

# A STRATEGIC IMPERATIVE: WHY SRI LANKA'S DEBT MANAGEMENT MUST TRANSITION BEYOND THE CENTRAL BANK

The recent enactment of the Central Bank of Sri Lanka Act No. 16 of 2023 (CBSL Act) and Public Debt Management Act No. 33 of 2024, in September 2023 and June 2024, respectively, mark a turning point in Sri Lanka's economic governance. These legislative reforms fundamentally reshape the institutional architecture of public finance management by transferring debt management functions from the Central Bank of Sri Lanka to the newly established Public Debt Management Office (PDMO) under the Ministry of Finance, Planning and Economic Development.

For decades, the Central Bank was tasked with the contradictory roles of controlling inflation and financing government borrowing. What seemed administratively convenient masked a structural conflict, one that increasingly diverged from global best practice. Meanwhile, access to low-cost monetary financing from the Central Bank reduced the incentives for stricter fiscal discipline. The enactment of the CBSL Act and the establishment of the PDMO under the Ministry of Finance, Planning and Economic Development address a fundamental conflict of interest that has long complicated effective fiscal and monetary policy implementation. By untangling these mandates, Sri Lanka is aligning itself with a global shift towards a clearer, more disciplined and ultimately more focused governance of public debt.

## The Quiet Cost of Fragmentation

Sri Lanka's debt management framework was, in effect, a patchwork of disconnected responsibilities. Domestic borrowing and debt servicing, both domestic and external, were handled by the Central Bank, external financing was negotiated by the Department of External Resources of the Ministry of Finance, Planning and Economic Development and state-owned enterprises (SOEs) accumulated liabilities through their own channels. Each institution operated diligently within its mandate; however, the system as a whole lacked coherence, leaving the country without a unified view of its true debt position.

This dispersion of responsibilities created coordination challenges and information gaps, hindering comprehensive risk assessment and preventing the government from viewing its debt portfolio as a single, interconnected whole. This issue of fragmentation has been repeatedly highlighted by both the International Monetary Fund and the World Bank. The establishment of PDMO is aimed at specifically addressing this fragmentation by consolidating all debt management functions such as strategy, issuance, debt servicing and oversight, under a single institutional framework.

## A Sharpened Mandate for the Central Bank

The CBSL Act clearly defines the mandate of the Central Bank by establishing price stability as its primary objective, with financial system stability recognized as an essential, yet secondary, responsibility. This legislative clarity underscores why debt management no longer belongs within the central banking mandate. The Act explicitly prohibits the Central Bank from directly or indirectly granting credits to the government or purchasing securities in the primary market, except under extraordinary circumstances with the approval of the Parliament.

By clearly delineating fiscal and monetary responsibilities, these safeguards address the structural conflicts that have historically weakened Sri Lanka's financial stability. The Central Bank is now confined to providing operational support within well-defined legal boundaries, leaving strategic control over borrowing entirely with the PDMO. This division helps avoid the conflicting incentives that once blurred the boundary between monetary and fiscal policy.

## The New Legislative Framework for Debt Management

The Public Debt Management Act No. 33 of 2024 provides a robust legal foundation for the establishment and operations of the PDMO, which is structured with a degree of autonomy while being housed within the Ministry of Finance, Planning and Economic Development. The PDMO is tasked with, inter alia, preparing and publishing a medium-term debt management strategy over a rolling five-year horizon, formulating annual borrowing plans subject to regular review, executing borrowing

operations, managing guarantees and on-lending activities and maintaining a comprehensive record of all public-sector debt obligations. These legally embedded responsibilities introduce long-advocated transparency mechanisms into the public debt management framework. Regular publication of strategies, borrowing plans and auction calendars ensures that investors, rating agencies and the public have a clear understanding of the intentions of the Government, rather than resorting to speculation.

## Strengthening Debt Management: The Transition Ahead

A key advantage of establishing a dedicated PDMO is that it cultivates specialized expertise. In today's highly evolving debt management landscape, where debt portfolios are laden with variable rate instruments, derivatives, contingent liabilities and exposure to global interest rate dynamics, undertaking public debt management as an adjunct to monetary policy is increasingly impractical and risks leaving governments unprepared for the complexities of modern financial markets.

The PDMO's dedicated focus allows it to develop specialised analytical capabilities tailored to debt portfolio management, rather than splitting attention between fiscal and monetary policy objectives.

The transition to this new arrangement is being implemented gradually, acknowledging that much of the operational knowledge and technical expertise currently reside within the Central Bank. The success of the transition will hinge on the effective transfer of systems, data and expertise, with the Central Bank providing support as needed during the interim.

## What Sri Lanka Stands to Gain?

The establishment of the PDMO delivers several obvious strategic advantages.

Foremost, it resolves the inherent conflict between the monetary and fiscal policies of securing low-cost financing for the Government and maintaining price stability by transferring debt management away from the scope of the Central Bank. This allows each institution to pursue its mandate without compromising the other.

In addition, consolidating all debt-related functions within a single institution finally removes the fragmentation that has complicated debt management for decades. A unified institutional framework, covering central government, SOEs and guarantees, enables comprehensive risk assessment, strategic portfolio management and transparent reporting of the overall debt position of the Government.

Finally, the institutional safeguards embedded in the legal framework help insulate the PDMO from short-term political pressures. Requirements for medium-term strategies, published borrowing plans and routine public reporting enhance predictability, reinforce credibility and strengthen fiscal governance, while ensuring the institution retains the operational flexibility needed to manage a dynamic debt environment.

## Conclusion

The transfer of public debt management responsibilities from the Central Bank to the PDMO represents a decisive step forward in the maturation of Sri Lanka's economic governance. As Sri Lanka strives to restore fiscal sustainability post the 2022 crisis, effective debt management will be critical to achieving this goal.

The establishment of the PDMO, anchored in the Public Debt Management Act and the CBSL Act, provides the much needed institutional architecture for this critical function. Consolidating previously fragmented responsibilities into a single, professionally led entity positions the country to confront its debt challenges with greater transparency, accountability and strategic clarity. More than an administrative change, this is a strategic imperative for Sri Lanka for strengthening fiscal governance and securing long-term debt sustainability in an increasingly complex global financial landscape.

Please refer the following QR code for more information.

