency depreciation and future inflation. As a result, investors may turn to gold as a hedge against inflation and currency risk, thereby increasing its demand.

In summary, accommodative monetary policies, including low interest rates and

2 Dario Caldara and Matteo Iacoviello constructed a measure of adverse geopolitical events and associated risks based on a tally of newspaper articles covering geopolitical tensions and examine its evolution and economic effects since 1900.

**Figure 8: Historical Price Movements of Gold, 1970-2025**




*Sources: Bloomberg*

asset-purchasing programs, tend to boost the attractiveness of gold by lowering the cost of holding it and increasing its value as a safe-haven and inflation-hedge asset.

### 3.4 Currency Reserves

The composition of currency reserves plays a key role in determining gold allocation. Diversification away from dominant currencies, such as the US dollar, often results in increased gold holdings to reduce reliance on a single currency. For instance, the Reserve Bank of India continued its 2024 buying spree, adding an additional 8 tons of gold to its reserves in November. This brought its year-to-date purchases to 73 tons and total gold holdings to 876 tons, solidifying its position as the second-largest gold buyer in 2024, following Poland. A significant development in November 2024 was the announcement that the People's Bank of China (PBoC) resumed gold purchases after a six-month pause. Official data indicates that the PBoC added 5 tons to its reserves, raising its year-to-date net purchases to 34 tons and total reported holdings to 2,264 tons, accounting for 5% of its total reserves.

### 3.5 Market Trends

Gold prices and global market trends influence reserve allocation decisions. Central banks may adjust their gold holdings in response to price movements, balancing the need for capital preservation with opportunities for value appreciation.

## 4. The Role of Gold in Emerging Economies

In recent years, emerging economies have increasingly turned to gold as a strategic component of their foreign reserve portfolios. Countries such as China, India, Russia, Turkey, and Brazil have actively expanded their official gold holdings. This trend reflects a broader shift in reserve management practices, where gold is valued not only for its historical role as a safe-haven asset but also for its strategic utility in a multipolar global economy. Several key factors are driving this renewed emphasis on gold accumulation by emerging markets:

### 4.1 Currency Diversification

Emerging economies have traditionally held a significant portion of their reserves in major

reserve currencies such as the US dollar (USD), euro (EUR), and British pound (GBP). However, growing concerns about overreliance on the USD, especially in light of geopolitical tensions, interest rate volatility, and the use of financial sanctions, have prompted central banks to diversify their reserve assets.

Gold offers a neutral, universally accepted asset that is not tied to the creditworthiness or economic policy of any single country. Unlike fiat currencies, gold is not subject to devaluation, debasement, or policy-induced inflation, making it a valuable tool for maintaining the stability and real value of a country's reserves over the long term.

### 4.2 Economic Resilience

Gold plays an important role in enhancing the economic and financial resilience of emerging markets. These economies often face higher vulnerability to external shocks, such as commodity price fluctuations, global interest rate cycles, and exchange rate volatility.

By holding gold, central banks in these regions can strengthen their balance sheets and increase public and investor confidence during periods of market stress. Gold's low correlation with other financial assets also provides portfolio diversification benefits, helping to reduce the overall risk in reserve portfolios.

In times of crisis, gold can be mobilized—either through direct sale or use as collateral—to secure foreign currency liquidity, support the exchange rate, or stabilize the domestic economy.

### 4.3 Strategic Autonomy

As the global geopolitical and economic order becomes more complex, strategic autonomy has become a central priority for many emerging economies. Gold is viewed as a sovereign asset, held outside the control of any foreign entity or financial system. Unlike reserve currencies, which are liabilities of foreign governments or institutions, gold is no one's liability, giving central banks direct ownership and control over the asset.

This autonomy is especially valuable in a world where economic sanctions and financial restrictions are increasingly used as tools of foreign policy. Holding substantial gold reserves allows countries to maintain a degree of independence in monetary and fiscal policy, even in the face of external political or economic pressures.

## 5. Challenges in Managing Gold Reserves

While gold is a valuable asset for Central Banks, offering stability and diversification benefits, managing gold reserves comes with its own set of challenges. These challenges require careful planning and strategic decision-making to ensure optimal reserve management.

### 5.1 Storage and Security

One of the primary challenges of holding gold reserves is ensuring their safe storage and security. Gold is a physical asset that requires highly secure facilities, often in central bank vaults or with international custodians. These storage solutions come with significant costs, including infrastructure, insurance, and ongoing maintenance. Additionally, transporting gold between locations or custodians involves logistical complexities and risks, such as theft or damage. Therefore, Central banks are required to invest in robust security measures and contingency plans to protect their gold holdings, which can be both resource-intensive and costly.

### 5.2 Market Volatility

Although gold is considered a stable and reliable asset, its price is not immune to fluctuations. Gold prices can be influenced by various factors, including changes in global demand, shifts in interest rates, geopolitical tensions, and macroeconomic trends. For example, rising interest rates often reduce gold's appeal as a non-yielding asset, leading to price declines. Central Banks must continuously monitor market conditions and trends to make informed decisions about buying, selling, or holding gold. Failure to anticipate market movements could result in suboptimal returns or losses on gold reserves.

### 5.3 Opportunity Cost

Unlike interest-bearing assets such as bonds or other financial instruments, gold does not generate an income. This lack of yield represents an opportunity cost for central banks, as funds allocated to gold could otherwise be invested in assets that provide regular returns. Central banks must carefully balance the benefits of holding gold—such as its role as a hedge against inflation and currency devaluation—against the potential returns from alternative investments. This trade-off requires a strategic approach to reserve management, ensuring that gold holdings align with broader financial and economic objectives.

### 5.4 Liquidity Constraints

While gold is generally considered a liquid asset, converting large quantities of gold into cash can pose challenges. Selling significant amounts of gold in a short period can temporarily depress market prices, leading to potential losses for the central bank. Similarly, purchasing large volumes of gold can drive prices higher, increasing acquisition costs. Central banks must carefully time their transactions and adopt a phased approach to buying or selling gold to minimize market impact. Additionally, the process of converting gold into cash or other assets can involve administrative delays and transaction costs, further complicating liquidity management.

## 6. Future Outlook for Gold in Reserve Management

The role of gold in international reserve management is expected to remain significant as central banks navigate an increasingly complex and uncertain global financial landscape. Several key factors are likely to shape the future of gold as a reserve asset, reflecting broader economic, technological, and geopolitical trends.

### 6.1 Technological Advancements

Innovations in financial technology, particularly blockchain and distributed ledger technology (DLT), are poised to revolutionize the way gold is managed and traded. Blockchain can enhance the traceability, transparency, and security of gold transactions, making it easier for central banks to verify the authenticity and ownership of gold reserves. Additionally, the emergence of digital gold tokens—backed by physical gold—could streamline the trading and securitization of gold, reduce transaction costs and improve liquidity. Complementing these developments is the rise of Central Bank Digital Currencies (CBDCs), which can integrate seamlessly with tokenized assets like digital gold. CBDCs could enable more efficient cross-border settlement mechanisms and facilitate real-time transactions in a secure and programmable monetary environment. These advancements may make gold an even more attractive and efficient reserve asset, further solidifying its role in central bank portfolios.

### 6.2 Green Energy Transition

The global shift toward renewable energy and the rise of electric vehicles (EVs) could have indirect implications for gold demand and its role in reserve management. Gold is widely used in industrial applications, particularly in electronics and renewable energy technologies, due to its excellent conductivity and resistance to corrosion. As the demand for green technologies grows, industrial demand for gold may increase, potentially influencing its price and availability. Central banks will need to monitor these trends closely, as changes in industrial demand could impact value of gold and its attractiveness as a reserve asset.

### 6.3 Global Economic Shifts

The continued economic growth of emerging markets, particularly in Asia and Africa, is expected to drive increased demand for gold. Many emerging economies view gold as a symbol of financial stability and a hedge against currency volatility. As these economies expand and their central banks accumulate larger reserves, their demand for gold is likely to rise. This trend could reinforce the status of gold as a global reserve asset, particularly in regions where trust in traditional fiat currencies or the global financial system is lower. Additionally, geopolitical tensions and the ongoing de-dollarization efforts in some countries may further boost gold's appeal as an alternative reserve asset.

## 7. Conclusion

Gold continues to be a crucial element in reserve management, valued for its role as a safe haven, inflation hedge, and a diversification tool. Despite challenges like storage costs and opportunity costs, strategic advantages it offers far surpass these drawbacks. In a time where central banks face increasingly complex economic and geopolitical uncertainty and shifting global dynamics, enduring qualities of gold position it as an indispensable reserve asset well into the future.

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# The Role of Special Drawing Rights and its impact on the IMF member countries

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## 1. Introduction

Since Sri Lanka obtained its membership of the International Monetary Fund (IMF) on 29 August 1950, history provides numerous examples of the strong relationship between the IMF and Sri Lanka. Special Drawing Rights (SDR) is a term closely linked to the IMF, and this article basically provides some insights into SDR and some understanding of the role of the IMF, which is a triggering topic at this juncture.

## 2. History

In 1944, at the Bretton Woods Conference, Gold was recognized as the central reserve asset of the international monetary system. This conference was held at Bretton Woods, New Hampshire, in July 1944, with representatives of 44 countries, during World War II, to make financial arrangements for the postwar world. Under the Bretton Woods system, the currencies belonging to 44 countries were pegged against the U.S. dollar, and the U.S. dollar was pegged against gold price. This helped control trade between the 44 nations and remained in operation from 1945 to the early 1970s. This system collapsed towards the end of the 1960s due to an inherent flaw in the Bretton Woods system, known as the Triffin Dilemma. In 1960, the Belgian-American economist Robert Triffin exposed the fundamental issue in the Bretton Woods system.

Since the currencies of 44 countries were pegged against the U.S. dollar, the growing level of world trade required a greater supply of U.S. dollars, resulting in a continuous deficit in the United States balance of payments figures. Thus, if the United States addresses its balance of payments deficit by increasing interest rates to draw more U.S. dollars back into the country, other member nations would experience a greater depletion of their reserves, potentially triggering a global economic downturn and resulting in increased instability. Otherwise, if the United States balance-of-payment deficit continues, the world economy will grow. However, eventually an excessive balance-of-payments deficit would wear away the value of the U.S. dollar, thereby dampening the relative value of the assets held by member countries and potentially leading to the collapse of the fixed exchange rate system. This is the concept behind the Triffin Dilemma.

Amidst these challenges, the necessity of creating a new international reserve asset emerged, and accordingly, the IMF made the SDR in 1969. When the Bretton Woods system collapsed in 1973, the IMF defined the SDR as the value of a basket of world currencies.

### 3. The concept and the purpose of SDR

The primary objective of SDRs is to supplement the official foreign currency reserves of IMF member countries. The SDR introduced in 1969 was designed to support the global economy by providing additional liquidity in response to potential shortfalls in the supply of reserve currencies. One of the main misconceptions of SDR is the assumption that SDR is a currency. Even though SDR is taken into account when compiling the international reserve asset position of a country, it is not considered as a currency. However, SDR does have a value, and this value is determined through a basket of five currencies, namely, the U.S. dollar, the British sterling pound, the Euro, the Japanese yen and the Chinese renminbi. Only three parties are permitted to hold SDRs: the IMF, the IMF member countries and prescribed holders.

Specifically, SDRs serve the following purposes:

- Augmenting Global Liquidity

SDR allocations help increase international liquidity, particularly during periods of financial distress or global economic instability, thereby reducing the pressure on countries to accumulate large foreign currency reserves through trade surpluses or borrowing.

- Functioning as a Reserve Asset

While SDR is not a currency, they signify a possible entitlement to the freely usable currencies of IMF member countries. In times of need, they can be traded between countries, serving as an interest-bearing international reserve asset.

- Stabilizing Balance of Payments

By providing a buffer, SDRs enable countries to address short-term balance of payments challenges without resorting to restrictive economic policies or measures that could hinder global trade and growth.

- Promoting Monetary Cooperation

SDRs are a tool for fostering international monetary cooperation and reducing reliance on a single national currency, thus supporting a more balanced and stable international monetary system.

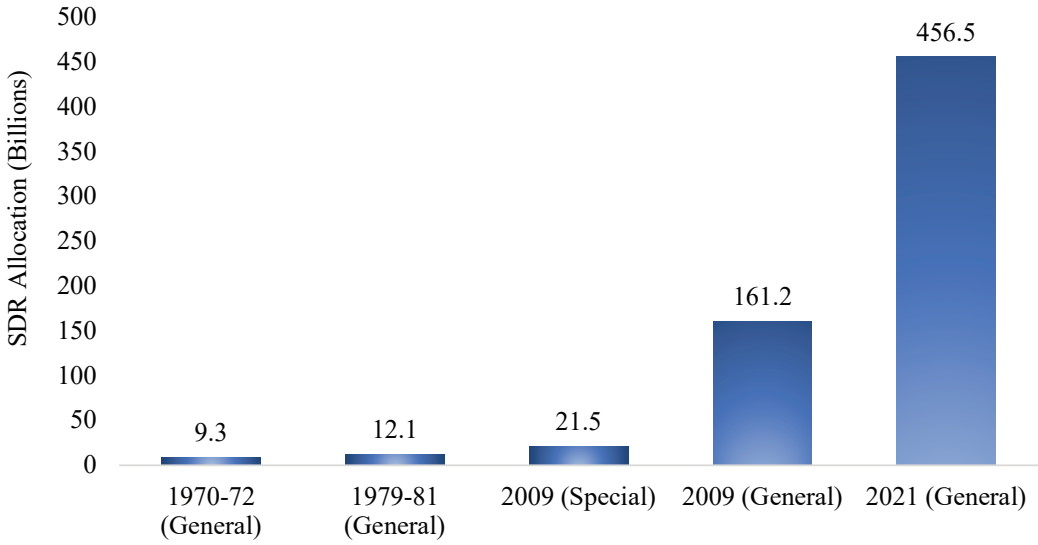
Currently, there are 190 Member Countries, including Sri Lanka, and 20 prescribed holders.[1]. Prescribed holders are the official entities designated by the IMF, and they are not participants of the SDR Department. IMF member countries hold their SDR positions as a part of their respective international reserves, together with their gold and other investment holdings in various financial instruments and reserve currencies.

### 4. SDR allocations and holdings

SDRs are distributed to member countries based on their respective IMF quotas. A quota of a member country is determined through its relative position in the world economy. A member country can

1 The current 20 prescribed holders are four central banks (European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank); 3 intergovernmental monetary institutions (Bank for International Settlements, Latin American Reserve Fund, and Arab Monetary Fund); and 13 development institutions (African Development Bank, African Development Fund, Asian Development Bank, Caribbean Development Bank, the Development Bank of Latin America (known as Corporación Andina de Fomento), the European Bank for Reconstruction and Development, the European Investment Bank, Inter-American Development Bank, International Bank for Reconstruction and Development and the International Development Association, Islamic Development Bank, Nordic Investment Bank, and International Fund for Agricultural Development).

**Figure 1: SDR Allocations in the history**




exchange its SDR for freely convertible currency for purposes such as to meet balance of payment needs or to adjust the currency composition in its international reserves. To date, one special allocation and four SDR general allocations have been undertaken, as shown in Figure 1. SDR allocations are typically aligned with global events, which do have a reserve requirement. The first general allocation was disbursed in 1970, and the largest ever general allocation of SDR 456.5 billion took place in 2021, which was also the most recent general allocation.

A summary of SDR allocations together with the reasons for such disbursements is shown in Table 1 below.

**Table 1: Purposes of General and Special SDR allocation**

| Year | Amount (SDR Billions) | Purpose |
|---|---|---|
| 1970-1972 (General) | 9.3 | To supplement global reserves amid concerns about liquidity and the Bretton Woods system. |
| 1979-1981(General) | 12.1 | Amid rising inflation and oil price shocks, it is necessary to support global liquidity. |
| 2009 (Special) | 21.5 | To correct the inequity in SDR allocations between the IMF member countries that became members after 1981 and have not received SDRs in earlier general allocations. |
| 2009 (General) | 161.2 | To strengthen member countries' reserves and confidence, subsequent to the Global Financial Crisis. |
| 2021 (General) | 456.5 | To address and support recovery from the COVID-19 pandemic. |

To date, a total of SDR 660.7 billion has been allocated to the IMF member countries, significantly boosting their international reserves. While advanced economies received larger allocations in absolute terms, reflecting their higher IMF quotas and greater influence on the global economy, the allocations constitute a greater share of international reserves among low-income countries, with emerging market economies next in line. The distribution of the general allocation of SDR among member countries, amounting to SDR 456.5 billion (U.S. dollars 650 billion) in 2021, became effective on 23 August 2021. Under this arrangement, the quota for Sri Lanka was SDR 578.8 million (0.12 per cent of the total), of which the allocated amount for Sri Lanka was SDR 554.8 million[2].

There are no specific requirements for the IMF member countries to receive their proportional share in the general allocation. At the time of SDR allocation, each member country gets two positions: SDR allocation and SDR holding, and initially, these two positions tally with each other. When a particular member country is holding an SDR position, that country receives interest for its holding and should pay interest for its allocation. Therefore, in a closed system, where a member country's SDR allocation equals its SDR holdings, both interest payable and receivable amounts are netted off. However, when a member country exchanges its SDR for freely usable currency, such a country becomes a debtor position, where its SDR position will be reduced, and the country has to pay interest for the shortfall. In contrast, if a member country exchanges its freely usable currency for SDR, such a country becomes a creditor, where its SDR position will increase, and the country will receive interest for the excess.

2 *https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation [Accessed 10 August. 2024]*

## 5. The Role of the SDR Department

The IMF SDR Department keeps a record of the SDR holdings of the IMF, member countries, and prescribed holders, and SDR allocations to member countries. Furthermore, all SDR-related transactions and operations also take place through the SDR Department. From a balance sheet perspective, when a new SDR allocation is made, a member country's gross international reserves increase by the amount of SDRs received. At the same time, an equivalent long-term liability is recorded to reflect the obligation to the IMF's SDR Department, resulting in a neutral net impact on the country's overall financial position. Accordingly, the participants in the SDR Department show their respective SDR allocation as a liability and SDR holdings as an asset in their balance sheet. However, since neither the IMF nor prescribed holders can receive SDR allocations, in their balance sheets, the SDR holding is shown as an asset without a corresponding liability.

## 6. SDR Basket

Although SDRs are not a currency, they can be exchanged for freely usable currencies based on the value of the SDR basket. During the period from 1970 to 1980, the value of SDR was derived from the currencies of 16 IMF member countries that accounted for at least 1% of global trade. However, the practicality of an SDR basket with 16 currencies was an issue, as it was challenging to replicate the basket, and some currencies were not extensively traded. As a solution, in 1981, the number of currencies in the SDR basket was reduced to five currencies from 16, namely the U.S. dollar, the Japanese yen, the German mark, the French Franc and the U.K. pound. In 1999, both the German mark and the French Franc were replaced by the Euro, resulting in the number of currencies in the SDR basket being further reduced to four currencies from five. In 2016, the

Chinese renminbi was introduced to the basket as a significant emerging market currency, resulting in the SDR basket settling with five currencies.

According to the IMF's Articles of Agreement, the authority to decide how SDRs are valued lies with the Executive Board, which reviews the composition of the SDR basket every five years, or sooner if necessary, to ensure it reflects the world's most widely traded currencies. Accordingly, the most recent review took place in 2022. Though the currencies in the basket remained unchanged at the most recent review, the weightage of renminbi has increased over time, surpassing both Japanese yen and the U.K. pound. Accordingly, the currency weights changed over time, representing the change in the impact made on international trade by the said countries, as shown in Figure 2, and the present currency weights in the SDR basket are presented in Figure 3.

During such reviews, in addition to selecting the most appropriate currencies for inclusion in the SDR basket, the Executive Board also evaluates

**Figure 2: Currency weights in the SDR basket (%)**

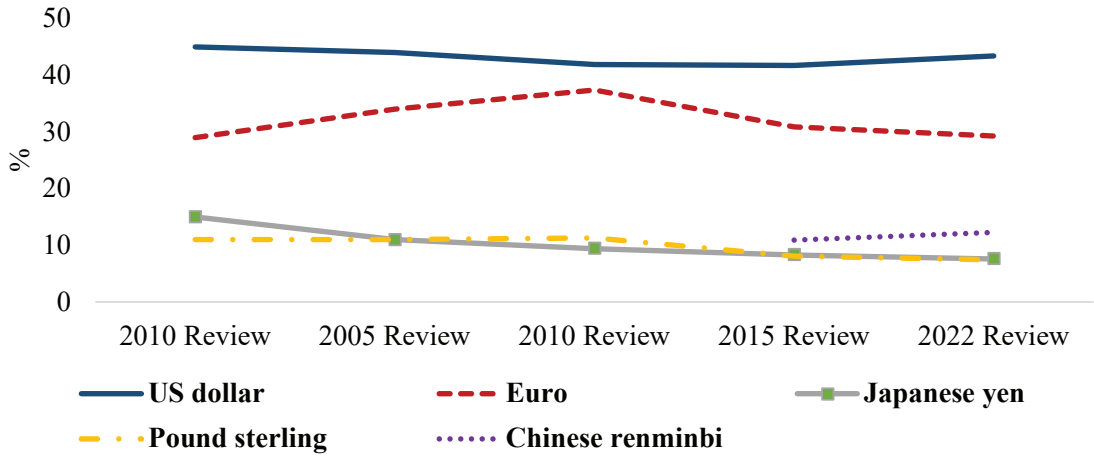
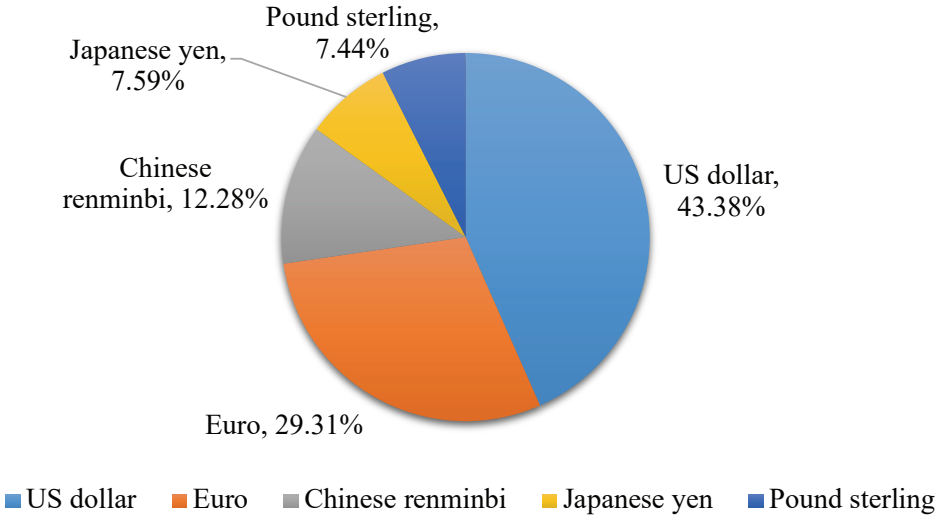



**Figure 3: Currency weights in the SDR basket under the 2022 review**



their relative weights and examines the financial instruments used to determine the SDR interest rate. When selecting currencies for inclusion in the SDR basket, the IMF's Executive Board focuses on two key criteria. First, the relative size of a country's exports, which indicates its significance in the global economy and its ability to provide reserve assets. Second, the currency's status as freely usable, meaning it is widely used for international transactions and broadly traded in global exchange markets.

## 7. SDR Valuation

The value of the SDR for a particular day is determined through the summation of the product of "Currency Amount" and the exchange rate for each currency in the SDR basket. A simple calculation of the SDR value for 16 September 2025 is as follows. Therein, the value of 1 SDR for 16 September 2025 is U.S. dollars 1.375804, or U.S. dollars 1 is equal to SDR 0.726848.

Both the Currency Amounts (fixed amounts of each currency) and weights of the currencies are derived at an SDR review, which takes place every five years. Once both are fixed, they will remain unchanged until the following SDR review takes place. The Currency Amounts and the weights of the currencies decided at the most recent SDR review, which took place in 2022, are in Table 3.

For the calculation of Currency Amount, the valuation date was taken as 29 July 2022 (just before the most recent SDR review took place), and the respective exchange rates of each currency to the U.S. dollar on the same day. The general equation to derive this number is that the sum of market values of the fixed amounts in U.S. dollar terms should be equal to one SDR.

**Table 2: Calculation of the SDR value for 16 September 2025**

| Currency Unit | Currency Amount | Exchange Rate | U.S. dollar equivalent |
|---|---|---|---|
| Chinese yuan | 1.0993 | 7.1125 | 0.154559 |
| Euro | 0.37379 | 1.18095 | 0.441427 |
| Japanese yen | 13.452 | 147.045 | 0.091482 |
| U.K. pound | 0.08087 | 1.36275 | 0.110206 |
| U.S. dollar | 0.57813 | 1 | 0.578130 |
| | | | 1.375804 |
| | 1 USD = SDR | | 0.726848 |
| | 1 SDR = USD | | 1.375804 |

**Table 3: Currency amounts and weights decided at the SDR review in 2022**

| | U.S. dollar | Euro | Chinese renminbi | Japanese yen | Pound sterling |
|---|---|---|---|---|---|
| Currency Amounts | 0.57813 | 0.37379 | 1.0993 | 13.452 | 0.08087 |
| Currency Weights (%) | 43.38 | 29.31 | 12.28 | 7.59 | 7.44 |

Solving the above equation for all the currencies at once gives the Currency Amounts of each currency, which will be fixed for the next five years.

The historical SDR values, together with the calculations, could be obtained through the IMF website[3].

## 8. SDR Interest Rate

In 1981, along with the revision to the SDR currency basket, the SDR interest rate was also considered. Members agreed that the SDR yield should be sufficiently attractive to encourage its acquisition and holding, but not so high as to discourage its use in balance of payments deficit situations or when converting it into a freely usable currency. Therefore, to support this, the SDR interest rate was aligned with the three-month market interest rates on short-term debt instruments for the currencies in the SDR valuation. Though SDR valuation takes place daily, the SDR Interest rate (SDRi) is calculated every week, that is, on every Monday, based on market interest rates for the preceding Friday. This SDRi is used to determine the quarterly payments on both interest charges on SDR allocations and interest payments on SDR holdings. Both, the prescribed holders and the IMF also earn an interest on their SDR holdings. The interest on the following financial instruments of currencies in the SDR basket is used in determining the SDR interest rate as follows.

The SDRi is determined as the higher of either: (i) the weighted average of the interest rates on the individual currencies in the SDR basket, calculated by multiplying each currency's amount by its respective interest rate and exchange rate against the SDR or (ii) a floor rate of 0.05 percent. In other words, the SDRi cannot fall below 0.05 percent. For example, during the Global Financial Crisis and the COVID-19 pandemic, although the calculated rate was negative, the SDRi was maintained at the floor rate of 0.05 percent. The historical SDRi rates are available on the IMF website[4].

## 9. Uses of SDR

A few benefits the IMF member countries would enjoy as a result of holding SDR are as follows;

- Once allocated, an IMF member country could hold its SDR amount as part of its international reserves, which would help the growth of the country's reserves.
- A member country could either sell or buy SDR for freely usable currencies through a Voluntary Trading Arrangement (VTA). The VTAs are bilateral agreements between the IMF and participants in the SDR Department,

**Table 4: Financial instruments considered in calculating the SDRi**

| Currency Unit | Financial instrument |
|---|---|
| Chinese renminbi | Three-month benchmark interest rate on China Treasury bonds |
| Euro | The three-month spot yield on euro area central government bonds rated AA and higher |
| Japanese yen | Three-month discount bills issued by the Japanese Treasury |
| Pound sterling | Three-month Treasury bills issued by the UK government |
| US. dollar | Three-month Treasury bills issued by the US government |

3 *https://www.imf.org/external/np/fin/data/rms_sdrv.aspx [Accessed 17 September 2024]*

4 *https://www.imf.org/external/np/fin/data/sdr_ir.aspx [Accessed 10 September 2024]*

under which parties agree to buy or sell SDRs within set limits. If no VTA participant is willing to conduct the transaction, the IMF activates the designation mechanism. This mechanism involves selecting member countries with strong balance of payments and reserve positions to provide freely usable currencies in exchange for SDRs. However, since 1987, this mechanism has not been used, as all transactions have been successfully carried out through VTAs.

- A member country or a prescribed user can freely donate SDRs to another member country.
- To settle financial obligations.
- Sell or buy SDR between member countries as spot transactions at pre-agreed exchange rates.
    - Swap arrangements between member countries allow the exchange of SDRs for a freely usable currency, excluding gold, with an agreement to reverse the transaction on a pre-determined date and at a fixed exchange rate.
    - Forward operations in SDR with member countries, at a pre-agreed exchange rate.
    - Provide loans in SDR for member countries at a pre-agreed maturity date and interest rate. These repayment and interest payments could also be allowed in SDR.

**10. The IMF, SDR, and Sri Lanka**

There is a long-standing relationship between the IMF and Sri Lanka; hence, Sri Lanka is one of the very first countries to become a member of the IMF in 1950. Historically, Sri Lanka has turned to IMF support in several instances during periods of economic instability, notably to support the country's balance of payments situation. The most recent IMF program under which Sri Lanka is operating is the Extended Fund Facility (EFF) arrangement, amounting to SDR 2,286 million (approximately US$3 billion), approved on 20 March 2023. Unlike in previous instances, this facility was offered to serve both Balance of Payment and budget support.

The IMF-related information on Sri Lanka, such as historical data, outstanding amounts, supporting documents, and latest news, can be obtained through the IMF website[5].

Under the 2021 general allocation of SDR, Sri Lanka received SDR 554.75 million in August 2021. Under the 2009 general and special allocations of SDR, Sri Lanka received SDR 306.46 million and SDR 18.13 million in August and September 2009, respectively. As of the end of June 2025, the total SDR allocation for Sri Lanka was SDR 950 million. This SDR holding forms a part of the assets in the Gross Official Reserves position of the country, and from time to time this SDR holding was used by the Central Bank of Sri Lanka (CBSL) to convert into U.S. dollars, as a way of meeting debt obligations and to adjust asset and currency composition of the reserves as well as to repay the IMF principal and interest amounts in SDR. Accordingly, although the total SDR allocation for Sri Lanka was SDR 950 million, as of the end of June 2025, Sri Lanka's SDR holding was SDR 1,737,524, which is 0.18 percent of the total allocation.

As in Table 5, Sri Lanka is currently in its seventeenth IMF program since obtaining membership in the IMF on 29 August 1950. Sri Lanka's first IMF program was in 1965, while the most recent ongoing programme commenced in March 2023. To date, the most successful IMF program began in 2009, when the IMF disbursed the full allocation for Sri Lanka. Until 1980, Sri Lanka was in 7 Stand-By Arrangements (SBAs) and 1 EFF, mainly

5 *https://www.imf.org/en/Countries/LKA [Accessed 25 August. 2024]*

to support liberalization and address balance of payments issues, followed by one SBA and Structural Adjustment Facility Commitment during the 1980s to support periods of external pressure and internal conflict. In the 1990s, the programme was more focused on liberalization and budget discipline. Subsequently, the programme targeted rebuilding reserves, stabilizing the economy, and supporting reconstruction, fiscal consolidation, reforms of State-Owned Enterprises (SOEs), and revenue mobilization.

In September 2022, Sri Lanka reached a staff-level agreement with the IMF for four years under the EFF, amounting to SDR 2.286 billion, with the primary objectives of restoring the country's macroeconomic stability and achieving debt sustainability. This is the most recent and ongoing EFF programme, where the IMF disbursed its fifth tranche of SDR 254 million in July 2025 after reaching the staff level agreement on economic policies following the conclusion of the Fourth Review of the reform programme. With the receipt of this tranche, Sri Lanka has received a total of SDR 1.0 billion (approximately U.S. dollars 1.74 billion), marking a 50 per cent implementation milestone. Both the CBSL and the Government are keen on achieving the targets set out in the

**Table 5: History of Lending Commitments for Sri Lanka as of 30 June 2025**

| Facility | Date of Arrangement | Expiration Date | Amount Agreed (SDR)'000 | Amount Drawn (SDR)'000 | Amount Outstanding (SDR) '000 |
|---|---|---|---|---|---|
| Extended Fund Facility | 20-Mar-23 | 19-Mar-27 | 2,286,000 | 1,016,000 | 1,016,000 |
| Extended Fund Facility | 3-Jun-16 | 2-Jun-20 | 1,070,780 | 952,230 | 430,746 |
| Stand-by Arrangement | 24-Jul-09 | 23-Jul-12 | 1,653,600 | 1,653,600 | 0 |
| Extended Fund Facility | 18-Apr-03 | 17-Apr-06 | 144,400 | 20,670 | 0 |
| Extended Credit Facility | 18-Apr-03 | 17-Apr-06 | 269,000 | 38,390 | 0 |
| Stand-by Arrangement | 20-Apr-01 | 19-Sep-02 | 200,000 | 200,000 | 0 |
| Extended Credit Facility | 13-Sep-91 | 31-Jul-95 | 336,000 | 280,000 | 0 |
| Structural Adjustment Facility Commitment | 9-Mar-88 | 8-Mar-91 | 156,170 | 156,170 | 0 |
| Stand-by Arrangement | 14-Sep-83 | 31-Jul-84 | 100,000 | 50,000 | 0 |
| Extended Fund Facility | 1-Jan-79 | 31-Dec-81 | 260,300 | 260,300 | 0 |
| Stand-by Arrangement | 2-Dec-77 | 1-Dec-78 | 93,000 | 93,000 | 0 |
| Stand-by Arrangement | 30-Apr-74 | 29-Apr-75 | 24,500 | 7,000 | 0 |
| Stand-by Arrangement | 18-Mar-71 | 17-Mar-72 | 24,500 | 24,500 | 0 |
| Stand-by Arrangement | 12-Aug-69 | 11-Aug-70 | 19,500 | 19,500 | 0 |
| Stand-by Arrangement | 6-May-68 | 5-May-69 | 19,500 | 19,500 | 0 |
| Stand-by Arrangement | 15-Jun-66 | 14-Jun-67 | 25,000 | 25,000 | 0 |
| Stand-by Arrangement | 15-Jun-65 | 14-Jun-66 | 30,000 | 22,500 | 0 |
| **Total** | | | **6,712,250** | **4,838,360** | **1,446,747** |

programme, which are basically designed to address much-needed and long-overdue structural reforms.

Accordingly, the total outstanding amount for Sri Lanka under the IMF lending commitments is SDR 1,446.75 million, which arises from the most recent two EFF programs executed in 2016 and 2023. This outstanding SRD amount is 250.0 per cent of the quota available for Sri Lanka (The quota available for Sri Lanka is SDR 578.80 million). Sri Lanka is under the obligation to repay principal and charges/ interests promptly in the forthcoming years on the outstanding amounts under such programs.

## 11. The most common IMF Facilities aiming at supporting economies

### a. Extended Fund Facility

The EFF is a specific type of lending arrangement provided by the IMF, which differs significantly from general or special allocations in various aspects. The purpose of EFF is to assist countries experiencing serious balance of payment issues and macroeconomic instabilities. All member countries with actual or probable economic problems are eligible for an EFF program. The facility is usually provided in tranches and on conditional arrangements for the implementation of various economic, social, and structural reforms. The Executive Board of the IMF regularly assesses the performance of the program and adjusts the program accordingly. Typically, the duration of an EFF program is either three or four years, with repayments spanning 4.5 to 10 years in 12 equal semi-annual installments. The applicable interest rate is the SDRi with a margin. Currently, the margin is 100 basis points. Surcharges are applicable for outstanding credits.

### b. Stand-By Arrangement

SBA is another form of the most commonly used IMF lending programme, especially targeting countries experiencing short-term balance of payments problems (i.e., instances where the countries are struggling to pay for imports or service foreign debt) as an "emergency fix". Governments that need quick access to foreign currency and are willing to commit to short-term economic reforms are most likely to obtain SBAs. Typical duration of an SBA is 12-24 months, and the repayment period is 3 ¼ to 5 years from disbursement. SBAs are less structured while focusing more on restoring short-term confidence.

### c. Extended Credit Facility

The Extended Credit Facility (ECF) is another part of a lending arrangement provided by the IMF, targeting the low-income IMF member countries. The ECF is considered an IMF concessional lending toolkit under the Poverty Reduction and Growth Trust (PRGT). The usual term of ECF is 3 to 5 years, with a grace period of 5 ½ years up to 10 years.

### d. Enhanced Structural Adjustment Facility (ESAF)

Established in 1987, the Enhanced Structural Adjustment Facility (ESAF) enabled the IMF to provide low-interest loans to poor and low-income countries, conditional upon the implementation of specific policy reforms. The 1980s–1990s period was exceptionally difficult for low-income countries, especially those in the African, Asian, and Latin American regions. Due to some criticisms, ESAF was replaced by PRGT in 1999.

## 12. Conclusion

The SDR is an international reserve asset created by the IMF in 1969 to supplement global liquidity, particularly in response to the shortcomings of the Bretton Woods system. To date, general and special allocations of SDR, EFF, and other similar programs of the IMF have assisted many countries in need, including Sri Lanka. The underlying

purposes of such programmes are primarily to serve as a supplementary international reserve asset, to provide access to unconditional liquidity, to facilitate financial transactions, as a unit of account, and to mitigate severe economic downturns and high inflation, thereby promoting macroeconomic stability and poverty reduction.

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# Global Best Practices on Sovereign Debt Management and its Application to Sri Lanka in Recent Reforms

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*"... ensure that the operational framework and practices are in line with the best practices of other comparable sovereign borrowers and the private sector".*

*Debt management report 2004-2005,*
*Department of Finance, Canada*[1]

## 1. Introduction

1.1 For a considerable period of time, the management of sovereign debt has invited the attention of policy makers. When the debt portfolio of the sovereign is considerably larger and complicated in nature, the size and the nature of that debt portfolio impacts negatively on the financial sector of the country as well as the economy. Hence, it was imperative for sovereigns to comparatively consider the practices adopted by other countries and adopt what suits best for the individual countries in debt management.

1.2 Sovereign debt management could be considered as the process of formulating and implementing sound strategies to handle a country's debt portfolio from debt raising in a cost-effective manner to aligning the same with other policies of the government such as fiscal policies and development of an efficient capital market for government securities.

1.3 Sri Lanka is no different to other sovereigns who adopt sound debt management practices introduced by other nations as well as global standard setting bodies such as the International Monetary Fund (IMF) and the World Bank (WB), in this regard. Thus, this article intends to summarize the efforts taken by Sri Lanka to adopt such best practices in managing its public debt portfolio in its recent policy reform agenda.

1 p. 11

## 2. Introduction to global best practices in managing public debt

2.1 The sovereign debt portfolio of a country is usually the largest fiscal portfolio in a particular country, inviting the attention of stakeholders of any kind. This usually is comprised of complicated and structured financial instruments giving rise to substantial risks to the government's balance sheet, and thereby to the country's financial stability. Thus, many countries and global standard setting bodies have designed certain practices to assist policymakers when implementing their reform agendas to ensure the sustainability of respective public debt portfolios in the domestic as well as international context.

2.2 However, when adopting pre-designed best practices, any government may face the dilemma on policy choices relating to debt management objectives, its risk appetite, the segment of the government balance sheet where focus should be directly aimed at, the manner in which contingent liabilities are managed, and how to establish sound governance structures for public debt management. The IMF, in its Guidelines for Public Debt Management (2001), has illustrated certain aspects of best practices to be considered by the sovereigns including the setting up of precise objectives for debt management, analysing the cost-benefit-risk factors attached to the debt portfolio, healthy monetary and fiscal policy coordination and accountability, advance setting of debt targets addressing refinancing and market risks, and establishing sound legal and institutional frameworks and governance structures to manage public debt.

2.3 Following is a summary of key global best practices introduced by the IMF and the WB jointly[2], and that have been made in line with the said aspects, in managing public debt addressing such dilemma that may be faced by sovereigns often.

- Identification and setting of advantages of having precise debt management objectives.
- Evaluating cost-benefit-risk factors.
- Healthy monetary and fiscal policy coordination, responsibilities and accountability.
- Containing debt expansion in a sustainable manner.
- Advance setting of debt targets addressing refinancing and market risks.
- Establishing sound legal and institutional frameworks and governance structures to manage public debt to lower the associated operational risks that may arise due to segregation of powers, functions and responsibilities among the government agencies that involve in public debt management.

2.4 However, the above best practices are not considered as a set of binding practices or mandatory standards or codes. Also, they are not a unique set of globally accepted sound and best practices that could be made applicable to all countries in all situations and under any circumstance. They would, in general, assist policy makers by disseminating sound practices adopted by other countries in debt management strategy and operations. Thus, the implementation of such best practices will differ from country to country, depending on each country's requirements and circumstances, such as its state of financial

2 Guidelines5 for Public Debt Management, IMF/WB

and market development and the criticality of the status of the debt portfolio.

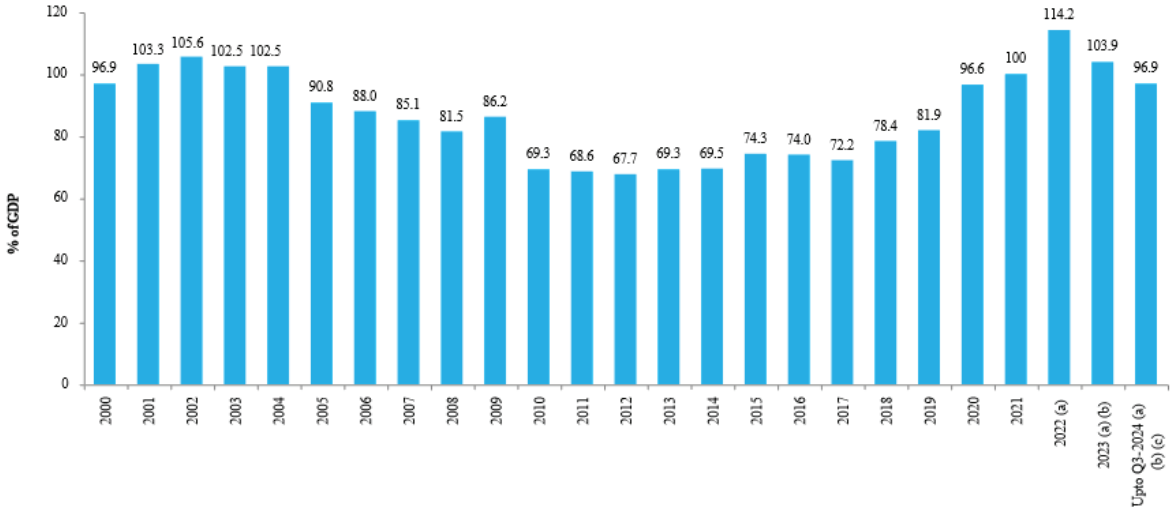
2.5 It is noteworthy to see that as per the best practices as summarized in paragraph 2.3, above, when conducting the debt management processes, it is essential to connect the debt management objectives to a clear macroeconomic framework, under which the governments are required to ensure that the public debt portfolio is leveled up and maintained in a sustainable manner where the economy can withstand the burden thereof without any adverse consequences.

2.6 Also, prudent and proactive debt management does not provide any additional funding or accumulating additional liabilities, rather improve the composition and sustainability of the outstanding debt. When sovereign debt is not sustainable, countries such as Sri Lanka are compelled to be aligned with reform agendas made in line with the said best practices. These reforms will mainly be used with a view to improve the structure of debt and governance. Even though the mechanisms and frameworks to be utilized to operationalize the structures and instruments may vary from time to time or from the debt category to debt category or the currency in which the borrowing was made, all debt management operations contain one common feature, i.e., "it restructures unpaid debt", as per the sound debt management practices.

## 3. Status and background to the public debt portfolio: Sri Lanka

3.1 Sri Lanka has been facing significantly large volumes of repayments of public debt

**Figure 1: Central Government Debt**




*Note: From 2010 onwards, data are based on rebased GDP estimates (base year 2015) of the Department of Census and Statistics released on 15 March 2023 Data from 2020-2023 are based on latest GDP estimates made available in March 2024 by the Department of Census and Statistics.*

(a) Provisional

(b) The outstanding central government debt excludes several debt service payments that became overdue after 12 April 2022, the date of which the Interim Policy regarding the servicing of Sri Lanka's external public debt was announced by the Ministry of Finance, Economic Stabilization and National Policies. These debt service payments comprise of overdue interest payments of affected debt which deemed to be capitalised as per the Interim Policy. Further, the December 2022 balance excludes the value of principal payments yet to be settled in relation to Sri Lanka Development Bonds from April 2022 till end 2022.

(c) The annual GDP estimate, based on the GDP estimates of the relevant quarter and the preceding three quarters, was used to compute the outstanding central government debt stock as a percentage of GDP.

Source: Central Bank of Sri Lanka (Chart Pack – Q$4-2024)

liabilities including contingencies starting from 2019. Between 2022 to 2030, the country was expected to repay/refinance USD 12.55 billion in already issued International Sovereign Bonds (ISBs) mainly, each worth above USD 500 million. In addition, there have been settlement of liabilities over project loans and Sri Lanka Development Bonds elevating the debt service pressure in foreign currency giving rise to an unbearable stress on the liability side of the sovereign balance sheet.

3.2 Summary of the details pertaining to central government debt accumulation over a period of time making the efforts to settle them difficult is given as per Figure 1, below.

3.3 As evidenced in Figure 01, above, the debt stock became unsustainable for Sri Lanka to handle creating adverse economic, humanitarian and social challenges causing a recessionary and high inflationary conditions, lower international reserves levels and making the financial sector vulnerable.

3.4 As of end-2022, the Sri Lanka's public debt including the Central Government debt, Guaranteed State-Owned Enterprises' (SOEs) debt and the Central Bank of Sri Lanka (CBSL) debt amounted to USD 83,595 million, equal to 128.1% of GDP. The Central Government debt accounted for 92% of total public debt (USD 76,758 million), SOEs debt guaranteed by the Government for 4% of total public debt (USD 3,739 million), and the CBSL owed 4% of total public debt (USD 3,098 million). Overall, public debt in foreign currency amounted to USD 45,543 million (USD 41,474 million in foreign law, and USD 4,069 million in local law respectively), while public debt in local currency amounted to USD 38,052 million. Foreign currency public debt mainly consisted of Central Government debt owed to commercial creditors (USD 20,658 million), while local currency public debt was mainly made up of Central Government bonded debt (Treasury Bills and Treasury Bonds, equivalent to USD 11,364 million and USD 24,020 million, respectively) of USD 35,384 million.

3.5 With a view to overcome the prevailing economic and financial system instability in the country, the Government of Sri Lanka (GOSL) entered into an Extended Fund Facility arrangement with the IMF commencing from March 2023 for SDR 2.286 billion (approximately USD 3.0 billion). One of the standards set by the IMF consequent to the above arrangement was for Sri Lanka to make its public debt portfolio sustainable. In order for Sri Lanka to arrive at this milestone, the IMF made it essential for Sri Lanka to:

(i) bring down the level of public debt below 95% of GDP by 2032,

(ii) decrease the average central government gross financing needs (GFNs) in 2027–32, including from the materialization of contingent liabilities, below 13% of GDP, so that rollover risks under stress are manageable,

(iii) keep foreign exchange (FX) debt service of the central government below 4.5% of GDP in any year during 2027-32, and

(iv) ensure that the fiscal and external financing gaps are closed (Staff Level Agreement, 2023).

## 4. Application of global best practices by Sri Lanka

4.1 In making its unsustainable public debt portfolio into a sustainable portfolio, GOSL initiated steps to adopt certain global best

practices as referred to in paragraph 2.3, above. These included:

(i) Evaluating risks against cost considerations and operating liability management to:

a. manage refinancing and market risks of the debt obligations, and

b. containing debt expansion in a sustainable manner.

(ii) Establishing a sound legal and institutional framework and governance structures to lower the associated operational risks that may arise due to segregation of responsibilities and accountabilities among the government agencies that involve in debt management.

(iii) Identification and setting of benefits of clear objectives for debt management within a single legal framework.

(iv) Healthy coordination between fiscal and monetary policies when they operate independently.

## 4.2 Liability management operations by Sri Lanka during sovereign debt restructuring

4.2.1 In the process of achieving debt sustainability, GOSL was to consider factors affecting the refinancing risk of the existing debt stock and comparability of treatment to be offered to every type of creditor. Designing of the domestic and external debt restructuring was made in this context and accordingly, during the restructuring process, the following instruments have been utilized by the Sri Lankan Government as part of its liability management operations.

(i) **Local law foreign currency (LLFC) debt*:*** These included Sri Lanka Development Bonds (SLDBs) and certain foreign currency denominated (FX) bank loans of the GOSL. In order to receive considerable relief, LLFC debt was restructured by switching/ converting into new instruments. Accordingly, under the Domestic Debt Optimization (DDO) program, the total outstanding stock of SLDBs worth of USD 837.59 million was settled by issuing new LKR denominated SLFR linked coupon Treasury bonds. Further, Foreign Currency Banking Units (FCBU) loans held by two state banks were converted into longer-term new SLFR linked coupon Treasury Bonds denominated in LKR. As well as one of the SOE's loans amounting to USD 2.43 billion were restructured by issuing new SLFR linked coupon Treasury bonds denominated in LKR.

(ii) **Local law local currency (LLLC) debt*:*** These included Treasury bills and Treasury bonds, mostly. LLLC debt was exchanged/ converted or switched with new instruments with different terms and conditions. Thus, eligible accepted Treasury Bonds worth Rs. 3,204 billion held by Superannuation Funds were converted to new step-down coupon Treasury Bonds while Treasury Bills held by the CBSL worth Rs. 2,368.4 billion and the provisional advances made by the CBSL to the GOSL of Rs. 344.7 billion were converted to new step-down coupon Treasury Bonds worth Rs. 2,492 billion

and new Treasury Bills worth Rs. 220.8 billion under the DDO program during the year 2024.

(iii) **Foreign law foreign currency (FLFC) debt:** FLFC debt to official bilateral and commercial creditors were restructured through postponement of the grace period and the maturity, discounting of interest rate(s), minimal haircuts, or a blend of any of the aforesaid methods, mainly.

Moreover, during 2024, ISBs are restructured under the Global Option and Local Option in External Debt Restructuring (EDR) process. In Local Option, a portion of ISBs were converted into new SLFR linked coupon Treasury bonds denominated in LKR amounting 155.7 billion.

## 4.3 Institutional and instrumental governance structure to improve debt management operations

Every government has the choice of selecting the composition of its institutional and governance framework to give effect to sound practices in best achieving its debt management objectives. These structures would entail a government to decide the optimal currency and maturity composition that suits a country. The importance of these aspects which are of utmost relevance to Sri Lanka was emphasized by the IMF in its report titled "Sri Lanka: Technical Assistance Report-Debt Management Reform Plan[3]" and according to that report, *inter alia*, the fragmented and less comprehensive legal and institutional frameworks pertaining to debt management have also contributed to the unsustainable public debt portfolio of the country. In view of that emphasis, the following have been recommended by the IMF to be implemented by Sri Lanka to improve, *inter alia*, the governance structure of liability management of the sovereign.

- A new legal framework for public debt management
- Establishment of a new public debt management office inside the Ministry of Finance (MoF)

4.3.1 Consequent to the near completion of the sovereign debt restructuring, GOSL has initiated many policy reforms to strengthen the institutional and instrumental governance structures relating to debt management. A summary of such reforms is given below.

**Public Debt Management Act, No. 33 of 2024 (PDMA)**

Sri Lankan has, therefore, taken steps to enact PDMA consolidating all existing laws relating to debt management, providing for the establishment of the Public Debt Management Office (PDMO), and defining the governance, transparency and accountability frameworks relating to debt management. In addition to the management of the debt stock of the government, PDMO is responsible for implementation of efficient and transparent borrowing practices, which are the essential ingredients to maintain debt sustainability and the medium to long

3 December 2024

term fiscal strength of the country. Within a stipulated period of time, PDMO will take over all relevant functions from the CBSL, External Resources Department and the Treasury Operations Department pertaining to public debt raising to management of the same. Hence, the public debt management process and operations will be centralized by January 2026. The following describes a few salient features of the PDMA.

- Formulation and publication of the medium-term debt management strategy, the annual borrowing plan and the auction calendars for the issuance of debt
- Arrange financial terms and conditions after negotiations with respective counterparties when borrowing from external and internal sources and to conduct debt management activities of the government
- Accessing financial markets and maintaining relationships to achieve objectives desired through such access
- Formulation of debt, cash flow management and coordination of debt operations by and between all relevant stakeholders
- Servicing of debt and liability management operations of the government
- Conduct risk assessments and risk mitigation activities on borrowing including loan guarantees and on-lending activities
- Maintaining records, generating reports, making disclosures of data/ information pertaining to raising and management of debt obligations to Parliament, stakeholders and the general public

**Public Debt Management Office**

PDMO was established on 02.12.2024 under the provisions of PDMA to further strengthen and centralize the debt management operations of the country. PDMO is the sole entity responsible for managing government debt and overseeing the activities related to public debt management. Its key responsibilities consist of management of public debt, issuance and management of loan guarantees, management of on-lending operations and recording and reporting of public debt. Further, the PDMO will be fully operationalized by January 2026.

**Public Finance Management Act, No. 44 of 2024**

There have been multitudes of attributes to the public finance management during the past few decades in the country with many ambiguities in implementation. The Public Finance Management Act was enacted with a view to further strengthening the accountability, oversight, management, and control of public funds in the public financial management framework of the country. With the enactment of this Act, the Fiscal Management Responsibility Act, No. 03 of 2003, and the provisions of sections 08 and 14 of the Finance Act, No. 38 of 1971, were repealed. However,

until the Act comes into force in full, the Financial Regulations of the Government (published in 1992), various circulars issued by the General Treasury and other authorities responsible for managing public finance, and the circulars approved by the Cabinet of Ministers from time to time will continue to be in effect.

4.3.3 Together with the effective implementation of the already adopted policies, structures and frameworks, sound macroeconomic policy settings and proper monetary-fiscal synchronization, the application of the global best practices in public debt management as detailed above would pave the path for Sri Lanka to maintain the sustainability of its sovereign public debt portfolio.

## 5. Conclusion

Unsustainable debt structures Sri Lanka experienced are the legacy consequences of doubtful economic policies, i.e., fiscal, monetary and exchange rate. In the efforts to fix such doubts, Sri Lanka recently adopted several globally accepted sound sovereign debt management practices in its policy reform framework such as operationalization of measures to contain the risks and costs, and setting up institutional and governance frameworks. However, sound debt management policies cannot be considered on a standalone basis to achieve the desired debt management objectives, but the same needs to be coordinated and interpreted with robust fiscal and monetary management.

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# The Importance of Responsible AI and Sri Lanka's Readiness

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## Introduction

Artificial Intelligence (AI) has been documented in literature since 1950s with continuous developments from conceptual level to classical machine learning to deep learning; and with the evolution of generative AI and agentic AI it has become the next big technological innovation which revolutionizes global development. Usage of AI for development in any sector not only impacts the technological proficiency but also the ethical standing, economic stability and social cohesiveness. Sri Lanka as a country which sits in a critical juncture of economic restructuring and digital transformation, responsible adoption of AI is necessary to transform many challenges to opportunities. This article explains what responsible AI is and Sri Lanka's journey and readiness in responsible AI.

## What is Responsible AI

Responsible AI is an approach to design, develop, assess and deploy AI solutions in a safe, trustworthy **and** ethical manner. It involves the consideration of a broader societal impact of AI systems and the measures required to align these technologies with stakeholder values, legal standards and ethical principles.

The severity of disaster that irresponsible AI can cause can be seen from the following global examples.

- In 2018 and 2019, two separate Boeing 737 Max aircrafts crashed killing 346 people due to the malfunctioning of Maneuvering Characteristics Augmentation System (MCAS) or the automated flight control system. In addition to the lives lost, this made the grounding of Boeing 737 Max fleet worldwide creating billions of financial losses.
- In 2023, an employee of Samsung copy-pasted internal source code and documents in ChatGPT for internal tasks creating a sensitive data leakage which made Samsung ban the use of generative AI tools internally.
- Amazon has used an AI based recruitment tool during 2014-2018 period which has taken biased decisions against women as it has been trained using male training data.

Similarly, there are many other instances which

**Table 1: Key Milestones of AI Evolution**

| Year | Event | Key Highlight |
|---|---|---|
| **1950** | Turing Test Proposed | Alan Turing suggested a test where a machine could be considered intelligent if it could hold a conversation indistinguishable from a human. |
| **1956** | AI Named at Dartmouth | The Dartmouth Conference officially coined the term "Artificial Intelligence", marking the birth of AI as a research field. |
| **1970** | First AI Winter | Funding dried up after early AI systems failed to deliver promised results. |
| **1980** | Second AI Winter | Expert systems boom collapsed due to high maintenance costs and limited scalability, leading to another funding cut. |
| **1997** | Deep Blue Defeats Kasparov | IBM's chess-playing computer beat world champion Garry Kasparov, proving machines could outperform humans in specific tasks. |
| **2012** | AlexNet Revolutionized Deep Learning | AlexNet won the ImageNet competition by a huge margin, showing the power of GPUs and deep neural networks for image recognition. |
| **2016** | AlphaGo Beats Lee Sedol | Google DeepMind's AlphaGo defeated a top Go player, demonstrating AI's ability to master complex, intuitive games. |
| **2020** | Generative AI Boom (GPT-3, DALL·E) | GPT-3 amazed the world with human-like text generation; DALL·E created realistic images from text prompts. |
| **2023** | Generative AI Mainstream (ChatGPT, Copilot) | ChatGPT became widely used for writing, coding, and customer service; Copilot integrated AI into everyday productivity tools. |

show the damage caused by irresponsible use of AI, which highlights the importance of responsible AI usage.

Many tech giants and international organizations such as Organization for Economic Co-operation and Development's (OECD) have defined AI principles/ pillars of trust highlighting the salient properties of an AI system to make the AI responsible and trustworthy. The OECD principles for responsible AI are as follows.

- Inclusive growth, sustainable development and well-being
- Human-centered values and fairness
- Transparency and explainability
- Robustness, security and safety
- Accountability

Just after issuing OECD recommendations in 2019, UNESCO published their recommendations on the ethics of AI in 2021 which is considered as the first global framework on the ethics of AI.

These core values guide national and international policies, including emerging AI-specific legislations. However, to put these principles into practice, deep ethical analysis, risk/opportunity assessment and human oversight are essential for any AI product.

**Stages of Responsible AI Journey**

As nations and businesses increasingly rely on digital infrastructure, integrating AI responsibly becomes essential for sustainable growth, economic resilience, and long-term strategic advantage. The Responsible AI journey is not a short one. It is a long journey spread over multiple stages. The key stages of Responsible AI journey can be outlined as below.

1. Establishing a National Vision and Principles

2. Building a Robust Governance Framework
3. Developing Technical and Legal Infrastructure
4. Fostering Inclusive Public Dialogue and Participation
5. Building Human and Institutional Capacity
6. Monitoring and Continuous Learning

Many countries have already started their responsible AI journeys and progressed to different stages. The next sections of this article will briefly describe each of these phases and the global presence in each stage and where Sri Lanka stands.

**Establishing a National Vision and Principles**

Having identified the strategic potential of AI in the country's development, over 50 countries around the world have already developed national and government-wide strategic initiatives for Responsible AI. The following Figure 1 depicts a timeline of National AI Strategy launches of some of those countries.

The vision itself highlights the importance of being responsible and further it emphasizes Responsible AI as the 1st pillar out of the seven core pillars identified in the Strategic Framework for advancing AI in Sri Lanka. These principles are not aspirational, they are necessary. In a society with diverse socio-economic realities, responsible AI ensures that progress is equitable and transparent.

**Building a Robust Governance Framework**

For any country to progress in responsible AI development, government activity and support is essential. Many governments around the world have understood this has taken initiatives to facilitate responsible AI development through various means. Ethical frameworks, hard and soft laws and governance frameworks together with the multi-disciplinary advisory bodies are the most common governance means. Regardless of the method, the policies should be inclusive in order to reflect the diverse perspectives and should be transparent and open to scrutiny.

Among the many countries, Canada was one of the front runners in mandating AI transparency in government through the Directive on Automated Decision Making in 2019. Treasury Board of Canada Secretariat is the governance body responsible of AI governance in Canada. An algorithmic Impact Assessment must be completed

**Figure 1: Global Evolution of AI Strategies**

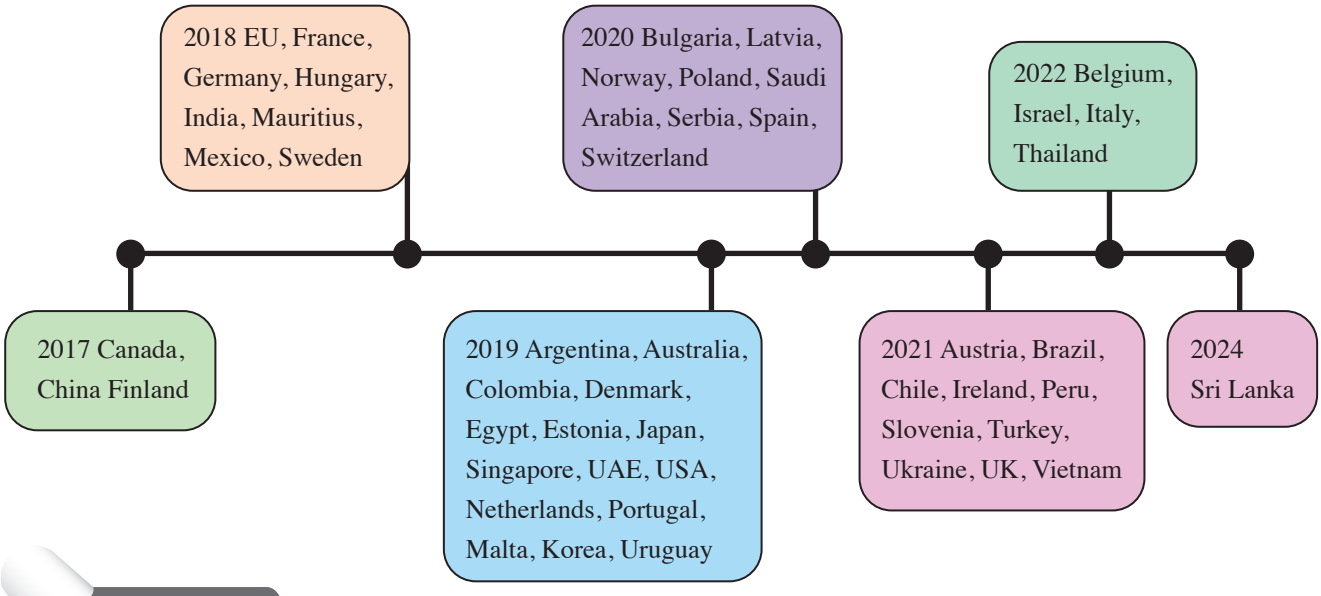
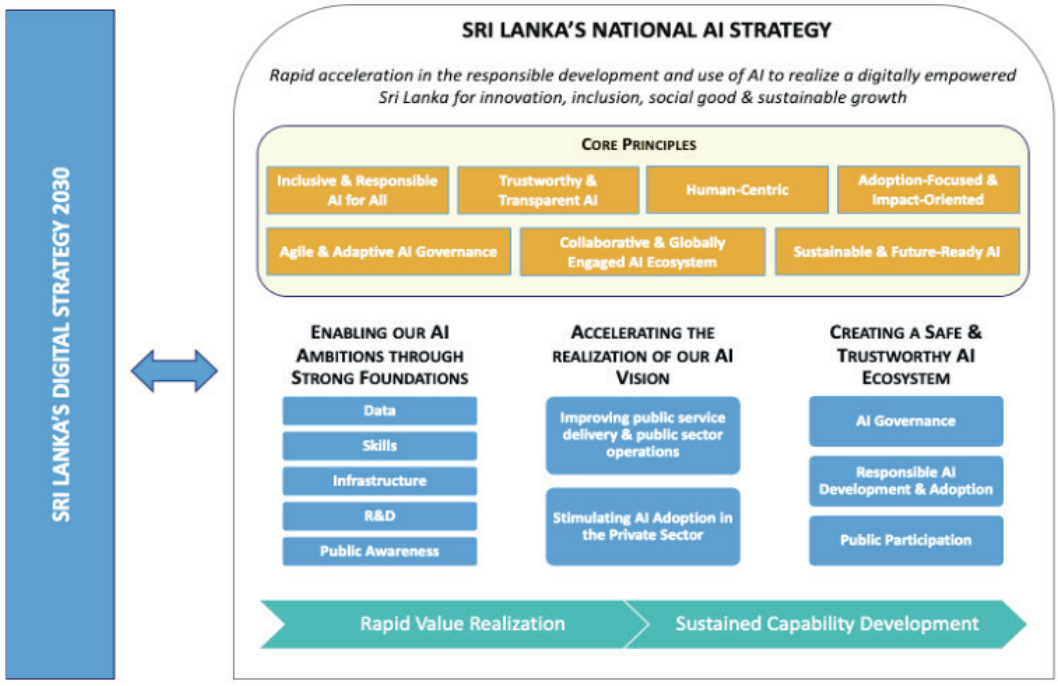


**Figure 2: Strategic Framework for Advancing AI in Sri Lanka**




Source: National AI Strategy for Sri Lanka

before any deployment of an AI tool for public services in Canada.

To guide the ethical and strategic use of AI, the government of Sri Lanka has launched several initiatives:

**Table 2: Comparison of AI Governance Models**

| Country | Main Governance Entity | Stakeholder Inclusion | Governance Style |
|---|---|---|---|
| Canada | Treasury Board (TBS) | Civil society, gov agencies | Public-sector-led |
| EU | European Commission + AI Alliance | Wide stakeholder forums | Multi-level, risk-based |
| Singapore | Infocomm Media Development Authority (IMDA) + AI Singapore | Strong industry involvement | Government-led, agile |
| New Zealand | Ministry of Business, Innovation and Employment + AI Forum NZ | Indigenous & public trust | Culturally inclusive |
| India | National Institution for Transforming India (NITI) Aayog + task forces | Sector-specific partnerships | Mission-oriented |
| Sri Lanka | Digital Transformation Agency + National Centre for AI (NCAI)<br><br>(Yet to establish) | Stakeholder forums | Collaborative: government, private sector, academia, and civil society to create a vibrant AI ecosystem |

- Presidential Task Force on AI (2023): Appointed to promote AI across critical sectors including agriculture, health, education, and public administration.
- National AI Advisory Committee: A multi-disciplinary group that advises on governance, education, regulation, and research.

These committees play a crucial role in developing Sri Lanka's AI Strategy and aligning it with the broader Digital Economy Strategy. The National AI strategy states that it is planned to establish a Digital Transformation Agency (DTA) and National Centre for AI (NCAI) under DTA which will ensure that the core principles of the AI Strategy are effectively reflected in the implementation of the strategy and the specific initiatives.

Table 1 shows a comparison of AI governance models of several countries against Sri Lanka.

**Table 3: Comparison of AI Technical and Legal Infrastructure**

| Country | Standards | Laws | Tools | AI Testing Environments |
|---|---|---|---|---|
| USA | NIST AI Risk Management Framework | Algorithmic Accountability Act (proposed) | National AI Research Resource (NAIRR) tools (in development), Fairness indicators | Research-use in public institutions, NAIRR (planned) |
| EU | Ethics Guidelines for Trustworthy AI | EU AI Act | AI-on-Demand platform, transparency templates | AI Testing and Experimenting Facilities (TEFs) across sectors |
| Singapore | Model AI Governance Framework | Non-legislative; sectoral guidance under Personal Data Protection Act | AI Verify Toolkit, industry self-assessment guides | Regulatory sandboxes (finance, health, transport) |
| UK | Understanding AI Ethics and Safety (Turing Institute) | No AI-specific law; Data Protection Act applies | Explainability guidelines, bias mitigation playbooks | Trusted Research Environments (TREs) |
| India | Responsible AI for All (NITI Aayog) | Digital Personal Data Protection Act (2023) | AI portals, public data platforms (planned) | Sectoral pilots, computing testbeds (in development) |
| China | AI Standardization Roadmap | Internet Information Services Algorithm Regulation | Open AI platforms (e.g., City Brain, PaddlePaddle) | Smart city test zones (Hangzhou, etc.) |
| Sri Lanka | National AI Strategy Ethical Principles | Personal Data Protection Act (2022), Online Safety Act (2024) | Forthcoming tools from National Centre for AI (NCAI) | Proposed AI sandbox and testbeds via NCAI.<br><br>Fintech Regulatory Sandbox of Central Bank of Sri Lanka. |

**Developing Technical and Legal Infrastructure**

Technical and legal infrastructure requirements of responsible AI consist of data infrastructure, compute infrastructure, toolkits, standards, laws and experimentation zones. Many developed countries already have sound technical infrastructure to fulfill the growing demands of AI. Further, the EU and US are ensuring trustworthy AI through digital Sovereignty. Sri Lanka is also moving towards the right direction through investment in high-speed internet connectivity and cloud platforms.

The following table 2 summarizes Sri Lanka and major AI players in the world in technical and legal infrastructure development.

It is observed that Sri Lankan Legislation is also catching up with AI's rapid development:

- Personal Data Protection Act (PDPA) – Passed in 2022, this law mandates how personal data can be processed, empowering users and protecting against misuse. The recent amendments made to this act have included provisions against the Automated Decision Making to cover AI and similar technologies.
- Online Safety Act (2024) – Aims to reduce online harm and misinformation but has been criticized for potential overreach. This is open for public comments and required amendments will be incorporated before enactment.
- Fintech Regulatory Sandbox of the Central Bank of Sri Lanka: To provide innovators with an opportunity to better equip themselves to seek regulatory approval and to facilitate robust and sustainable innovations that can enable greater financial inclusion CBSL has established the Fintech Regulatory Sandbox which enables AI innovators to align AI developments with regulatory compliance requirements and for the regulators also to update the regulations to better suit responsible AI developments.

However, legacy legal and technical provisions still exist in many areas which create challenges and limit the usefulness of AI. Most of the public sector datasets are in silos and the data quality is inconsistent and poor. Different ministries and departments are governed by different regulations and laws which create barriers in sharing data horizontally across departments. Therefore, a coordinated data strategy is essential to unlock the full potential of AI. Multiple initiatives are being carried out such as National Data Sharing Policy and Sri Lanka government Agriculture Interoperability Framework show signs of solid foundations leading to rich data sets in future.

**Fostering Inclusive Public Dialogue and Participation**

To reflect the needs, values and concerns of all segments of society beyond the policy makers and tech experts it is essential to foster inclusive public dialogue and participation. This involves actively engaging citizens, marginalized communities, civil society, academia and industry in the design, oversight, and evaluation of AI systems. Going beyond consultation, giving people a voice, agency, and influence in shaping AI policy and applications that impact their lives is needed.

The following table summarizes the public involvement in AI governance in different countries.

As an emerging player in AI, Sri Lanka is well in line with the public participation and stakeholder inclusiveness in AI policy making which is an integral part of the local policy formulation framework. However, the actual participation needs to be improved through proper awareness and capacity building.

**Table 4: Comparison of Public Inclusiveness in AI**

| Country | Public Engagement Tools | Involved Stakeholders | Method of Engagement |
|---|---|---|---|
| **Canada** | Publicly accessible Algorithmic Impact Assessment | Civil society, academia, Indigenous groups | The public can view and critique risk assessments pre-deployment |
| **France** | National consultation platforms, AI debates, ethics forums | Public, ethicists, researchers | Structured ethical input for national strategy |
| **EU** | European AI Alliance, open consultations | Citizens, NGOs, industry, academia | Feedback for the EU AI Act and risk classification |
| **Singapore** | Industry roundtables, IMDA workshops | Tech firms, academia, limited civil society | Practical dialogue |
| **India** | Sectoral AI use case consultations, policy workshops | Startups, academics, industry leaders, regional experts | Direct inputs for "AI for All" mission, but citizen participation limited |
| **New Zealand** | Maori engagement forums on data and tech | Indigenous groups, open government forums | Reused Indigenous data sovereignty principles for AI ethics |
| **Sri Lanka** | Stakeholder feedback invited in AI Strategy (2024) | Government, ICTA, universities, private sector | Engagement mechanisms are emerging; civil society input growing |

**Building Human and Institutional Capacity**

Building AI literacy in all segments of society is of utmost importance in succeeding in the Responsible AI journey. As much as data and infrastructure are important, ultimately, it's all about the people and institutions who will design, deploy, govern and oversee AI technologies ethically and effectively.

Building human capital and institutional capacity requires strengthening work force skills not only in technical but also in non-technical disciplines. Furthermore, institutional structures and ecosystems should be enhanced to regulate, monitor and innovate responsibly.

Building human and institutional capacity is tightly coupled with fostering public inclusiveness in responsible AI because, to provide constructive and productive inputs, people and institutions must be capable and skilled in the respective disciplines. A comparison of human and institutional capacity building strategies of several countries around the world is tabulated below.

Having identified that the future of AI in Sri Lanka depends on our human capital, Sri Lanka has taken numerous initiatives in enhancing human capital in AI. Some of them are as follows.

- Sri Lanka Association of Software and Services Companies (SLASSCOM) together with AWS has carried out a mass training program in AI and cloud technologies to train over 50,000 learners over the past two years.
- A dedicated government led institution (National Centre for AI) is planned to be established.

**Table 5: Comparison of Human and Institutional Capacity building**

| Country | Skill Development Programs | Institutional Investments | Approach |
|---|---|---|---|
| **Singapore** | AI Apprenticeship Program (AIAP), TechSkills Accelerator | AI Singapore, IMDA, Ethics advisory panels | Development of robust pipeline of AI talent through structured pathways |
| **USA** | National AI Institute programs, NSF AI Research Institutes | National AI Initiative Office, NAIRR (planned) | Funding centers of excellence at top universities |
| **EU** | Digital Europe Program, European AI Skills Strategy | European AI Office (planned), national AI regulators | Cross-country coordination on AI skills and oversight |
| **India** | FutureSkills PRIME, NASSCOM skill partnerships | NITI Aayog-led AI working groups across sectors | Focus on workforce skilling and inclusion through public-private models |
| **France** | AI in education programs, national STEM investment | INRIA (AI research), National AI strategy implementation units | Promoting AI education and ethics research |
| **Sri Lanka** | AI and Data science programs in government universities.<br>AI Clubs in schools | NCAI (Yet to operationalize).<br>SLASSCOMM is actively engaged in AI development. | Mass training programs conducted by SLASSCOM together with AWS. |

- The government and private universities have introduced new courses in AI and data science promoting AI.
- Government together with SLASSCOM has formed AI Clubs at schools targeting AI literacy improvement in school kids.
- Many conferences and summits were held during the recent period with a focus on AI.

Therefore, Sri Lanka has done and currently taking well-structured approach in capacity building. However, training programs must focus not just on coding or data science but on ethical reasoning, interdisciplinary thinking, and civic responsibility as Responsible AI means having a workforce that understands both technology and its consequences.

**Monitoring and Continuous Learning**

The last but never-ending stage of the Responsible AI journey is monitoring, continuous learning and improvement. As AI is a rapidly evolving discipline, AI systems monitoring mechanisms must evolve in parallel, to monitor their real-world performance and to make policy improvements which are necessary. To make this process working, there must be proper institutional arrangements and tools in place as AI governance requires ongoing oversight.

These institutions and tools should be able to track the ethical, social and technical impact of AI, enable independent audits and promote adaptive learning and improvements across government, industry and society.

The key components of such monitoring should consist of the following.

- Impact monitoring tools to systematically the track fairness, accuracy and accessibility outcomes.
- Feedback mechanisms for the users to channel complaints, appeals and comments.
- Periodic audits to independently evaluate the risks.
- Data-driven policy updates to improve rules and guidelines
- Institutional datastores for knowledge retention and sharing with peers.

The following table shows some of the international examples in AI monitoring tools and learning mechanisms.

**Conclusion**

The whole world is moving ahead rapidly enjoying the greater benefits of generative and agentic AI while adhering to the global ethics and guidelines of responsible AI. These benefits include innovating cures for serious diseases with high precision medicine, saving millions of lives; driving automated fraud identification and predictive analysis saving billions of dollars and saving hours of time in document preparation and summarization. As a tiny island in this global village, Sri Lanka can never be too late for the adoption of AI to succeed in the race of development.

Sri Lanka, as a country stands at a crucial juncture in rebuilding economy with a strong focus on the digital empowerment. In this cause, AI's effect can significantly impact either for the accelerated growth, improved lives and reduced inequality or to deepen divides and distrust among the society. Which outcome AI will bring mainly depends on how responsibly we develop, deploy and govern it.

Having identified the importance of responsible AI, Sri Lanka has set forth a strong vision embracing the responsible AI principles including transparency, ethicalness, inclusiveness and sustainability. With that solid foundation, it is high time to progress the responsible AI journey to the next stages. In that course, formal establishment of the proposed National Centre for AI is essential. It should play a key role in regulating AI and operationalizing the enforcement of guidelines.

Technical infrastructure building is happening gradually with improved connectivity, datacenters and through cloud adoption. The legal base which is required is also emerging. Even though PDPA and Online Safety Act play an important role,

**Table 6: AI Monitoring tools and Learning Mechanisms**

| Country | Monitoring Tools | Learning Mechanisms |
|---|---|---|
| EU | Database of High-risk AI systems, conformity assessments | Adaptive rulemaking via European AI Board |
| Singapore | AI Verify toolkit for performance evaluation | Continuous refinement of AI Governance Framework |
| USA | Voluntary adoption of NIST AI Risk Management Framework | Stakeholder workshops to update RMF and sectoral playbooks |
| India | Task forces in health, agriculture, fintech | "AI for All" pilots inform scalable use cases |
| Sri Lanka | National AI Strategy mandates review of AI deployments | National Centre for AI (NCAI) to coordinate audit and feedback systems |

the need for an AI specific regulation is yet to be fulfilled. Especially, performing algorithmic impact assessments for all public sector AI deployments must be mandated through such legislation.

The limited but growing public participation and dialogue in responsible AI shows positive signs. However, deeply embedded and widespread public dialog is essential specially to decide on guidelines for AI integration for public services. Even though the national AI strategy contains inputs from academia and industry, inputs from public/civil society remain underrepresented.

As much as we require public participation and input from the public, it is equally important to build their capacity in AI. It is observed that industry and universities have adopted AI focused curricular in those institutions. But a sustainable scaling up of the capacity building requires close collaboration across government, academia and industry. Therefore, the operationalization of the proposed NCAI should be expedited.

AI has matured beyond a technical tool to significantly affect political, social and cultural forces. The responsible AI principles we adopt now will shape not just how AI will work but also to whom it will work for. Therefore, building on the national AI vision with strong governance, ethical leadership and inclusive policy making, Sri Lanka can foster in human centered responsible AI while setting an example for the region.

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