

Sri Lanka's Foreign Debt Restructuring: Assessing the Omission of Debt-for-Nature Swaps and Odious Debt Claims

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Abstract

Sri Lanka's recently completed debt restructuring marks a key step toward post-crisis economic stabilization. While the primary objective of the debt restructuring has been to restore macroeconomic stability and regain access to international financial markets, this paper critically examines the exclusion of debt-for-nature swaps (DFNS) and the notion of odious debt, assessing their feasibility and the factors behind their omission. Drawing on secondary data sources and using a mixed methods approach, primarily focusing on qualitative methods, the analysis is situated within the framework of debt overhang theory to demonstrate how Sri Lanka's high debt service obligations severely constrained fiscal space, underscoring the need to consider alternative debt management mechanisms such as DFNS. Compared to the legally and politically contentious invocation of odious debt, DFNS is more practical and widely accepted, as demonstrated by implementation in other countries. Although the exact reasons for Sri Lanka's decision to forgo DFNS remain unclear, several contributing factors can be identified: procedural complexity, time constraints, prioritization of immediate fiscal stabilization over environmental objectives, absence of a binding legal framework and limited engagement with bilateral creditors experienced in such mechanisms. This study argues that DFNS could be implemented even in the post-debt restructuring context, given its focus on environmental conservation rather than solely on debt relief. This argument is further reinforced by debate on whether Sri Lanka has received adequate debt relief. This study addresses a critical research gap by systematically analyzing the exclusion of DFNS and infeasibility of odious debt.

Key words: *Sovereign Debt restructuring, Debt-for-Nature Swap, Odious debt, Sri Lanka, Foreign Debt, Debt Justice*

JEL Code: E6, E62, E620

Introduction

The outbreak of COVID-19, exacerbated the macro-economic weakness of the Sri Lanka's economy. Sri Lanka has experienced a prolonged twin deficit, marked by persistent fiscal and current account imbalances, for over a decade, reflecting deep-rooted structural and macroeconomic challenges (ADB, 2019). These twin deficits contributed to the accumulation of debt, including foreign debt. The World Bank (2022) pointed out that years of fiscal indiscipline, along with policy missteps such as the tax cuts in 2019, led to unsustainable levels of public debt amid the COVID-19 pandemic. As illustrated in Table 01 below, central government debt as a percentage of GDP has increased in recent years, reaching a peak of 114.2% in 2022, of which 51.8% constitutes foreign debt.

Table 01: Central Government Debt of Sri Lanka as % of GDP

Description	2018	2019	2020	2021	2022	2023
Total	78.4	81.9	96.6	100	114.2	104.7
Foreign	38.8	39	38.7	37	51.8	42.5
Domestic	39.6	42.9	57.9	63	62.4	62.2

Source: Central Bank of Sri Lanka, 2025

By the time Sri Lanka faced COVID-19 pandemic, the country was already experiencing debt overhang resulting from decades of fiscal deficit (UNDP Regional Bureau for Asia and the Pacific, 2022). Amidst rapidly depleting foreign exchange reserves and negative net foreign assets in the banking system, Sri Lanka announced in April 2022 a suspension of foreign debt servicing, excluding obligations to multilateral creditors (Ministry of Finance, 2022a). The depletion of foreign exchange reserves led to severe shortages of fuel, food, medicines, cooking gas, and inputs needed for economic activity (World Bank, 2023). The island-wide protests that emerged from the economic crisis forced then President Gotabaya Rajapaksa to resign. According to the World Bank (2023), between 2021 and 2022, the poverty rate in Sri Lanka doubled, from 13.1% to 25% (measured at USD 3.65 per capita per day, 2017 PPP), resulting in an increase of approximately 2.5 million people falling into poverty. Sri Lanka suffered an unprecedented economic crisis, with the economy contracting by 7.3% in 2022 and 2.3% in 2023 (Central Bank of Sri Lanka, 2024).

As the crisis deepened, Sri Lanka sought the support of the IMF in early 2022. A staff-level agreement between the IMF and the Government of Sri Lanka for a 48-month Extended Fund Facility (EFF) program amounting to USD 2.9 billion was reached in September 2022 and subsequently approved by the IMF Board of

Directors. Following the debt service suspension, Sri Lanka appointed France-based Lazard as its financial advisor and Clifford Chance LLP as its legal advisor to support the debt restructuring efforts (Ministry of Finance, Sri Lanka, 2022b). In June 2024, Sri Lanka signed debt restructuring agreements with the Official Creditors Committee (OCC), covering USD 5.8 billion in debt and another agreement with China for an additional USD 4.2 billion (Ministry of Finance, 2024a). Subsequently, in July 2024, Sri Lanka succeeded in finalizing an agreement with international sovereign bondholders (Ministry of Finance, 2024b). Although it was initially announced that the agreements would be tabled in Parliament, the content of the agreements has not yet been made available to the public. In December 2024, the Government announced the successful completion of its International Sovereign Bonds (ISBs) exchange offer, with participation of 98% of bondholders (Daily Mirror, 2024). The World Bank (2024) points out that despite signs of economic recovery; Sri Lanka's macroeconomic vulnerability remains high.

Despite a growing body of literature on Sri Lanka's debt crisis and restructuring, existing studies largely ignore the potential role of debt-for-nature swaps (DFNS) and omit discussion of odious debt claims in the Sri Lankan context. While DFNS have been discussed in a few policy briefs, a gap persists in the scholarly literature regarding why Sri Lanka has not adopted such mechanisms. Similarly, odious debt has not been examined in relation to Sri Lanka. Accordingly, this study fills this gap by systematically analyzing the exclusion of DFNS and the impracticality of odious debt.

As mentioned earlier, Sri Lanka announced a suspension of foreign debt servicing in April 2022 amidst depleting foreign exchange reserves. After nearly two years of negotiations, Sri Lanka signed debt restructuring agreements in 2024 with the Official Creditors Committee (OCC) and a separate agreement with China. In the same year, an agreement was also signed with international sovereign bondholders. Notably, Sri Lanka's foreign debt restructuring has largely focused on traditional instruments, namely haircuts, interest rate reductions and maturity extensions, with limited consideration given to alternative approaches such as debt-for-nature swaps and the recognition of odious debt. This exclusion raises critical questions in the context of debt overhang where high debt service obligations constrain fiscal space, and in terms of debt justice, where normative and environmental considerations that could be addressed through alternative mechanisms such as DFNS have largely been overlooked. This study seeks to investigate the feasibility of these alternative mechanisms and to analyze the legal, political, and economic factors that led to their omission, with a view to informing more sustainable and equity-oriented debt management strategies.

This paper assesses the feasibility of applying the debt-for-nature swap mechanism and the notion of odious debt in the context of Sri Lanka's recently completed foreign debt restructuring process. It also identifies and analyzes the key legal, political and economic factors that led to their exclusion from the final restructuring framework. In doing so, the paper situates Sri Lanka's experience within its own legal, political and economic context, highlighting how the aforesaid domestic dynamics shaped the consideration and eventual omission of innovative mechanisms such as debt-for-nature swaps and odious debt claims in the restructuring process. By exploring aforesaid dimensions, the study also examines how DFNS and odious debt claims despite their non-adoption in this instance could, serve as ethically grounded and potentially transformative tools to promote fiscal sustainability, environmental conservation and social accountability in highly indebted countries such as Sri Lanka. Finally, the paper contributes to the broader discourse on responsible debt governance by analyzing the factors behind the omission and infeasibility of debt-for-nature swaps and odious debt claims in Sri Lanka's recent debt restructuring.

Theoretical Framework

This research adopts a multi-lens theoretical framework to analyze Sri Lanka's foreign debt restructuring and the omission of alternative mechanisms such as debt-for-nature swaps (DFNS) and odious debt claims. Debt overhang theory is applied to explain how high levels of debt can constrain fiscal space and limit investment in essential sectors such as health, education and environmental protection (Krugman, 1988; Sachs, 1989). This theory justifies the need to explore alternative debt instruments like DFNS which could alleviate the negative effects of debt overhang while promoting sustainable development. The study also draws on the framework of debt justice, which incorporates the odious debt doctrine and provides a legal and ethical lens to assess whether certain debts are illegitimate or morally contestable by borrowing states (Howse, 2007). This framework supports the evaluation of odious debt claims and highlights how DFNS can transform unsustainable or unjust debt obligations into opportunities for environmental conservation and development, aligning financial restructuring with broader ethical and sustainability goals. By integrating these two theoretical perspectives, the study systematically examines both economic constraints and normative considerations shaping Sri Lanka's debt restructuring, providing a comprehensive understanding of why DFNS and odious debt mechanisms were omitted and their potential feasibility in future debt management strategies.

Literature Review

Although there is no universally accepted definition of debt-for-nature swaps (DFNS), the concept is widely understood as a financial mechanism linking debt relief to environmental conservation. Broadly, DFNS involve the cancellation of a portion of a developing country's foreign debt in return for commitments to implement domestic environmental initiatives. Hansen (1988) described a DFNS typically involves the acquisition of a developing country's foreign debt, often at a discounted rate on the secondary debt market which is then cancelled in exchange for the debtor country's commitment to undertake environmental conservation or related initiatives. Expressing a similar view, Sheikh (2018) noted "debt-for-nature swaps typically involve restructuring, reducing, or buying a portion of a developing country's outstanding debt, with a percentage of proceeds (in local currency) being used to support conservation programs in the debtor country" (p. i). According to UNCTAD (2001), the debt-for-nature swap is one of the debt conversion options recognized by the Paris Club, alongside other mechanisms such as debt-for-development and debt-for-equity conversions. Debt-for-nature swaps represent an innovative approach to facilitate debt restructuring while simultaneously promoting sustainable development.

Debt-for-nature swaps (DFNS), sometimes also referred to in the literature as debt-for-environment swaps (DFES) and, more recently, as debt-for-climate swaps, reflect evolving terminology aligned with shifting environmental priorities. While DFES is often used interchangeably with DFNS, the term debt-for-climate swap typically denotes a narrower focus, targeting climate mitigation and adaptation objectives rather than broader environmental or conservation goals.

The majority of developing countries rely on primary industries and primary export products, and the pressure to repay foreign debts often leads to the exploitation of natural resources for economic activities such as timber extraction, cattle ranching, mining and agricultural production often at the expense of the environment (Sheikh, 2018). Hence, the debt-for-nature swap is considered a novel approach to prevent environmental degradation and the loss of biodiversity.

Cassimon et. al. (2011) point out that in certain instances debt-for-nature swaps involve a non-governmental organization (NGO) or a consortium of NGOs purchasing a developing country's sovereign debt on the secondary market at a discounted rate. This debt is then exchanged for commitments by the debtor government to fund domestic environmental conservation efforts, typically through local currency investments. World Bank (1993) indicates that the first DFNS took

place in 1987, when Conservation International bought USD 650,000 worth of Bolivian debt owed to Citicorp for USD 100,000 in the secondary market. Under the terms of the aforesaid agreement, the Bolivian government designated roughly 3.7 million acres of forest for conservation purposes. The notable DFNS during 1991 to 2002 are illustrated in the Table 02.

Table 02: Notable Debt for Nature Swap During 1991 - 2002

Year	Country	Purchaser	Cost	Face value of Debt
2002	Peru	USA, World Wildlife Fund, The Nature Conservancy, Conservation International	USD 5.5 Mn	USD 14 Mn
1993	Philippines	World Wildlife Fund	USD 13 Mn	USD 19 Mn
1992	Philippines	World Wildlife Fund & USAID	USD 5 Mn	USD 10 Mn
1991	Ghana	Conservation International Institution	USD 0.25Mn	USD 1 Mn

Source: Sheikh, 2018

The United States is the single largest creditor involved in bilateral debt-for-nature swaps (Yue & Wang, 2021). The DFNS initiatives involving the United States are as follows:

Table 03: USA Bilateral Debt for Nature Swap Transactions in 1990s

Year	Country	Debt Reduction	Original value of the debt
1998	Peru	USD 177 Mn	USD 350 Mn
1993	Argentina	USD 3.8 Mn	USD 38 Mn
1992	Columbia	USD 31 Mn	USD 310 Mn
1992	Uruguay	USD 3.7 Mn	USD 34.4 Mn
1992	El Salvador	USD 469.9 Mn	USD 614 Mn
1991	Bolivia	USD 30.7 Mn	USD 38.4 Mn

Source: Sheikh, 2018

According to Table 03, the role of the United States in DFNS is significant. Yue and Wang (2021) point out, by the end of 2003 around 66 bilateral DFNS had been completed, mainly in the Latin America and Caribbean region, of which the United States was involved in nearly 28%.

Several countries have successfully executed debt-for-nature swaps in recent years. Recent examples of debt-for-nature swaps include those implemented by Belize, Seychelles, Barbados, Ecuador, and Gabon (White & Case, 2024). In 2023, Ecuador's Debt-for-Nature Swap (DFNS) became the largest in history, restructuring USD 1.6 billion in debt to secure approximately USD 450 million for long-term marine conservation (World Economic Forum, 2023).

Many developing countries are burdened with debt incurred by successive governments without the consent of the people and the funds were often used corruptly or to repress the population (Kremer & Jayachandran, 2002a). The concept of odious debt is particularly pertinent, as 59 countries were experiencing debt distress globally by the end of 2022, according to the United Nations (2023).

According to principles underpinning the doctrine of odious debt, Sovereign debt incurred without the consent of the population and that fails to provide public benefit is considered odious, and as such, should not be legally transferable to successor governments (Kremer & Jayachandran, 2002a). The Greek Debt Truth Committee on Public Debt (2014:10) defines odious debt as “debt which the lender knew or ought to have known was incurred in violation of democratic principles (including consent, participation, transparency, and accountability) and used against the best interests of the population of the borrower state”. The doctrine of odious debt is somewhat analogous to situations in which individuals are not held responsible for repaying debts fraudulently incurred in their name.

There are instances where some countries repay debts considered odious, fearing that failure to do so could tarnish their reputation and hinder future borrowing and foreign direct investments (FDIs). For example, South Africa's apartheid regime borrowed from private banks, allocating a large portion of its budget to finance security expenditures aimed at repressing the African majority. Despite appeals from the Archbishop of Cape Town and South Africa's Truth and Reconciliation Commission to have the odious apartheid-era debt written off, the post-apartheid government accepted responsibility for the debt, fearing that defaulting might jeopardize the country's chances of attracting FDI and accessing international credit markets (Kremer & Jayachandran, 2002b). However, Thomas (2003) argues that unilateral debt repudiation differs from debt cancellation under the doctrine of odious debt and

the latter is therefore less likely to cause problems for future borrowing. Nevertheless, it is indisputable that the doctrine of odious debt can be easily misused, as explained by Paulus (2008).

The doctrine of odious debt traces its origins to the writings of Alexander Nahum Sack, who formally articulated the concept in the 1920s. Kremer and Jayachandran (2002b) pointed out that limiting an odious regime's ability to borrow is more effective than imposing trade sanctions. According to international law, a successor government is generally expected to honor the public debt of its predecessor regime (World Bank, 2008). However, the legal implications become more complex in cases of state succession rather than a simple change in government, in which case the Vienna Convention on Succession of States is the prevailing legal framework. (World Bank, 2008).

Building on the pioneering work of Sack (1927), the World Bank (2008) identified 03 categories of odious debt. First, regime debt occurs when a despotic regime contracts debt not to serve the needs or interests of the state, but rather to consolidate its own power, such debt is considered illegitimate under the doctrine of odious debt. Second, subjugation debt arises when a government incurs debt with the intent to subjugate a segment of its own population or to colonize it through members of the dominant nationality, such debt may be classified as odious under international legal and ethical standards. Third, war debts refer to situations in which government contracts debt with the intention of waging war against another state, such debt may be considered odious, particularly when it violates international peace and security norms.

The Greek Debt Truth Committee on Public Debt (2014) expanded the above categorization by adding two additional types of odious debt: illegitimate debt and illegal debt. Illegitimate debt arises when a loan agreement, its guarantees, or its terms and conditions violate national or international law, contravene public policy, or are considered grossly unfair or unreasonable to the borrower, potentially rendering the debt void or unenforceable. Illegal debt, on the other hand, refers to debt that may be deemed invalid where proper legal procedures such as lawful authorization, approval or oversight by the appropriate state institutions were not followed or where the lending process involved clear misconduct by the lender, including acts of bribery or coercion.

Paulus (2008) proposed two additional categories of odious debt: "criminal debt" and "ineffective debt." Criminal debt refers to situations where the repayment burden imposed on society is unjust, either because sovereign loans were embezzled by corrupt officials and their affiliates, or because the debt was incurred to address

economic harm caused by the criminal conduct of powerful actors. In contrast, ineffective debt denotes obligations that fail to deliver any meaningful benefit to the public or the state, thereby lacking legitimacy in both ethical and developmental terms.

Methodology

This study is based on secondary data sources such as the *Sri Lanka Development Updates* compiled by the World Bank; publications from the Asian Development Bank (ADB), International Monetary Fund (IMF), and United Nations; annual reports of the Central Bank of Sri Lanka (CBSL); and publications from the Ministry of Finance in Sri Lanka. The study employs a mixed-methods approach; however, the analysis is largely qualitative, drawing primarily on secondary data and qualitative interpretation. Quantitative data are incorporated in a supporting role, analyzed using descriptive techniques such as percentage calculations, and presented through tables to facilitate interpretation of key debt indicators. By integrating qualitative interpretation with descriptive quantitative evidence, this methodology enables a rigorous and comprehensive assessment of the feasibility, constraints and potential benefits of DFNS and odious debt claims in Sri Lanka, situating the study within broader discourses on debt justice, sustainable development and climate finance.

A key limitation of this study is that the debt restructuring negotiations were conducted confidentially and the agreements pertaining to Sri Lanka's debt restructuring have not been made public, necessitating reliance on information available in the public domain. Furthermore, scholarly literature on debt-for-nature swaps (DFNS) and odious debt remains limited, with much of the existing discourse primarily confined to institutional reports and working papers rather than peer-reviewed academic publications.

Analysis and Discussion

Recent research by Volz et. al. (2025) highlight that developing countries in the Asia Pacific region are at the frontline of climate vulnerability while simultaneously experiencing a rapid escalation in external indebtedness. According to their analysis, the external sovereign debt of developing Asia-Pacific economies, excluding the People's Republic of China (PRC) more than doubled between 2008 and 2023, leaving many countries with limited fiscal space to address climate-related risks or invest in long-term economic resilience. High debt service burdens have constrained governments' ability to allocate resources to climate adaptation, social protection and sustainable development. Sri Lanka is no exception to this regional trend. As a

climate-vulnerable island nation with a heavily indebted economy, Sri Lanka faced an acute economic crisis, culminating in a sovereign debt default in 2022 while grappling with the cumulative effects of prolonged debt accumulation and a severely constrained fiscal space. The country's debt service obligations which accounted for nearly half of government expenditure in most years between 2017 and 2023, mirror the broader regional pattern emphasized by Volz et. al. (2025). These structural constraints underscore the relevance of exploring alternative debt treatment mechanisms particularly those that link fiscal relief with climate or environmental objectives, such as debt-for-nature swaps (DFNS).

Table 4 presents Sri Lanka's debt service obligations in relation to government expenditure and revenue between 2017 and 2023. Both indicators reveal a fiscal position that has become increasingly constrained, with debt service accounting for nearly half of total government expenditure and in 2023 reaching a peak of 59.5%. The ratio of debt service to revenue reached a high of 163.4% in 2021, meaning that for every rupee earned, another 63 cents have to be borrowed to service the existing debt obligation. Although the aforesaid debt service to revenue ratio decreased somewhat in 2023, it remained well above sustainable levels, reflecting continued fiscal stress.

Table 04: Central Government Debt Service Obligation

Year	Total Debt service/ Government Expenditure	Debt Service/ Government Revenue
2017	46.6	87.5
2018	53.1	108.8
2019	45.4	107
2020	48.5	141.9
2021	49	163.4
2022	50.8	151.5
2023	59.5	139.8

Source: Central Bank of Sri Lanka, 2024

The table above provide empirical evidence of the debt overhang condition in Sri Lanka where high debt repayment obligations constrain fiscal space and limit resources available for country's development including spending on education, healthcare and social welfare. Accordingly, the debt overhang conditions reinforce the case for alternative debt restructuring mechanisms including DFNS which could alleviate repayment pressures while advancing sustainable development objectives. The magnitude of debt service obligations also raises normative questions regarding

debt legitimacy, particularly where some debts may not have yielded commensurate public benefits, as highlighted in the debt justice and odious debt frameworks.

Foreign debt is usually divided into three categories: multilateral, bilateral, and commercial debt. Multilateral debt refers to borrowings at concessionary rates from multilateral organizations such as the World Bank, Asian Development Bank and the IMF etc. Bilateral debt refers to loans obtained directly from other sovereign governments, often in the form of development finance. These may also carry favorable terms, although they are sometimes influenced by political or strategic considerations. Commercial debt refers to borrowing from private creditors, including international banks or through the issuance of sovereign bonds on global capital markets. Sovereign bonds typically carry shorter repayment terms and are generally associated with higher borrowing costs compared to multilateral or bilateral loans. In the case of Sri Lanka, commercial debt mainly consists of International Sovereign Bonds (ISBs). The table below illustrates a summary of Central Government debt, including foreign debt, as of 31st December 2023 which reflects the debt position prior to the finalization of the debt restructuring agreements in 2024.

Table 05: Summary of Central Government Debt as at 31st December 2023

No	Category	Amount (USD Mn)	As % of GDP
01	Domestic Debt	52,642.32	62.2%
02	Bilateral Debt	10,809.94	12.5%
03	Paris Club	4,432	5.1%
04	Non-Paris Club	6,378	7.4%
05	Multilateral Debt	11,783.50	13.5%
06	Commercial Debt	14,741.08	17%
07	ISB	12,550.00	14.5%
08	Term Financing Facilities	2,191.08	2.5%
09	Total Foreign Debt (Total of row no. 02+05+06)	37,334.51	42.5%
10	Total Central Government Debt (Total of row 01+09)	89,976.83	104.7%

Source: Ministry of Finance, 2023

During the foreign debt restructuring, there were media reports that the Government of Sri Lanka was considering a Debt-for-Nature Swap deal of up to USD 1 billion (Reuters, 2022; The Hindu, 2023). It was reported that after the Government announced the suspension of foreign debt service in April 2022, the United Nations Development Programme (UNDP) proposed to the Sri Lankan Government to utilize debt-for-nature swaps as part of the debt restructuring process (Daily Mirror, 2022).

The USA is the single largest creditor involved in bilateral debt-for-nature swaps (Yue & Wang, 2021). In addition to the United States, Canada which is another member of the Paris Club has actively provided debt relief to various countries including Colombia, El Salvador, Honduras, Nicaragua, and Peru, in exchange for commitments to environmental conservation (Horgan *et al.*, 2020). Several creditor nations including Finland, Germany, Norway, Sweden, Switzerland, and the United Kingdom, all of which are members of the Paris Club have also supported debt-for-nature swaps in countries such as Brazil, the Dominican Republic, Costa Rica, Ghana, Guatemala, Jamaica, Madagascar, Mexico, Peru, the Philippines, the Seychelles, and Zambia (Horgan *et al.*, 2020).

Given the prominent role of Paris Club members in debt-for-nature swap (DFNS) initiatives, it is pertinent to examine the composition of Sri Lanka's bilateral creditors, particularly in light of the fact that, to date, there are no documented cases of multilateral creditors, and only limited instances of commercial creditors, participating in such arrangements.

Table 06: Sri Lanka's Bilateral Debt Composition

Paris Club	Amount (USD Millions)	%	Non-Paris club	Amount (USD Millions)	%
Japan	2,524.3	23.4%	China	4,685.1	43.3%
France	435.7	4.0%	India	1,366.4	12.6%
Korea	308.3	2.9%	Saudi Arabia	148	1.4%
Netherlands	267.7	2.5%	Kuwait	95.4	0.9%
Germany	204.4	1.9%	Hungary	48.4	0.4%
UK	191	1.8%	Iran	32.9	0.3%
USA	132.5	1.2%	Pakistan	2.1	0.0%
Austria	108.9	1.0%			
Sweden	34.7	0.3%			
Canada	18.6	0.2%			
Other	367.8	3.4%			
Total	4,431.7	41%	Total	6,378.30	59%

Source: Ministry of Finance, 2023

Among Sri Lanka's bilateral creditors, several Paris Club members, including the United States, United Kingdom, France, Germany, Sweden, and Canada have previously engaged in DFNS with other countries. The combined outstanding loans from these Paris Club creditors to Sri Lanka amount to USD 1,016.9 million, as

displayed in Table 06. Therefore, Sri Lanka could have considered a debt-for-nature swap of comparable scale, especially given its status as an island nation with heightened vulnerability to climate change.

Determining the precise reasons for the exclusion of debt-for-nature swaps (DFNS) from the foreign debt restructuring remains challenging especially since the process was conducted in a highly confidential manner due to market sensitivities and the complexity of creditor negotiations. As illustrated in Table 06, China and India, (two of Sri Lanka's largest bilateral creditors, together accounting for 56% of its total bilateral debt) are not members of the Paris Club and have no precedent of participating in DFNS. Consequently, Sri Lanka's only viable opportunity for DFNS arrangement could have been only with Paris Club lenders. Because there is no documented case of multilateral creditors participating in Debt-for-Nature Swaps (DFNS) to date and commercial creditors have only rarely engaged in such arrangements. In the few instances involving commercial debt, participation has typically occurred through secondary market transactions facilitated by non-governmental organizations (NGOs), rather than through direct involvement by the creditors themselves. Accordingly, it is evident that the scope of DFNS has been predominantly confined to official bilateral creditors, more precisely to members of the Paris Club. In addition to the above, the limited global precedent, particularly within the Asian region combined with the complexity and political sensitivity of the restructuring process may have discouraged Sri Lanka from pursuing DFNS.

The government's primary objective was to conclude foreign debt restructuring and restore macroeconomic stability. While DFNS may offer long-term environmental and developmental benefits, they were likely viewed as peripheral to the government's immediate fiscal priorities during the economic crisis and debt restructuring process. According to the *Daily Mirror* (2025), although Sri Lanka was initially expected to complete its debt restructuring by June 2023, the government only announced the completion of the external debt exchange in December 2024, marking a significant delay. According to government sources, this delay is estimated to have incurred an additional interest cost of approximately USD 1.7 billion (Daily Mirror, 2025). Accordingly, the urgency to conclude foreign debt restructuring without further delay may have contributed to the exclusion of DFNS, as engaging in such arrangements could have further complicated and prolonged the restructuring process.

In light of preceding discussion, the exclusion of DFNS can be traced to a combination of interrelated factors: (i) procedural complexity requiring coordination with multiple creditors, (ii) limited precedent for DFNS within the Asian region,

particularly among major bilateral lenders like China and India, (iii) urgent fiscal pressures necessitating rapid completion of restructuring, and (iv) the prioritization of immediate macroeconomic stabilization over environmental objectives. These factors collectively constrained the government's ability to incorporate DFNS, illustrating how practical, institutional, and geopolitical considerations can outweigh theoretical feasibility.

Compared to DFNS, the implementation of the odious debt doctrine is significantly more complex and generally considered less feasible in practice. For example, Kremer and Jayachandran (2002b) emphasized the absence of a proper institutional mechanism to recognize odious debt and advocated for the establishment of an independent body capable of assessing the legitimacy of regimes. The proposed institution should be similar to the International Court of Justice, according to Kremer and Jayachandran (2002b).

One of the challenges in invoking the doctrine of odious debt is the existence of a secondary market for debt. In many developing countries, debt is held by third parties who purchased it in the secondary market, and any attempt to cancel the debt would harm the secondary creditors rather than the initial lenders (Thomas, 2003). In the case of Sri Lanka, International Sovereign Bonds (ISBs) which account for nearly one-third of the total foreign debt (Table 05) are predominantly held by private investors in the secondary market, making the application of the odious debt doctrine both legally contentious and financially disruptive. Invoking the doctrine of odious debt under the aforementioned circumstances, particularly in relation to International Sovereign Bonds (ISBs), would have likely compromised Sri Lanka's international credibility and significantly constrained its future access to global financial markets.

There are limitations to invoking the doctrine of odious debt and repudiation of sovereign debt. Thomas (2003) pointed out that some developing countries choose to refrain from invoking the doctrine of odious debt due to fear that such legal actions would discourage lenders in the future. In the case of Sri Lanka, as illustrated in Table 06, approximately 56% of the total bilateral debt is held collectively by China and India, both of which are regional superpowers. This concentration of debt among key geopolitical actors may have discouraged the pursuit of alternative debt treatments, such as the doctrine of odious debt, due to concerns over the risk of straining important diplomatic and economic relationships.

The exclusion of odious debt claim from Sri Lanka's debt restructuring reflects both structural and legal constraints. The doctrine lacks formal recognition under international law, and no established institutional mechanism exists to evaluate or enforce claims of odious debt. In Sri Lanka's case, the presence of International

Sovereign Bonds held predominantly in secondary markets would make repudiation highly disruptive to private creditors, while the concentration of bilateral debt among major geopolitical actors such as China and India reduces diplomatic leverage to pursue such claims. Additionally, the absence of prior cases in similar contexts demonstrates the high political and reputational risks associated with invoking odious debt. Unlike DFNS, which offers a concrete, legally recognized mechanism to link debt relief with development outcomes, odious debt remains largely theoretical and impractical in the immediate post-crisis context. However, a public debt audit or the establishment of a national commission to assess debt legitimacy could have laid the groundwork for future discussions on odious debt, potentially enhancing transparency and informing subsequent debt management strategies.

After the outbreak of the economic crisis in Greece, the government appointed a Greek Debt Truth Committee, which was mandated to raise awareness of issues pertaining to the Greek debt both domestically and internationally and to formulate arguments and options concerning the cancellation of the debt (The Greek Debt Truth Committee on Public Debt, 2014). The preliminary report concluded that certain portions of the debt constituted a direct infringement on the fundamental human rights of the residents of Greece. As a result, the committee determined that Greece should not repay this debt, as it was deemed illegal, illegitimate, and odious (The Greek Debt Truth Committee on Public Debt, 2014). Sri Lanka could also have considered appointing a commission to assess the use of public debt and to evaluate the potential presence of odious debt, at least as a starting point. Alternatively, conducting a comprehensive public debt audit would have provided greater transparency and accountability, while laying the groundwork for more informed and equitable debt restructuring discussions.

Despite the completion of Sri Lanka's debt restructuring, evidence indicates that the country continues to face a significant debt burden. Drawing on the net present value approach consistent with the IMF's methodology, Volz et. al. (2025) report that bilateral creditors are expected to recover approximately 67 cents for every dollar lent, while international bondholders may recover around 80 cents per dollar, potentially rising to 98 cents, if economic growth exceeds IMF projections by 13% or more. Furthermore, external debt payments are projected to exceed 20% of government revenue for at least the next decade, peaking at over 29% in 2028 (IMF, 2023, as cited in Volz et al., 2025). These figures indicate that Sri Lanka's debt burden remains significant, suggesting that the restructuring provided only limited fiscal relief. Consequently, this reinforces the argument that debt-for-nature swaps (DFNS) could still be pursued in the post-restructuring context, offering a mechanism

to link debt relief with environmental conservation, rather than focusing solely on financial repayment.

Conclusion

The recent completion of Sri Lanka's foreign debt restructuring represents a pivotal milestone in the country's path toward economic recovery. However, the process has drawn critical attention for its exclusion of alternative restructuring mechanisms, most notably, debt-for-nature swaps and the invocation of odious debt principles. The fiscal data shows, debt overhang situation is in existence in Sri Lanka where limited fiscal space constrained development trajectory of the country highlighting importance of exploring innovative debt restructuring mechanisms such as DFNS. This paper examines the feasibility of incorporating debt-for-nature swap mechanisms and the doctrine of odious debt into Sri Lanka's foreign debt restructuring and investigates the underlying factors that led to their exclusion from the final process.

Although the precise reasons for not pursuing DFNS remain unclear, several factors emerge from the analysis. These include the time-consuming and complex nature of DFNS negotiations, the limited regional and global precedent for such arrangements in Asia, and the government's urgency to conclude the debt restructuring process to restore macroeconomic stability. Moreover, while certain bilateral creditors, particularly Paris Club members have prior experience with DFNS, the majority of Sri Lanka's largest bilateral lenders, including China and India, lack such precedent, thereby narrowing viable opportunities for such arrangements. Despite these constraints, post-restructuring debt burdens remain high; external debt payments are projected to exceed 20% of government revenue for the next decade, peaking at over 29% in 2028 (Volz *et al.*, 2025). This continuing fiscal pressure suggests that DFNS could still be considered as a complementary mechanism to address environmental and developmental priorities even in the post-restructuring context.

The concept of odious debt, while theoretically compelling, faces significant practical challenges. It lacks formal recognition under international law and no institutional mechanism currently exists to assess, enforce, or repudiate such debts. In Sri Lanka's case, the prevalence of sovereign bonds held in secondary markets, the concentration of bilateral debt among major regional powers, and limited diplomatic leverage further diminish the feasibility of invoking odious debt principles. Consequently, its exclusion from Sri Lanka's debt restructuring reflects both legal and practical constraints rather than a lack of theoretical validity.

In conclusion, the Sri Lankan case demonstrates the persistence of a debt overhang even after formal restructuring, highlighting the need for innovative, environmentally and socially oriented mechanisms like DFNS. Simultaneously, it illustrates the significant barriers to applying doctrines such as odious debt, reinforcing the notion that post-restructuring policy innovation and proactive engagement with environmentally committed creditors may provide a more feasible pathway for aligning fiscal stability with sustainable development objectives.

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