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**Promotion and protection of all human rights, civil,  
political, economic, social and cultural rights,  
including the right to development**

## Visit to Sri Lanka

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

#### *Summary*

The Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Juan Pablo Bohoslavsky, conducted an official visit to Sri Lanka from 3 to 11 September 2018, at the invitation of the Government.

In the present report, the Independent Expert presents his findings and recommendations with regard to four areas: the impact of public debt, structural adjustment, fiscal consolidation and other economic reform policies on the realization of human rights; illicit financial flows; international development assistance, project finance, and lending to Sri Lanka from a human rights perspective; and the integration of human rights standards into the financial sector, with special emphasis on microfinance.

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\* The summary of the report is being circulated in all official languages. The report itself, which is annexed to the summary, is being circulated in the language of submission only.

\*\* Agreement was reached to publish the present report after the standard publication date owing to circumstances beyond the submitter's control.



## Annex

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

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## I. Introduction

1. The Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Juan Pablo Bohoslavsky, conducted an official visit to Sri Lanka from 3 to 11 September 2018.
2. The aim of the visit was to study the effects of public debt, structural adjustment, fiscal consolidation and other economic reform policies on the realization of human rights and to assess the efforts made by the Government to curb illicit financial flows. It was also to analyse the effects of international development assistance for and lending to Sri Lanka from a human rights standpoint, and the efforts made by the Government to integrate human rights standards into the financial sector, with a particular focus on microfinance.
3. A cross-cutting objective of the visit was to understand how some recent economic and social policies aimed at promoting inclusive growth and strengthening economic development have contributed to the realization of economic, social and cultural rights for all in Sri Lanka. Furthermore, the visit has provided the Independent Expert with an important opportunity to witness certain reforms and to examine how progress in the social and economic spheres had consolidated from a human rights standpoint.
4. The Independent Expert thanks the Government of Sri Lanka for its invitation and full cooperation before, during and after the visit. During his visit, he had the opportunity to meet and speak with a number of high-level officials, with representatives of United Nations agencies, international financial institutions, development cooperation agencies, civil society, professional associations, trade unions and community organizations, and also with experts in fields pertaining to his mandate. He is grateful to all those who took the time to meet with him.

## II. International human rights obligations and commitments

5. Sri Lanka is a State party to all international human rights treaties, including the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights. While the State has been a party to latter treaty since 11 June 1980, the rights described in the Covenant have not yet been explicitly integrated into the Constitution of Sri Lanka or other legislation. Nevertheless, the Constitution contains a section on the protection of fundamental rights, which includes a number of human rights, guaranteeing for instance freedom of expression, assembly and association, equality before the law and equal protection of the law, non-discrimination, as well as freedom of thought, conscience and religion. In this connection, the Independent Expert emphasizes that the principle of indivisibility of human rights calls for all human rights to be protected, including social, economic and cultural rights.
6. Article 27 of the Constitution provides for “directive principles of State policy” to guide Parliament, the President and the Cabinet of Ministers in the enactment of laws and in governance. Although article 27 also refers specifically to the right to an adequate standard of living for all citizens and their families, and equal and universal access to education, article 29 expressly states that those provisions are not enforceable. National courts have nonetheless recognized the enforceability of some social, economic and cultural rights to a certain extent.
7. The Independent Expert welcomes the nineteenth amendment to the Constitution and the establishment of the Constitutional Council. He also welcomes the process of reforms initiated through the creation of the Constitutional Assembly by means of Parliamentary resolution of 9 March 2016, and the appointment of a subcommittee specifically in charge of making recommendations in the area of human rights. In its report, the subcommittee particularly considered the inclusion of economic, social and cultural rights in the Constitution of Sri Lanka, highlighting that their inclusion was of paramount importance today.

8. In this connection, the Independent Expert advises the Government to pursue the constitution reform process in order to ensure the full protection of all economic, social and cultural rights in the national legal system, including their justiciability. He also recommends that courts take explicitly into account the international human rights obligations of Sri Lanka when adjudicating cases relating to economic, social and cultural rights.

9. During his visit, the Independent Expert had the opportunity to discuss various objectives listed in the national action plan for the promotion and protection of human rights for the period 2017–2021. He also took note of its broad range of targets and activities, including in the area of economic, social and cultural rights.

### III. Macroeconomics, finance and human rights

10. As the end of the conflict and ensuing reconciliation process provided the country with new economic opportunities, steps taken to boost growth and consolidate peace and democracy have, inter alia, led to important public investment programmes and economic measures. In this context, the Independent Expert was particularly interested in gaining an insight into the impact that some recent economic and social policies aiming at promoting inclusive growth and enhancing economic development have had on the realization of economic, social and cultural rights.

11. Sri Lanka currently has a score of 0.766 on the Human Development Index, making it 73rd of the 188 States considered. The Gini coefficient (used to measure income inequality) of Sri Lanka was 32.5 in 1985, and peaked in the early 2000s at around 40. Although the coefficient dropped to 36.4 in 2009, by 2016 it had risen to 39.8 in the country as a whole.<sup>1</sup>

12. The latest official household survey, conducted in 2016, found that 4.1 per cent of the population lived below the national poverty threshold of Rs. 4,166 per person per month. There is an important disparity between regions, particularly between populations living in urban centres and those living in rural areas and “estate sectors”. According to the United Nations Sustainable Development Framework for 2018–2022, only 18.2 per cent of the national population lives in urban areas; the most recent data indicate that the urban poverty rate is 1.9 per cent, while the rural rate is 4.3 per cent and the estates sector is 8.8 per cent.<sup>2</sup> In addition, regional disparity is significant: 21 per cent of all households live below the poverty line in some provinces.<sup>3</sup> Some sectors of the population, in particular the most vulnerable, live just above the poverty line; <sup>4</sup> in 2014–2016, the prevalence of undernourishment in the country was found to be 22.1 per cent.<sup>5</sup>

13. According to the United Nations Sustainable Development Framework for 2018–2022, a quarter of Sri Lankan households are headed by women. Employment among women is of only 35 per cent. Furthermore, a significant portion of the working population in the country is employed in the informal sector, while a large proportion – around 10 per cent – employed abroad. Approximately 10 per cent of workers belong to a trade union. Weak trade unions have the potential to entrench income inequality and stagnation of workers’ wages in the bottom half of the labour market, and lose the power to fulfil their traditional role of contributing to redistribution (A/HRC/34/57, para. 11). Approximately 20 per cent of persons aged 60 years or older benefit from pension schemes.<sup>6</sup> Persons working in the informal sector do not have access to the right to social security.

<sup>1</sup> See <https://data.worldbank.org/indicator/SI.POV.GINI?locations=LK>.

<sup>2</sup> See Ministry of National Policies and Economic Affairs, Household Income and Expenditure Survey 2016, p. 41, available from [www.statistics.gov.lk/HIES/HIES2016/HIES2016\\_FinalReport.pdf](http://www.statistics.gov.lk/HIES/HIES2016/HIES2016_FinalReport.pdf).

<sup>3</sup> See “Vision 2025: A Country Enriched”, Prime Minister’s Office, Colombo, Sri Lanka, 2017, p. 43.

<sup>4</sup> Central Bank Report, Annual Report, 2017, p. 84.

<sup>5</sup> See [www.adb.org/countries/sri-lanka/poverty](http://www.adb.org/countries/sri-lanka/poverty).

<sup>6</sup> See “Vision 2025”, p. 39.

## A. Debt and macroeconomic stability

14. The public debt of Sri Lanka has increased significantly in recent years, rising from 68.7 per cent of GDP in 2012 to 78.8 per cent in 2016.<sup>7</sup> The strategy chosen by the Government, as recommended by international financial institutions, notably the International Monetary Fund (IMF), was to stabilize the economy by strengthening the fiscal and external sectors. In their view, external indebtedness would help achieve this goal. The Government's strategy also included financing mega infrastructure projects that, jointly with stabilization of the economy and export promotion, would create the enabling environment to promote sustainable growth.

15. Between 2000 to 2009, foreign debt (calculated in rupees) doubled<sup>8</sup> and it has continued to grow ever since. At the end of 2017, foreign debt amounted to \$28.7 billion, an increase of 13 per cent over 2016, when it was estimated at \$25.3 billion at the end of the year.<sup>9</sup> While the debt to GDP ratio has declined, the more onerous composition of the debt should be carefully considered, given that servicing a debt also involves paying interest. Since 2010, the amount of interest paid has steadily increased. In addition, by the end of 2017, the share of market borrowing of overall debt stock accumulated was 39 per cent, making it the most important type. During the same period, the main creditors (39 per cent) were bilateral sources, while the share of market borrowing was 34 per cent.<sup>10</sup>

16. Foreign direct investment and exports has not increased as projected, nor has GDP growth been as robust as hoped. After three years of significant growth, from 2010 to 2012, thanks to rapid development of the debt-funded non-tradable sector, when GDP grew at an annual average rate of 8.5 per cent GDP growth slowed to an average 4.5 per cent from 2013 to 2016. It is true that the legacy of such borrowing heavily compounded the State's foreign debt, and that some of the projects that they financed have longer gestation periods; but debt keeps growing nonetheless. A series of natural disasters, such as floods and droughts, have also affected GDP growth, which slowed to 3.3 per cent in 2017. In September 2018, the Asian Development Bank forecasted a growth rate of 3.8 per cent for 2018 and 4.5 per cent for 2019.<sup>11</sup>

17. The Independent Expert recommends that the debt sustainability analyses carried out by the Government and international financial institutions be based on a more comprehensive understanding of debt sustainability, incorporating human rights (see A/HRC/20/23 and Corr.1) and the social and environmental dimensions of sustainability (see A/71/305). The Auditors General's Department has at its disposal the technical standards to audit public debt formulated by the International Organization of Supreme Audit Institutions, based on the Principles on Promoting Responsible Sovereign Lending and Borrowing developed by the United Nations Conference on Trade and Development. The recent enactment of the Active Liability Management Act, aiming at improving public debt management, represents a timely opportunity to incorporate a more holistic approach to debt sustainability.

## B. Economic reform programme

18. The Government of Sri Lanka has taken robust measures to reduce the fiscal deficit to the target of 3.5 per cent by 2020. In this context, it has made significant efforts to maintain macroeconomic stability, carrying through a range of reforms to that end. Vision 2025 also describes a number of measures that will be taken.

<sup>7</sup> Ministry of Finance, Annual Report 2017, p. 120.

<sup>8</sup> See [www.cbsl.gov.lk/en/publications/other-publications/statistical-publications/economic-and-social-statistics-of-sri-lanka](http://www.cbsl.gov.lk/en/publications/other-publications/statistical-publications/economic-and-social-statistics-of-sri-lanka).

<sup>9</sup> Ministry of Finance, Annual Report 2017, p. 118

<sup>10</sup> See [www.erd.gov.lk/index.php?option=com\\_content&view=article&id=86&Itemid=307&lang=en#government-external-debt-and-key-debt-indicators](http://www.erd.gov.lk/index.php?option=com_content&view=article&id=86&Itemid=307&lang=en#government-external-debt-and-key-debt-indicators).

<sup>11</sup> See [www.adb.org/sites/default/files/publication/452971/ado2018-update.pdf](http://www.adb.org/sites/default/files/publication/452971/ado2018-update.pdf).

19. During his visit, the Independent Expert pointed out that, while maintaining macroeconomic stability is an important concern, it should not prevent a human rights assessment of planned reforms in line with international human rights norms and standards. In this regard, it is important to highlight that institutions, like borrowing States, have obligations under international human rights law when implementing economic reform and structural adjustment programmes (see A/HRC/37/54, paras. 25–34; see also A/HRC/20/23, annex and Corr.1).

20. The Independent Expert noted with regret that neither the Government nor IMF had conducted a human rights impact assessment of the economic reforms implemented or announced. Such an assessment is, however, of paramount importance from a human rights standpoint when, for example, rationalizing fuel subsidies and social security benefits, or when a more profit-oriented logic is introduced into public services or State-owned corporations. This is without condoning the lack of due diligence in the supply of public goods, which can itself be deleterious to the enjoyment of economic, social and cultural rights.

21. Approved in June 2016, the three-year programme supported by an IMF extended arrangement under the Extended Fund Facility of \$1.5 billion has resulted in a number of reforms, including measures to lower the budget deficit, raise government revenue and strengthen public financial management, as well as monetary policy review, reform of State-owned enterprises and stimulating trade and investments.

22. In 2017, the Government launched Vision 2025, an ambitious economic programme that focuses on creating opportunities for inclusive growth, ensuring a better standard of living and adopting an export-oriented strategy to enhance growth. Aimed at creating a million jobs and increasing per capita income and foreign direct investments and exports, the programme covers a number of reforms, including in the sectors of social safety nets, land and the labour market. It also aims at strengthening macroeconomic stability through fiscal consolidation, ensuring price stability and maintaining a market-based competitive exchange rate.

23. While some macroeconomic targets have been met in general, such as those set with regard to the inflation rate and fiscal targets, there are some gaps to be addressed from a human rights standpoint. The Independent Expert analyses some of the reforms undertaken by the Government below.

#### **1. Fiscal reform, public expenditure and social spending**

24. A number of measures aimed at lowering the national fiscal deficit to 3.5 per cent by 2020 have been taken, including with regard to the rationalization of public expenditure and broadening the tax base.

25. While there is a consensus that a greater mobilization of resources is needed and despite the measures taken by the Government to broaden the tax base, the fiscal deficit remains significant, while public finances are affected by the limited reserves available. The adoption of the Inland Revenue Act in 2017 has helped to simplify tax collection and the broadening of the tax base. At the same time, the Government has made an effort to tackle existing discretion regarding tax exemptions at various levels. Further steps should, however, be taken to ensure that income and wealth taxes effectively generate sufficient public revenue and reduce economic and social inequality in the country.

26. In this regard, during his visit, the Independent Expert expressed his concern at the significant rise in the value added tax rate, given that the brunt of taxes of this type is often borne by the poorest. In fact, revenue collection through value added tax accelerated to 56.5 per cent in 2017. Regressive tax measures can particularly affect the livelihoods of women, especially those who are living in poverty, since it will most heavily affect women and reproduce inequality, while also failing to substitute for the revenue lost through tax evasion and avoidance (A/73/179, para. 54). It has also been brought to the attention of the mandate holder that the instructions on filling out the new self-assessment forms were confusing, resulting in the risk of citizens being penalized for non-compliance.

27. The Independent Expert shares the views expressed by the Committee on Economic, Social and Cultural Rights regarding the need to put in place a more equitable fiscal system (E/C.12/LKA/CO/5, para. 22) in order to expand the State's fiscal space and resources available for the progressive realization of economic, social and cultural rights. In his view, as fiscal discipline was implemented and as the social budget is considerably underspent in Sri Lanka, social expenditures in particular should be increased to avoid potential retrogression.

28. Having introduced free health-care and education schemes in the 1940s, the State has made a special effort to safeguard and maintain important social policies over the decades. The Independent Expert is concerned that, despite the will to preserve this legacy, and while nominal expenditure has been rising in recent years, some setbacks were registered in the 2017 budget in the education and health sectors; recurrent expenditure by the Government in those sectors (accounting for 14.5 per cent of GDP) is already relatively small if compared to that in the early 2000s (more than 20 per cent of GDP) or to that of other developing countries, and should not be subject to further cuts.

29. In general, public expenditure in education, health and social transfers should not be reduced to achieve fiscal adjustment. In this regard, the Independent Expert welcomes the increase in expenditure announced for education and health in 2018. The mandate holder was, however, informed that, in the past, social spending has not always matched budget estimates in some sectors. For instance, in the case of health services, published estimates were higher than what was actually spent in 2016. In 2016 and 2017, the budget allocated to the education sector was also underspent. The Independent Expert shares the view of the Committee on Economic, Social and Cultural Rights with regard to the importance of budgetary allocation reflecting GDP growth (E/C.12/LKA/CO/5, paras. 21–58).

30. With regard to welfare expenditure, the budget has been gradually rising in recent years. Nevertheless, it is expected that ongoing reform of its safety net programme will have important implications for the Samurdhi national social protection programme. In this regard, the Independent Expert is concerned about efforts to “better target” beneficiaries by redefining the programme's admissibility criteria.<sup>12</sup> In 2018, the programme benefited 1,400,000 people (out of a national population of more than 21 million).

31. The Government has also expressed its intention of engaging in public-private partnerships in important social sectors, such as health and education. Partnerships of this type should not, however, replace the Government's primary obligation of ensuring economic, social and cultural rights equally among everyone and its obligation to allocate maximum available resources (see A/73/396). Such considerations should be borne in mind when establishing the national agency for public-private partnerships and defining its operations.

32. Debt repayment is the country's largest expenditure; a significant amount of borrowing is in fact currently allocated for this purpose.<sup>13</sup> As a general principle, social spending should not be cut in order to repay increasing debts if less harmful policy options are available (A/HRC/37/54, para. 7). At least three (complementary) options deserve to be considered: first, boosting domestic demand through various channels, such as progressive tax reforms, expanding social benefits and increasing minimum wages; the resulting growth in GDP increases fiscal revenues; second, opening discussions on whether the military budget reflects the fundamental changes the country has undergone in recent years, in particular in the fields of peace and economic development; and third, renegotiating debt with creditors in order to expand the fiscal space to boost domestic demand and generate revenues to ensure that nobody is left behind. Fiscal, monetary, economic and social policies should be fully consistent.

<sup>12</sup> “Vision 2025”, p. 39.

<sup>13</sup> See [www.auditorgeneral.gov.lk/web/images/special\\_report/Public-Debt-Management-finalEnglish.pdf](http://www.auditorgeneral.gov.lk/web/images/special_report/Public-Debt-Management-finalEnglish.pdf).

## 2. Monetary policy

33. With a view to keeping the rate of inflation low, the Central Bank introduced a comprehensive “inflation targeting road map” and plans to ensure flexible inflation targeting in the future.<sup>14</sup> It recently reiterated its intention to maintain the inflation rate in single digits.<sup>15</sup>

34. The rupee depreciated in 2018.<sup>16</sup> While depreciation might be beneficial for certain segments of the economy, it increased the cost of imports, including of food, into Sri Lanka, and reduced the purchasing power of wage earners. While efforts have been made to keep the rate of inflation down to prevent food price volatility, they also have an impact on interest rates.<sup>17</sup> The poor may also be affected by the price increase of imported goods, especially food prices. Fiscal retrenchment and public spending cuts may affect social assistance outlays, amplifying the consequences of the crisis on the poor. Changes in the value of assets have an impact on income distribution because variations in interest rates, assets and real estate prices are more likely to affect the wealth of the better off (A/HRC/31/60, para. 42).

## 3. Reform of State-owned enterprises

35. At the time of signing the agreement with IMF in 2016, Sri Lanka owned 200 enterprises, some of which delivered public services. With a view to maintaining macroeconomic stability, the Government, according to Vision 2025, intends to address “unproductive expenditure” and has initiated a restructuring of its enterprises, the largest of which operate in electricity, fuel and water.<sup>18</sup> The aim of their restructuring is to eliminate losses and ensure their commercial viability. The reforms also ensure that the price of services and goods delivered by these State-owned enterprises will be determined by the market.

36. The Independent Expert is concerned that measures adopted in this context may also have an impact on the realization of the social, economic and cultural rights of rights holders, such as through the introduction of a petroleum and electricity formula. While kerosene is still supplied at a subsidised price, fuel prices are now set through an automatic market-based mechanism, as will be the price of electricity. Further recent reforms have resulted in the rationalization of energy and farming subsidies. The mandate holder is concerned at the impact that such measures could have, in particular on the livelihood of fishing, farming and rural communities. It should be noted, however, that the Government has recently introduced a subsidy for fertilizers for this purpose.

37. Such cuts should be compensated at least through cash transfers targeting those in need in a timely and efficient manner. Investments in rural economy should be directed at supporting the livelihoods of small-scale producers by facilitating technology transfer, market access and access to financial, physical and natural resources – to compensate for the subsidy reductions targeting those in need.

## 4. Trade and investment

38. The strategy contained in Vision 2025 is to ensure growth by empowering the private sector and doubling the rate of exports.<sup>19</sup> In this regard, a new five-year national export strategy was launched in 2018. Along with the new trade policy, it seeks to increase the efficiency of trade facilitation, remove barriers to foreign investment entry and

<sup>14</sup> “Vision 2025”, p. 19.

<sup>15</sup> See [www.cbsl.gov.lk/sites/default/files/press\\_20180103\\_Road\\_Map\\_2018\\_e.pdf](http://www.cbsl.gov.lk/sites/default/files/press_20180103_Road_Map_2018_e.pdf).

<sup>16</sup> See <http://groundviews.org/2018/08/21/hidden-costs-the-impact-of-foreign-aid-on-sri-lankan-citizens/>.

<sup>17</sup> See <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.487.7665&rep=rep1&type=pdf>.

<sup>18</sup> Bandula Sirimanna, “Five top SOEs targeted for major reforms”, *Sunday Times*, 24 September 2017.

<sup>19</sup> Ministry of Finance, Annual Report 2017, p. 136.

establishment (including access to land), enhance access to finance and strengthen financial market infrastructure.<sup>20</sup>

39. While the need to generate more resources and attract investments is an important concern for the Government, any negotiations should take into account the guiding principles for human rights impact assessments of trade and investment agreements (A/HRC/19/59/Add.5, appendix), which set out specific criteria for human rights impact assessments. In implementing specific reform measures to ensure investments, it is essential that any potential adverse impact on specific human rights is prevented, in accordance with international norms and standards. The Independent Expert also recommends in this context that Sri Lanka consider adopting a national plan of action on business and human rights.

## 5. Reforms to strengthen growth

40. The current economic programme contained in Vision 2025 considers the dearth of land available for commercial use an obstacle to growth. It therefore proposes to reform the sector by changing land tenure restrictions associated with alienated lands, offering clear transferable titles, and removing barriers to competitive real estate markets". Nevertheless, it is important to note that areas of land are still being used by the military in the north and east of the country for commercial purposes (E/C.12/LKA/CO/5, para. 49). In this regard, the United Nations High Commissioner for Human Rights stated that he still considered that the military should only retain land when it was strictly necessary for security purposes, and upon payment of proper compensation (A/HRC/37/23, para. 27). Furthermore, while having a significant impact on the livelihood of local communities, the Land Development Ordinance (1935) also has an impact on access to land for women and with regard to land titles. The mandate holder reiterates the recommendation made by the Committee on Economic, Social and Cultural Rights, and encourages Sri Lanka to take measures to map private and public land under the control of the military, ensure its restitution, in line with the recommendation of the Consultation Task Force on Reconciliation Mechanisms, and end military involvement in commercial and other civilian activities (E/C.12/LKA/CO/5, para. 50).

41. Furthermore, in going forward with new economic zones, the Government should ensure that a human rights impact assessment of projects and infrastructure is conducted. In doing so, people potentially affected by them should be meaningfully consulted.

42. With regard to the labour reform currently under way, the Independent Expert welcomes the Government's intention to take measures to strengthen women's participation in the labour market. The unemployment rate of women is over twice that of men.<sup>21</sup> Furthermore, women are overrepresented in the informal sector in general and low productivity and low-income agriculture areas. In 2010, it was calculated that female workers accounted for 61.9 per cent of all persons employed in the country's four industrial parks and nine export processing zones.<sup>22</sup>

43. The Independent Expert also encourages Sri Lanka to address the issue of informal employment, which concerns an important portion of the workforce, including by enforcing labour laws already in place. He once again highlights the significant effect of strong labour laws on labour rights, and challenges the widespread belief that deregulating the labour market will further growth and employment (A/HRC/34/57, para. 56).

<sup>20</sup> IMF, Sri Lanka: 2018 Article IV Consultation and the Fourth Review Under the Extended Arrangement Under the Extended Fund Facility, p. 84.

<sup>21</sup> Asian Development Bank, Country Gender assessment: An Update, August 2015, p. 25.

<sup>22</sup> Peter Hancock et al., "Gender, Status and Empowerment: a study among women who work in Sri Lanka's Export Processing Zones (EPZs)", 2011, Colombo.

## IV. Illicit financial flows and human rights

### A. Impact on human rights

44. Illicit financial flows cover a broad range of phenomena, including tax avoidance, tax evasion, money-laundering and corruption. Their negative impact on human rights can in particular contribute to the erosion of public finances and available resources (see A/HRC/31/61).

45. In order to assess those impact and to design and implement adequate policies, estimations of illicit flows are needed. The Independent Expert was informed, however, that no study on or official estimation of illicit outflows or inflows has been conducted to date in Sri Lanka. While acknowledging that this is a complex task, he urges the Government to conduct these studies in order to further curb illicit financial flows, in accordance with the Sustainable Development Goals. Goal 16, target 5 aims at the reduction of corruption, while target 4 calls upon States to significantly reduce illicit financial flows by 2030. A recent report by the Department of Statistics of the Ministry of National Policies and Economic Affairs on the realization of the Sustainable Development Goals<sup>23</sup> does not provide information on specific indicators in this regard.

46. According to corruption perception index compiled by Transparency International, in 2017, Sri Lanka ranked 91st out of 180 countries. Although it is a slight improvement on its ranking of 96 the previous year, the State still obtained a score of only 38 out of 100 (the lower the score, the more corrupt a country is perceived).<sup>24</sup>

47. Corruption and other types of illicit financial practices have an impact on human rights given that they draw a sizable part of the State budget away from its social function. Empirical studies have shown the strong correlation between such flows and lower levels of economic development.

48. According to the Vision 2025 programme, governance and institutional mechanisms should be strengthened to boost the country's long-term growth potential, by enhancing public confidence.<sup>25</sup> Sri Lanka has been included in the list of jurisdictions monitored by the Financial Action Task Force for their anti-money-laundering deficiencies, for which a plan of action has been developed.<sup>26</sup> The State has, however, taken steps to strengthen its current regime; its status was recently revised to show that it was compliant or partially compliant with 27 of 40 recommendations made by the Task Force.<sup>27</sup> Some of the Independent Expert's interlocutors also pointed out that corruption also has an impact on investments and attractiveness for business. According to regulation 2018/212 issued by the European Union on 13 December 2017, Sri Lanka should be considered a State with strategic deficiencies in its regime on anti-money-laundering and countering terrorist financing, which pose significant threats to the financial system of the Union.

### B. Legal framework and international commitments

49. Sri Lanka ratified the United Nations Convention against Corruption in 2004. Article 156, paragraph 1 (c) of the Constitution of Sri Lanka provides for the implementation of measures laid out in the international instruments and any other international convention aiming at preventing corruption to which the State is a party. While the Convention requires States parties to incorporate its provisions at the domestic level through the adoption of a specific law, Sri Lanka has yet to do so. The Independent Expert also notes that Sri Lanka has not yet ratified the framework developed by the Organization

<sup>23</sup> See [www.statistics.gov.lk/sdg/application/publications/book.pdf](http://www.statistics.gov.lk/sdg/application/publications/book.pdf).

<sup>24</sup> See [www.transparency.org/news/feature/corruption\\_perception00s\\_index\\_2017](http://www.transparency.org/news/feature/corruption_perception00s_index_2017).

<sup>25</sup> Ministry of Finance, Annual Report 2017, p. 137.

<sup>26</sup> See [www.fatf-gafi.org/countries/#high-risk](http://www.fatf-gafi.org/countries/#high-risk).

<sup>27</sup> See [www.fatf-gafi.org/media/fatf/documents/reports/fur/APG-3rd%20Follow-up%20Report-Sri%20Lanka-2018.pdf](http://www.fatf-gafi.org/media/fatf/documents/reports/fur/APG-3rd%20Follow-up%20Report-Sri%20Lanka-2018.pdf), pp. 5–6.

for Economic Cooperation and Development providing for the automatic exchange of information.

50. The Prevention of Money Laundering Act No. 5 of 2006, amended in 2011, is at the core of the legislative framework to combat money-laundering. Article 3, paragraph 1 (a) refers to the offence of money-laundering as any person engaging “directly or indirectly in any transaction in relation to any property which is derived or realized directly or indirectly, from any unlawful activity or from the proceeds of any unlawful activity”. Subsection (b) also cover cases where a person receives, possesses, conceals, disposes of or brings or invests such property in Sri Lanka, or transfers money out of the country. While the definition of “unlawful activities” provided by the law covers a wide range of offences, it does not expressly refer to tax-related offences.

51. Globally, most illicit financial flows are thought to concern cross-border tax-related transactions (A/HRC/31/61, para. 5), circulate mainly through banking and financial institutions. On the basis of the principle “know your customer”, and in accordance with section 7 of the Financial Transactions Reporting Act, No. 6 (2006), banks have a duty to report suspicious transactions to the Financial Investigation Unit. Customer due diligence is described in section 2, paragraph 1 of the Act, prohibiting financial institutions to open, operate or hold anonymous accounts.

52. Because tax evasion is not considered a predicate offence in the country (and therefore cannot be the basis for money-laundering), financial institutions are not required to report suspicious transactions involving tax evasion by their clients. The Independent Expert urges the Government to close this legal gap and to request help from the banks to report suspicious transactions based on tax reasons in order to improve tax collection.

53. Sri Lanka is a member of the Egmont Group and the Asia-Pacific Group on Money Laundering. While assessing that Sri Lanka has a reasonable understanding of the risks of money-laundering, in 2015, the Asia-Pacific Group, in its Mutual Evaluation Report, identified challenges in the areas of prevention, transparency and beneficial ownership and international cooperation. For instance, besides highlighting the need for an anti-money-laundering strategy, it also recommended that the State put in place enforceable rules to complement prevention efforts with regard to politically-exposed persons and beneficial ownership.

54. According to the national anti-money-laundering policy for 2015–2020, Sri Lanka has a medium risk of money-laundering.<sup>28</sup> In this regard, the latest Mutual Evaluation Report by the Asia-Pacific Group identified corruption and drug-related proceeds as posing the greatest money-laundering risk in 2015. In 2018, new guidelines were put in place by the Financial Intelligence Unit, which operates under the Central Bank, with a view to ensuring better management reports of suspicious transactions.

### C. Institutional framework

55. The Financial Intelligence Unit of the Central Bank plays a key role in the institutional anti-money-laundering institutional framework in Sri Lanka. It facilitates investigations and receives, collects and manages suspect transaction reports and related information. Law enforcement remains the responsibility of the Financial Criminal Investigation Division of the police. The Independent Expert notes that Sri Lanka, with a view to improving information exchange, recently signed a memorandum of understanding drafted by the Financial Intelligence Unit with various governmental agencies, including Inland Revenue, Registration of Persons and Immigration, and the police.<sup>29</sup>

56. While improvements have been made to strengthen the legal and institutional framework, challenges remain in the implementation of existing legislation. As pointed out by the Asia-Pacific Group in its Mutual Evaluation Report of 2015, prosecutions and

<sup>28</sup> See [http://fiusrilanka.gov.lk/docs/Other/National\\_AML\\_CFT\\_Policy-2015-2020.pdf](http://fiusrilanka.gov.lk/docs/Other/National_AML_CFT_Policy-2015-2020.pdf).

<sup>29</sup> Asia-Pacific Group on Money Laundering, Mutual Evaluation of Sri Lanka, Third Follow-up Report, September 2018, p. 3.

convictions have been low over the years. It referred to one registered conviction for money-laundering in 2014, while the Financial Intelligence Unit has reported two other convictions for money-laundering since then.<sup>30</sup> The number of suspicious transaction reports has been rising gradually since 2012, despite a slight decrease in 2016. The latest statistics also indicate that, in 2016, 146 million Rs were suspended under section 15, paragraph 2 of the Financial Transaction Reporting Act, compared to 263.2 million Rs in 2015.<sup>31</sup>

57. The mandate of the Commission to Investigate Allegations of Bribery or Corruption includes investigating allegations of bribery or corruption against a person. It may also “direct the institution of proceedings against such person for such offence in the appropriate court” if an offence under the Bribery Act is disclosed during the investigation. Its mandate is, however, limited to allegations in the public sector. While the Commission mainly directed its efforts towards low-ranking officials, the Independent Expert notes that recent initiatives aimed at addressing cases allegedly implicating high-level officials.<sup>32</sup>

58. The Independent Expert was also informed about alleged corruption at various levels, including in the context of the implementation of social programmes. Cases of arrest, investigation and prosecution of officials have recently been registered.<sup>33</sup> He is concerned at reports of “sexual bribery” by public officials in 2017 (CEDAW/C/LKA/CO/8, paras. 24 (b)).<sup>34</sup> One report found that complaints in this regard had been made to the Commission in the past. The fact that the complaints were actually taken to court is a step forward.<sup>35</sup> At least five complaints were filed by women between 2012 and 2016 regarding alleged “demands for sexual gratification in lieu of money, for political or administrative services”.<sup>36</sup>

59. The Independent Expert commends the Government and the Parliament for having established in May 2018 special courts to handle cases specifically related to bribery and corruption, in order to speed up cases that have dragged on sometimes for years. In this regard, he recalls that it is equally important to ensure that the members of these special courts are appointed and are independent during their entire tenure, and that the courts are financially autonomous and not subject to political pressure or interference.

## V. Project financing and international development assistance

### A. International development assistance, lending and recent projects

60. Since the end of the war in 2009, large-scale infrastructure projects have flourished throughout Sri Lanka. Today, project loans made by the World Bank, the Asian Development Bank, Japan, the Republic of Korea, India and China alone amount to some \$19.3 billion, or 48 per cent of all loans contracted by the State. Furthermore, infrastructure projects accounted for 49 per cent of all disbursements for official development assistance for 2017; when combined with the energy and transport sectors, the total accounts for 63 per cent.<sup>37</sup>

61. Examples of recent projects include the Colombo Outer Circular Expressway, the Hambantota port and the Hambantota airport, and various dams and power plants, which were approved and commenced in the late 2000s and early 2010s. During the visit of the

<sup>30</sup> See [http://fiusrilanka.gov.lk/docs/AR/FIU\\_AR\\_2016.pdf](http://fiusrilanka.gov.lk/docs/AR/FIU_AR_2016.pdf), p. 22 and [http://fiusrilanka.gov.lk/docs/AR/FIU\\_AR\\_2015.pdf](http://fiusrilanka.gov.lk/docs/AR/FIU_AR_2015.pdf), p.22.

<sup>31</sup> Ibid.

<sup>32</sup> “Top Sri Lanka officials arrested while taking bribe-anti-graft body”, Reuters, 3 May 2018.

<sup>33</sup> See [www.ciaboc.gov.lk/investigation/detection-raids?start=36](http://www.ciaboc.gov.lk/investigation/detection-raids?start=36).

<sup>34</sup> See also [www.ciaboc.gov.lk/investigation/detection-raids/127-divinagama-development-officer-divisional-secretary-s-office-katharagama](http://www.ciaboc.gov.lk/investigation/detection-raids/127-divinagama-development-officer-divisional-secretary-s-office-katharagama).

<sup>35</sup> Transparency International Sri Lanka, *Anti-corruption agency strengthening initiative assessment of the commission to investigate allegations of bribery or corruption, 2016*, p. 35.

<sup>36</sup> Ibid.

<sup>37</sup> Ministry of Finance, *Annual Report 2017*, p. 115.

Independent Expert, a number of concerns were expressed pertaining to the prevention of the adverse effects of these projects for human rights, and whether and how their success was being used as an opportunity to boost inclusive development and address inequalities.

62. The Urban Regeneration Programme, a project implemented since the early 2010s, has the objective of transforming Colombo into “a world recognized city”.<sup>38</sup> More than 50,000 families were relocated between 2010 and 2014 from informal settlements and similar areas into new housing projects. In 2014, the Special Rapporteur on adequate housing as a component of the right to an adequate standard of living, and on the right to non-discrimination in this context brought to the attention of the Government of Sri Lanka information pertaining to alleged forced evictions of local populations in Colombo without due process.<sup>39</sup> Reportedly, many families that have been evicted have not been adequately compensated, and alternative housing has not been provided, despite the pledges made to this effect. A recent study has highlighted various shortcomings in the implementation of the National Involuntary Resettlement Policy, including the fact that the policy itself is not available in all national languages in the first phases of its implementation, and issues relating to compensation for those who lost their homes as a result of eviction and resettlement.<sup>40</sup>

63. International human rights instruments have a crucial economic role to play; they help to capitalize internally the expected multipliers of foreign investment, ensuring that the positive aspects of the projects will lead to a real benefit to the entire population, while preventing and/or minimizing their negative human rights effects, which, in turn, reinforce the environmental and social sustainability of the projects.

64. The legislative and policy framework in Sri Lanka already provides certain criteria relevant to project assessment, notably with regard to land acquisition and involuntary resettlement. The National Involuntary Resettlement Policy includes certain provisions for consultation and compensation for affected communities. In that context, measures have also been taken to assess the environmental implications of projects through the National Environment Act (as amended in 1988). There are, however, shortcomings in the length of public consultations, while documentation is often lacking due to location and language.<sup>41</sup> Concerns about the social and environmental impact assessments conducted for projects such as Uma Oya and Port City also raise questions with regard to the effectiveness of these processes. Further, the National Involuntary Resettlement Policy, which is not legally binding, is reportedly not used systematically in large-scale infrastructure development projects, such as Port City.

65. While there are certain procedures in place, the Sri Lankan legislative framework does not provide for detailed obligations to conduct a comprehensive and ex ante human rights impact assessment of infrastructure projects. The Independent Expert therefore advises the Government to close this gap by adopting robust and consolidated relevant legislation on the basis of existing international human rights norms and standards.<sup>42</sup> Improving transparency, consultation and participation of potentially affected people is essential. The procedural aspects of the process should also be established and duly regulated by law.

66. The Independent Expert also commends the provisions contained in the 19th amendment to the Constitution with regard to the right of access to any to information “required for the exercise or protection of the citizen’s rights” (art. 14A). He recalls the importance of access to information in the context of infrastructure projects, and welcomes the establishment of the Right to Information Commission under the Right to Information Act, No. 12 (2016).

<sup>38</sup> See [www.uda.gov.lk/urban-regeneration-programme.html](http://www.uda.gov.lk/urban-regeneration-programme.html).

<sup>39</sup> A/HRC/28/85, annex, LKA 11/2014.

<sup>40</sup> See [www.cpalanka.org/wp-content/uploads/2017/02/The-Making-of-a-World-Class-City\\_Final.pdf](http://www.cpalanka.org/wp-content/uploads/2017/02/The-Making-of-a-World-Class-City_Final.pdf).

<sup>41</sup> See <http://documents.worldbank.org/curated/en/217371525338067142/pdf/SFG4316-RP-REVISED-PUBLIC-disclosed-7-24-18.pdf>

<sup>42</sup> OHCHR, Baseline Study on the Human Rights Impacts and Implication of Mega-Infrastructure Investment, 6 July 2017.

## B. Assessment framework of international financial institutions

67. In Colombo, international lenders and donors expressed their concern at the environmental and human rights implications of the projects they financed, although none of them had a human rights impact assessment framework. While some referred to “social” and “gender” impact evaluations conducted before taking the final decisions on projects, the standards against which the projects were assessed were not clear. Furthermore, the result of the evaluations were not always publicly available, nor were complaints relating to specific projects.

68. For instance, even though the World Bank and the Asian Development Bank each has a set of social and environmental safeguards,<sup>43</sup> their policies do not explicitly cover human rights. In addition, the Independent Expert was informed that no systematic gender assessments for World Bank projects were conducted in Sri Lanka, given that the World Bank reviews each project on a case-by-case basis to identify potential issues of gender sensitivity. After each such assessment, the project is stamped with a “gender tag”.

69. In certain cases, the Asian Development Bank can conduct “country safeguards evaluations” aiming at ensuring that national legislation and policy meet certain standards. In Sri Lanka, the application of this system is being considered for Asian Development Bank projects with the Road Development Authorities; national standards are thus being assessed against the bank’s own requirements.<sup>44</sup> The Independent Expert emphasizes that this can be an opportunity to improve what is already in place, and recommends that international financial partners establish more robust frameworks to assess the human rights implications of projects, covering both substantive and procedural rights.

70. The Independent Expert also met with cooperation agencies financing various projects in Sri Lanka, and learned that some had a similar internal impact assessment policy.

## VI. Microcredit and human rights

### A. Microfinance in Sri Lanka

71. Microcredit has a long history in Sri Lanka that dates back decades, though its use began to expand particularly during the 1990s. The goal of the system was to lift people out of poverty by enabling borrowers, who did not have systemically access to credit, to sustain their livelihoods through financial inclusion and economic empowerment. The projects put in place in this context also paid particular attention to women borrowers.

72. The Independent Expert is not aware of any study to assess the achievement of the above-mentioned goal in Sri Lanka over the years. This is crucial, given that there is no evidence that microcredit actually helps to alleviate poverty in countries where it is broadly used, in particular when the private sector is deeply involved in lending the funds; on the contrary, microcredit has been associated with “anti-developmental” flaws.<sup>45</sup>

73. The microfinance landscape in Sri Lanka is wide and diverse. It comprises various types of financial institutions operating at different levels in both the formal and informal sectors. It includes, for instance, microfinance companies, non-governmental organizations, non-banking finance institutions, development banks, cooperatives, farmer organizations and other types of lenders, such as village banks and informal lenders. A large number of institutions offer microfinance. Given the diverse landscape and the coexistence of informal as well as formal institutions, it is difficult to know exactly how many actually operate in

<sup>43</sup> See [www.worldbank.org/en/projects-operations/environmental-and-social-policies](http://www.worldbank.org/en/projects-operations/environmental-and-social-policies) and [www.adb.org/site/safeguards/overview](http://www.adb.org/site/safeguards/overview).

<sup>44</sup> See [www.adb.org/site/safeguards/country-safeguard-systems](http://www.adb.org/site/safeguards/country-safeguard-systems).

<sup>45</sup> See Milford Bateman et al., *The Rise and Fall of Global Microcredit: Development, Debt and Disillusion* (New York, Routledge, 2019).

the country. The Lanka Microfinance Practitioners' Association has 66 microfinance institutions as members.<sup>46</sup>

74. In addition, while private loan providers are numerous among microfinance actors, government-run institutions account for a significant number of microfinance entities. The Samurdhi programme, for example, oversees its own microcredit schemes. The international development assistance sector is also active in microfinance-related initiatives.

75. According to the performance report of the Department of Development Finance for 2017, Rs. 165 billion were disbursed in loans to the microfinance sector by the banking sector in 2017.<sup>47</sup> The microfinance portfolio of the main government microfinance institutions accounted for a total of Rs. 263 billion in 2017. According to the Lanka Microfinance Practitioners' Association, its loan portfolio for 2017–2018 amounted to Rs. 94,415,629,796.00 for 39 of its members.<sup>48</sup> During the same period, 2,898,232 people borrowed, of which 2,439,187 (84 per cent) were women.

## **B. Human rights impact of loan practices on borrowers**

76. The Independent Expert learned that while the universe of borrowers is broad, women in poor or war-affected areas are specifically targeted by microfinance financial institutions. While some institutions charge a maximum flat rate of 30 per cent in interest, some levy up to 220 per cent, and also apply compound interest. Given that lenders do not follow any particular guidelines to assess the credit risks of loans, combined with the usurious terms often applied, a very high number of women default on their debts and become trapped in an exploitative financial system.

77. Sri Lanka ratified the Convention on the Elimination of All Forms of Discrimination against Women in 1981, which includes the obligation to eliminate discrimination against women in economic and social life (art. 13). In 2017, the Committee on the Elimination of Discrimination against Women expressed its concern at the exploitation of women by private financial companies as a result of women's limited access to credit (CEDAW/C/LKA/CO/8, para. 36 (d)). It recommended that Sri Lanka introduce low interest or interest-free credit schemes for women heads of households and families living in poverty, with recovery plans adapted to their income-generation patterns (para. 37 (e)).

78. While the objective of the microfinance system has been to lift people out of poverty by allowing them credit to sustain their livelihoods, it has also been observed that, in actual fact, some institutions generate huge profits by putting enormous pressure on poor borrowers, and on women in particular. Although some women seek loans to build a business, many of them do not succeed in their projects – which is not surprising, given the lack of an enabling environment for micro and small enterprises (such as extremely high interest rates), coupled with very modest economic growth. Other women seek loans to cover the basic consumption needs for their families. Others borrow to pay off previous loans. It is common to see women owing multiple loans to different lenders at the same time.<sup>49</sup>

79. Reportedly, collectors go to women's houses to be paid, sometimes on a daily basis, and even stay for hours until they are. Women are at times exposed to psychological and physical violence by collectors. It was also brought to the Independent Expert's attention that, in some cases, women were pressured by collectors to exchange "sexual favours" for instalments (see CEDAW/C/LKA/CO/8), and that some women borrowers even offered to sell their kidneys to repay loans.

<sup>46</sup> See Lanka Microfinance Practitioners' Association, Annual Report 2017, p. 9.

<sup>47</sup> See [www.parliament.lk/uploads/documents/paperspresented/performance-report-department-of-development-finance-2017.pdf](http://www.parliament.lk/uploads/documents/paperspresented/performance-report-department-of-development-finance-2017.pdf).

<sup>48</sup> See [www.microfinance.lk/stats.php](http://www.microfinance.lk/stats.php).

<sup>49</sup> See for instance International Crisis Group, "Sri Lanka's Conflict-Affected Women: Dealing with the Legacy of War", 28 July 2017, p. 9, footnote 32.

80. Reports also indicate that some women leave their villages, while others suffer domestic violence as a punishment for “contract breach”, or have to work much harder and more hours to earn sufficient money to repay their debts. Cases of suicide have also been reported.<sup>50</sup>

### **C. Legislative framework and current initiatives to regulate the sector**

81. In 2016, Sri Lanka adopted the Microfinance Act No. 6, which was aimed at regulating licensing requirements and establishing regulation for microfinance businesses. Sections 3 and 4 of the Act specify the type of institutions eligible to apply for a license, and the specific requirements to do so. While it is a step in the right direction, the Independent Expert nevertheless emphasizes that licences are mandatory for any person conducting “microfinance business”, namely, accepting deposits and providing financial accommodation or other financial services. According to the Department of Development Finance, in 2017, 11 licence applications were received by the Central Bank.<sup>51</sup> While also providing for the “registration of non-governmental organizations accepting limited savings deposits as microfinance non-governmental organizations”, the Act only covers a part of the broad microfinance landscape in Sri Lanka, as the Central Bank regulates and oversees financial institutions that receive and manage deposits from the public. The mandate holder notes that banks are also required to comply with (and public authorities to enforce) the Banking Act Direction No. 8 of 2011 on the Customer Charter of Licensed Banks, which prohibits abusive debt collection.

82. As highlighted above, the Independent Expert learned during his mission about the number, frequency and seriousness of lender abuse. In his view, the current situation calls for urgent action by the State. The entire sector should be robustly regulated and closely monitored to ensure that all form of abuse come to an end expeditiously. It is also important to ensure effective remedies and reparation for the persons affected.

83. In Development Finance Circular No. 1/2018, the Department of Development Finance announced that a 35 per cent interest rate cap per annum would be applied in the future to finance companies and microfinance institutions. Furthermore, relevant guidelines would be developed for the Central Bank’s regulatory body. Much of all microcredit volume is, however, channelled through non-regulated lenders, which do not have any restriction with regard to the rates of interest they may charge. Private (profit-driven) financial institutions are the most aggressive in loan pushing and the quickest in disbursing funds, which make them particularly pervasive in local communities.

84. The Independent Expert welcomes the Government’s current policy, as outlined in the above-mentioned circular, to write off the microdebts taken on by women in 12 regions affected by droughts, providing they are not higher than 100,000 rupees and are at least three months in arrears as at 30 June 2018, from microfinance institutions registered with the Lanka Microfinance Practitioners’ Association and finance companies registered with the Central Bank of Sri Lanka. The mandate holder emphasizes, however, that given the pressure lenders that can place on debtors, collectors do not usually allow for long delays in payment; many women, particularly the most vulnerable, might therefore not find relief through the programme. Besides, the above-mentioned microcredit practices and abuses have not been limited to regions targeted by the programme; the scope of the policy should therefore be broadened.

85. In market economies, lenders should be responsible for the risks they take; otherwise, if they are always fully repaid regardless of the interest charged (which in the cases examined by the Independent Expert seem to cover a generous credit risk insurance), serious moral issues may arise. This is actually what has happened: thousands of women without repayment capacity have been granted loans with unfair conditions.

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<sup>50</sup> Ibid.

<sup>51</sup> Department of Development Finance, Performance Report 2017, p. 18.

86. The current situation illustrates the importance of establishing a national plan of action on business and human rights in line with international standards, including for the financial sector, notably all types of institutions and organizations engaged in financial business, regardless of whether they are officially registered as such.

87. The Independent Expert furthermore urges the Government to set a cap on interest rates for all financial institutions and individual lenders operating in the microcredit business. In the same vein, he also recommends that it adopt and implement a robust and strict regulatory framework, including guidelines on how microcredit lenders assess the credit risk of their loans and the actions they can take to collect loans in accordance with international human rights norms and standards. Such a regulatory framework should establish that usurious microcredits are void (or voidable), and provide victims the right to request the return of the money as compensation. He also urges the Government to declare a moratorium on repayments until such legislation is adopted in order to prevent groups at heightened risk – in particular women – from being exploited further by lenders.

88. The Independent Expert commends other initiatives aiming at providing a framework for microfinance actors, such as the code of conduct developed by the Lanka Microfinance Practitioners' Association for its members. Application of the code, which promotes a “do no harm” approach to microfinance operations, is now mandatory in order to be eligible for membership in the Association. He therefore recommends that the code be expanded to other actors, and include explicit reference to corporate responsibility to respect human rights in microfinance operations.

89. The Independent Expert recognizes that borrowers have basic financial needs that need to be met. This is the State's responsibility, because the poor cannot be forced to pay for public goods through private microcredit. On the one hand, public banks should expand their concessional credit lines to make them massively available for those most in need (even a normal interest rate would represent a dramatic improvement for poor borrowers); on the other, cooperative financial initiatives to improve the microcredit industry with a purely social goal should also be explored. The Independent Expert welcomes the Government's decision to launch a pilot cooperative financial scheme in the North to provide credit to those in need and that charges reasonable interest rates. The scheme should be expanded to all regions in the country.

## VII. Conclusions and recommendations

90. **Recent economic and social policies aiming at promoting inclusive growth and economic development have led to the implementation of a number of projects and initiatives in Sri Lanka. As the end of the conflict and the ensuing reconciliation process provided the country with new economic opportunities, measures taken to boost growth and consolidate peace and democracy have materialized in the form of important public investment programmes and economic policy reforms.**

91. **Public debt in Sri Lanka has increased significantly in recent years: from 68.7 per cent of GDP in 2012 to 78.8 per cent in 2016.<sup>52</sup> The Government has adopted a wide range of reforms and measures in order to maintain macroeconomic stability with a view to promoting inclusive growth. Besides targeting fiscal deficit, recent measures have also included important reforms in various sectors, such as land, labour, social safety nets and State-owned enterprises. These measures have also had an impact on public spending and the budget of certain social sectors.**

92. **Human rights impact assessments should be conducted systemically prior to the adoption of dynamic reforms in order to evaluate potential human rights risks and to avoid retrogression. With regard to debt repayment, the Independent Expert also emphasizes that complementary alternatives and less harmful policy options deserve to be explored and publicly debated. They include considering boosting domestic**

<sup>52</sup> Ministry of Finance, Annual Report 2017, p. 120.

demand, opening a discussion on whether the military budget reflects the fundamental changes in the country, and renegotiating debt in order to boost fiscal space.

93. Illicit financial flows can affect the realization of human rights in many ways, most notably through the erosion of the public resources available. Combating and preventing corruption and money-laundering is of particular importance from a human rights viewpoint; the Independent Expert has in fact highlighted the need to devote particular attention to tax-related offences, given estimates most illicit international financial flows concern cross-border tax-related transactions. Legislative reforms are needed in Sri Lanka in order to ensure that the cases of tax evasion detected by financial institutions are reported to the authorities responsible in a timely manner.

94. Respect for human rights and inclusive economic growth can reinforce each other. While foreign investments and projects, including mega-infrastructure projects, can have a positive impact on the economy, they can also generate diverse risks to a broad range of human rights, from the rights to food, housing and health through to the right to water and sanitation. In this context, there is a need to ensure that the positive impact of a project truly benefits the whole population while preventing and/or minimizing any potential adverse impact on human rights. Any such impact should be carefully assessed, and affected persons should be effectively informed and consulted.

95. The microfinance scheme introduced in Sri Lanka had the objective of lifting people out of poverty by enabling them to sustain their livelihoods. No study to assess whether this objective has indeed been reached has been conducted. In particular, women borrowers from (but not limited to) conflict-related areas have been affected in extreme ways, many becoming victims of reckless lending, over-indebtedness and outrageous exploitation, greed and abuses from a number of lenders. The seriousness of the situation highlights the importance of taking urgent governmental action regarding all types of lenders, regardless of whether they are officially registered as such.

96. The grave situation in the field of microcredit shows how relevant and timely the discussion around ensuring the justiciability of economic, social and cultural rights in Sri Lanka is. If a debtor in a desperate situation makes the case to a court and/or the Human Rights Commission of Sri Lanka that the principle of *pacta sunt servanda* has to be reconciled with her economic and social human rights, such as the right to food and adequate housing, how would the case be adjudicated in Sri Lanka? The State must provide a human rights-sensitive response.

97. The Independent Expert recommends that the Government of Sri Lanka:

(a) Regularly conduct human rights impact assessments before, during and after the implementation of economic reforms that have the potential to cause an adverse human rights impact (see A/HRC/37/54);

(b) Carry out debt sustainability analyses on a more comprehensive understanding of debt sustainability, incorporating human rights and the social and environmental dimensions of sustainability;

(c) Take effective measures to ensure progressive tax policies and to rationalize the budget, in terms of both revenues and of outputs and investments, with the aim of reducing socioeconomic inequalities and poverty, and to ensure the redistribution of the benefits of economic growth and the full realization of human rights;

(d) Conduct estimation studies in order to further curb illicit financial flows, in accordance with the Sustainable Development Goals;

(e) Make tax evasion and providing assistance for tax evasion a criminal offence under the Penal (Criminal) Code;

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

(g) Establish robust and consolidated legislation on human rights impact assessment for infrastructure projects based on international human rights norms and standards to ensure transparency, consultation and participation of potentially affected people;

(h) Implement infrastructure projects only with the prior and informed consent from those that may be directly affected, and ensure that those affected may genuinely participate in decision-making based on adequate and timely information;

(i) Require by law that project developers undertake meaningful consultations with affected individuals and communities before, during and after project implementation;

(j) Ensure compensation to communities that have been negatively affected by infrastructure projects, and that they receive reparations in accordance with human rights standards;

(k) Conduct a comprehensive survey to assess whether and to what extent the microcredit scheme has actually alleviated poverty in the country in the past decade, and to identify all the actors operating in the sector to better understand the role that each of them plays;

(l) Adopt and effectively implement a robust and comprehensive regulatory framework in the field of microfinance applicable to all types of microfinance service providers; it should include guidelines on assessing the credit risk of loans and interest rates, and regulate and restrict the actions that lenders can take for collection, in accordance with international human rights norms and standards;

(m) Amend the legislative framework in place to ensure that usurious microcredits are void (or voidable), and afford victims the right to request the return of money as compensation;

(n) Declare a moratorium on repayments until the laws and regulatory frameworks referred in section V of the present report are adopted and effectively implemented, in order to prevent groups at heightened risk – in particular women – from being further exploited by lenders;

(o) Enhance concessional credit lines and cooperative financial initiatives in the field of microcredit to boost sustainable development;

(p) Support the constitutional reform process in order to ensure inclusion of all economic, social and cultural rights in the national legal system, including their justiciability;

(q) Ratify the Optional Protocol to the International Covenant on Economic, Social and Cultural Rights;

(r) Consider adopting a national plan of action on business and human rights, to be applied also to the financial sector;

(s) Establish accessible and effective operational-level non-judicial grievance mechanisms that are legitimate, accessible, predictable, equitable, transparent and rights-compatible.

98. The Independent Expert recommends that international financial institutions, international development assistance actors and foreign lenders:

(a) Base debt sustainability analyses on a comprehensive understanding of debt sustainability, incorporating human rights and the social and environmental dimensions of sustainability;

(b) Grant priority in their development cooperation and lending to the realization of economic, social and cultural rights in Sri Lanka and to the attainment

of the 2030 Agenda for Sustainable Development, in collaboration with the Sri Lankan authorities;

(c) Establish more robust frameworks to assess the human rights implications of projects, covering both substantive and procedural human rights;

(d) Implement infrastructure projects with the prior and informed consent of those that may be directly affected, and ensure that those affected may participate in decision-making based on adequate and timely information;

(e) Include human rights into risk analysis and due diligence processes, and conduct human rights impact assessments alongside environmental and social impact assessments prior to making funding decisions;

(f) Make the result of the above-mentioned assessment publicly and easily available in all national languages.

99. The Independent Expert recommends that private financial actors:

(a) Contribute to the establishment of a national plan of action on business and human rights, including all types of institutions and organizations engaged in financial businesses, regardless of whether they are officially registered as such;

(b) Incorporate international human rights standards into their codes of conduct and practices for microfinance institutions, including limits to interest rates that can be charged to loans and the actions that lenders may and may not take to collect loans;

(c) Include human rights in risk analysis and due diligence processes on the basis of reliable information;

(d) Conduct human rights impact assessments alongside environmental and social impact assessments prior to making funding decisions;

(e) Develop institutional policies relating to access to information and information disclosure, and make them publicly available.

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