

RESEARCH ARTICLE

Impact of Corruption-Driven Vulnerabilities of an Emerging Economy in Achieving Economic Prosperity and Strengthening the Anti-Money Laundering Legal Framework

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Abstract: This paper investigates the impact of corruption on economic growth. It discusses the corruption-driven vulnerabilities in achieving economic prosperity and preventing money laundering in emerging economies where corruption is prevalent. This paper employs a combination of quantitative and qualitative approaches, utilizing robust regression in the first phase to investigate the relationship between corruption and economic growth. The second phase employs qualitative analysis, in which 66 convictions are categorized and analyzed to provide micro-level evidence supporting the empirical findings on corruption and economic growth. The empirical results indicate that corruption is detrimental to economic growth, posing a significant challenge for emerging economies. The second-phase analysis reveals that widespread corruption is a significant barrier to implementing an effective regime to combat money laundering and terrorist financing in emerging countries with high levels of corruption. The corrupt policymaking, government administration, and management of resources, including lands, the education system, and law enforcement processes, hinder the effective implementation of the anti-money laundering (AML) regime due to higher human intervention. Therefore, this study proposes to develop a comprehensive payment ecosystem that reduces human intervention to improve the effectiveness of the AML regime and address many macroeconomic issues driven by the government's fiscal limitations. This paper provides only a conceptualized model based on the analysis of convictions related to bribery and corruption in the Sri Lankan context.

Keywords: corruption, money laundering, law enforcement, convictions, payment ecosystem

1. Introduction

Global initiatives for combating money laundering have been evolving since the inception of the Financial Action Task Force (FATF) in 1989. Evolving technologies and payment mechanisms make policymakers vulnerable to combating money laundering. Despite various measures taken by many jurisdictions, the effectiveness of global initiatives in combating money laundering is questionable due to the ever-rising number of financial crimes. Jurisdictions develop respective anti-money laundering (AML) regimes in compliance with the recommendations issued by the FATF. However, the position becomes complicated with respect to emerging economies because there is evidence for some countries where they have been categorized several times in the gray list, weak AML regimes, after the release of each mutual evaluation report. This study focuses on Sri Lanka as an emerging economy that was recognized as an AML-deficient regime in 2011 and 2017. Corruption affects economic growth negatively, and if corruption control is effective, it fosters economic growth [1]. Globally, these issues are considered in many dimensions; for example, the three

zeros theory argues that modern capitalism is the root cause of growing economic and social inequality [2]. Therefore, strong preventive measures are a prerequisite to achieving macroeconomic objectives of an economy to enhance the quality of life of citizens. Hence, this study discusses the structural issues related to corruption in the AML regime, which prevent achieving economic growth.

2. Theoretical Foundation

Corruption is a global issue, and when it comes to emerging economies, the situation becomes pathetic because it affects the living standards of the innocent and poor masses. Literature provides extensive evidence to show that corruption is a detrimental factor to economic growth [3, 4]. Kunieda et al. [5] state that highly corrupt countries impose higher tax rates compared to the less corrupt countries. This may be due to the inefficiencies of the fiscal management of the government. However, this may negatively impact economic growth. Gründler and Potrafke [6] state that corruption decreases economic growth in countries where the governance structures are weak. On the other hand, public participation in anti-corruption initiatives and a strengthened governance structure in countries where the rule of

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Table 1
Progress of amending the anti-money laundering and countering the financing of terrorism (AML/CFT) laws in Sri Lanka

Year	Status	Financial Intelligence Unit of Sri Lanka (FIU-Sri Lanka) Annual Report
2011	Finalizing amendments to the FTRA	2011, pp 8
2012	Appointing a Legal Review Committee (LRC) to review and draft legislation in line with the new FATF Recommendations.	2012, pp 29
2013	The LRC reviewed the revised FATF standards adopted in 2012.	2013, pp 9
2014	The FIU-Sri Lanka is in the process of amending the laws relating to money laundering (ML) and terrorist financing (TF), with the approval of the Advisory Board.	2014, pp 36
2016	The LRC was reconstituted to recommend amendments to the legislation relating to Anti-money laundering and countering the financing of terrorism (AML/CFT).	2016, pp 40
2017	The LRC recommended amendments to the FTRA and the PMLA.	2017, pp.71
2018	Technical assistance from the International Monetary Fund (IMF) was received for the legislative amendment process.	2018, pp.34
2019	Initiated the process of introducing amendments to the FTRA, PMLA, and CSTFA.	2019 pp.73
2021	FIU-Sri Lanka is actively facilitating the finalization of proposed amendments to the three main legislations that form the foundation of the AML/CFT legal framework.	2021, pp.11
2022	Various actions were initiated by FIU-Sri Lanka during 2022 to bring in legislative amendments to the legal framework on AML/CFT.	2022, pp. 9
2023	The FIU-Sri Lanka has been actively involved in bringing up necessary legislative amendments to further strengthen the legal framework on AML/CFT in Sri Lanka.	2023, pp. 10
2024	During 2024, FIU-Sri Lanka engaged in and facilitated several legislative amendments to strengthen the AML/CFT legal framework of the country.	2024, pp. 42

law prevails promote economic growth by optimizing the business environment and enhancing economic freedom [3]. Gründler and Potrafke [6] find that the impact of corruption on economic growth is pronounced in autocracies, where it is transmitted to growth by decreasing Foreign direct investments (FDI) and increasing inflation.

However, there is also contrary evidence in this area, where some studies suggest corruption promotes economic growth. For instance, the “grease the wheels” hypothesis suggests that corruption may facilitate economic development under certain conditions [7]. Huang [8] supports the “grease the wheels” hypothesis in the South Korean context, arguing that the use of anti-corruption policies as a tool for economic development may be ineffective. It proposes that economic growth could, in fact, contribute to rising levels of corruption. Swaleheen [9] shows that the relationship between corruption and economic growth is nonlinear because evidence shows that the reversed CPI is negatively correlated and the squared reversed CPI is positively correlated with economic growth. Spyromitros and Panagiotidis [10] also indicate that corruption hinders economic growth in emerging economies, with its impact varying across regions. In Latin America, corruption appears to have a positive correlation with economic growth, whereas in other regions, the relationship is predominantly negative. Further, Capasso and Santoro [11] state three interest points on the findings of their study. First, they show that active corruption displays a short-run “grease” association with growth in highly bureaucratic settings, but the effect is nonlinear and quickly dissipates at higher levels. Second, active

corruption sands the wheels by weakening the growth-promoting role of public expenditure, whereas the passive form shows no comparable interaction. Third, this erosion is strongest in weaker institutional environments, particularly in emerging economies. However, Djomo et al. [12] confirm the “grease the wheels” hypothesis in a context of weak democracy as well. Therefore, an in-depth analysis of the root causes of corruption is a prerequisite for eradicating corruption and achieving economic prosperity.

3. AML Regime of Sri Lanka

Sri Lanka became a founding member of the Asia Pacific Group on Money Laundering (APG) in 1997, with 12 other members. The AML/CFT legal framework of the country has evolved with three pieces of legislation, that is, the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 (CSTFA), the Prevention of Money Laundering Act No. 5 of 2006 (PMLA), and the Financial Transactions Reporting Act No. 6 of 2006 (FTRA). However, the AML regime of the country has not been developed to the level of the majority of the APG founding members, which is reflected in the results of previous mutual evaluation reports. Further, the process of the amendments to the AML/CFT legislation has been time-consuming without a proper outcome, as shown in Table 1¹.

¹Financial Intelligence Unit of Sri Lanka. (n.d.). *Annual reports*. Central Bank of Sri Lanka. https://fiusrilanka.gov.lk/annual_reports.html

This delay may lead to the future mutual evaluation process, as well as the initiatives of reducing corruption through strengthening the AML/CFT regime. The National Risk Assessment (NRA) is a suitable starting point for understanding the jurisdiction’s risk profile. According to Sri Lanka’s NRA-2023, drug trafficking, bribery and corruption, and customs-related offenses are key drivers of money laundering risk (FIU-Sri Lanka, 2022). The NRA results show bribery and corruption as the second main threat to combating money laundering in Sri Lanka, with a rating of medium-high level. Implementation of an effective AML regime in a corrupt society is questionable. Therefore, a sound AML legal framework alone may not be sufficient due to corrupt individuals in public authorities. Such a corrupt society needs fully structured and automated systems and controls in order to improve its effectiveness. Hence, this study proposes implementing a comprehensive payment ecosystem suggested by Jayasekara [13] not only to improve the effectiveness of the AML regime but also to provide a comprehensive solution for the fiscal management-driven issues affecting the economy. This background shows a weaker institutional framework in the Sri Lankan context, where the grease the wheel hypothesis [7, 8] cannot be held, and hence, the sand the wheel hypothesis could be held [11]. Therefore, in the Sri Lankan context, this study develops the hypothesis (H1) following previous studies rejecting the green the wheel hypothesis [3, 6, 4, 5].

H1: Corruption has a negative impact on economic growth.

4. Methodology and Data

The interest of this study is to assess the impact of corruption on economic growth, where a two-phase methodology is used to achieve the objectives. Previous studies on corruption and economic growth are based on quantitative econometric models [8, 12, 10]. However, this study proposes to use micro-level corruption-related events to justify the results of macro-level econometric models. Therefore, qualitative information will add value to the findings of econometric models. Therefore, this study uses a two-phase study as shown below to improve the validity of the study.

The first phase uses a quantitative approach to identify the links between economic growth and corruption as proposed by Nguyen and Bui [1], and the second phase uses a qualitative case study approach to provide additional evidence for the results of the first phase. This includes an analysis of 66 incidents reported on the CIABOC website from 2016 to 2023. The empirical results of the first phase show that corruption has a significant negative impact on the economic growth of Sri Lanka.

The second phase of evidence justifies the empirical findings, which show that during the considered period, there were only five instances out of 65 convicted cases where the offender had rejected the offered bribe and reported it to the authorities, which suggests that public officials are corrupt. It affects the implementation of an effective AML regime. The primary characteristics of CIABOC data are that corruption can be observed in both public and private sectors. Often, individuals and private corporations are forced to pay bribes in return for services obtained by them. In such a context, the effectiveness of manual intervention for the implementation of the rules and regulations in a corrupted society may not be effective, and hence, the need to consider implementing an automated comprehensive mechanism is a prerequisite to reducing the level of corruption. The limited commitment of the jurisdiction to implement a sound mechanism in terms of the FATF recommendations has resulted in this ineffectiveness. The corruption in all parts of the government organs and policymaking is a major concern for the ineffectiveness of the AML regime. On the other hand, the effective mechanism is essential to combat corruption as well as to improve the confidence of investors, improving the ranking and quality in terms of CPI in the long run. This study provides novel conceptualization and novel evidence in the study of corruption and economic growth.

Two-phase analysis is used in this study, where the first phase analyzes the impact of corruption on economic growth using robust regression. Rousseeuw and van Zomeren [14] show that this approach eliminates the sensitivity to the presence of observations that lie outside the norm for the regression model of interest in least squares models, which can result in coefficient estimates that do not accurately reflect the underlying statistical relationship.

$$EG_t = \beta_1 + \beta_2CPI_t + \beta_3X_t + \epsilon_t \tag{1}$$

In this model, EG represents economic growth, while CPI serves as a proxy for corruption. The variable X denotes a set of control variables, which include Gross Capital Formation (GCF), Government Expenditure (GE), Corruption Control (CC), and Inflation (INF). It is the error in the model. These control variables are also used in some other studies [1, 15]. The details of the definitions of the variables are given in Table 2.

Data for the study are sourced from different databases, such as CPI, Transparency International, CC, Worldwide Governance Indicators of the World Bank, and all other macroeconomic indicators are obtained from the annual report of the [16].

The second phase of the study will involve an analysis of 66 bribery and corruption-related convictions. The quantitative findings from the first phase will strengthen the reliability and validity of the qualitative insights derived in the second phase.

Table 2
Variables and definitions

Variable	Definition
Economic Growth (EG)	Annual GDP growth rate (%)
Corruption Perception Index (CPI)	Corruption Perception Index compiled by Transparency International
Government Expenditure (GE)	Total government expenditure (% of GDP)
Corruption Control (CC)	The Corruption Control Index measures the effectiveness of a government’s efforts to control corruption. It is scored on a scale from -2.5, indicating weak control, to 2.5, indicating strong control
Gross Capital Formation (GCF)	Gross Capital Formation as a percentage of GDP
Inflation (INF)	Consumer prices (annual% %)

5. Results and Analysis

Table 3 presents preliminary statistics for the selected variables of the first phase of the study over the period from 1998 to 2023.

The empirical results are given below in Table 4.

The findings support the previous research, which provided evidence for a negative relationship between corruption and economic growth [3, 4, 5]. For control variables, only inflation shows a significant negative relationship with economic growth, following the results of previous studies (Nguyen & Bui, 2022; [15]). This strong negative relationship warrants an identification of micro-level issues in order to prevent corruption. Therefore, the second phase of qualitative analysis is performed below to identify

micro-level issues and to recommend appropriate measures. The qualitative analysis begins with the identification of the global position of Sri Lanka in terms of CPI, as shown in Figure 1, which shows a continuous deterioration in perception.

On the other hand, economic growth also shows a fragility during the same period, as shown in Figure 2 [16].

This context suggests analyzing widespread corruption in detail. In Sri Lanka, bribery and corruption have been identified as the second major threat to money laundering as per the NRA-2023. Having identified this issue, the IMF [17] sets a structural benchmark under the program in order to address deep-rooted corruption-related issues in Sri Lanka. However, there have hardly been any instances of corruption by rulers, officials, and businessmen mentioned in the early history of Sri Lanka,

Table 3
Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min.	Max.
EG	26	3.91	4.053	-7.30	8.50
CPI	26	34.96	2.55	31.00	40.00
GE	26	21.43	3.37	16.67	27.46
CC	26	-0.29	0.11	-0.49	-0.06
GCF	26	28.08	4.84	17.80	39.10
INF	26	8.65	8.40	2.20	46.40

Table 4
Estimation results of the robust regression model

Variable	Coefficient	Std. Error	z-Statistic	Probability
C	43.20874	8.511906	5.076270	0.0000***
CPI	-0.984706	0.141045	-6.981505	0.0000***
GE	-0.150333	0.153792	-0.977505	0.3283
CC	0.630350	3.240666	0.194512	0.8458
GCF	0.053260	0.072154	0.738150	0.4604
INF	-0.297202	0.031605	-9.403781	0.0000***

Dependent Variable: EG
Note: *significant at 1%**

Figure 1
Movement of the ranking of the Corruption Perception Index of Sri Lanka

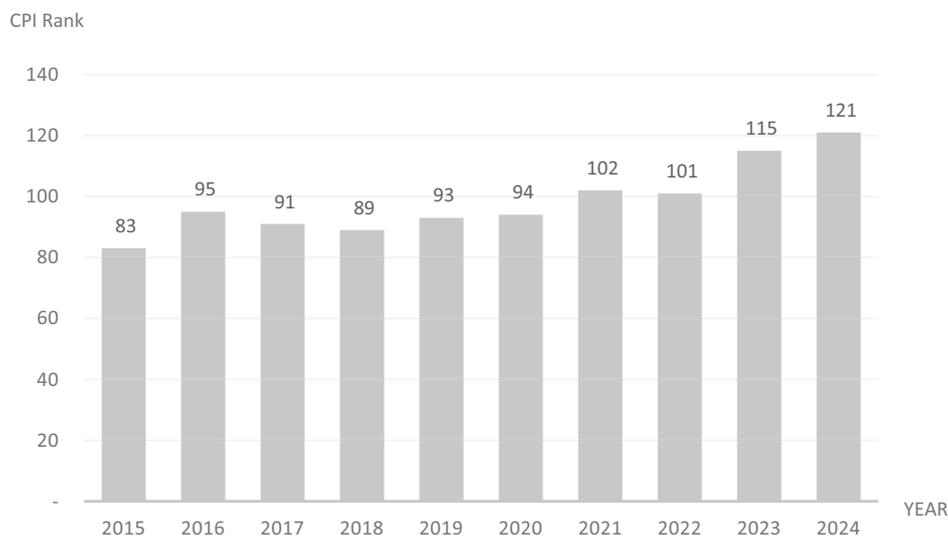


Figure 2
Movement of the economic growth of Sri Lanka

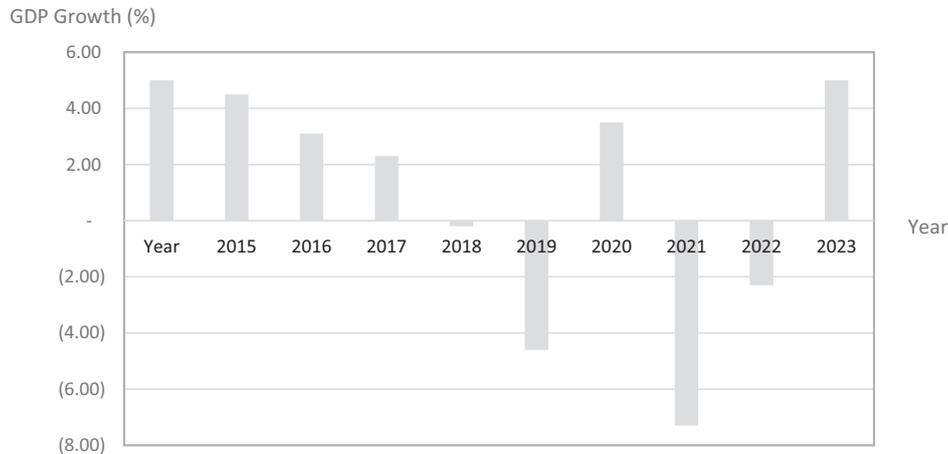
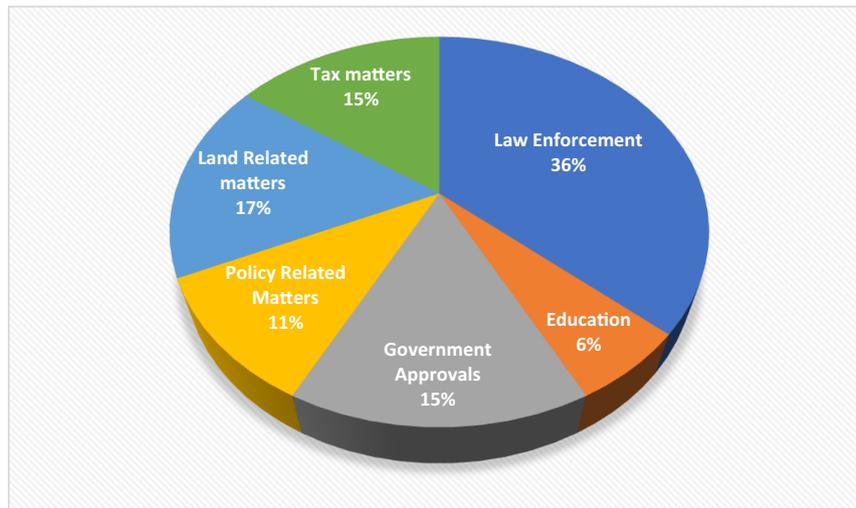


Figure 3
Disclosed convictions for bribery and corruption as of the end of 2023



probably because almost all lived virtuous, simple, and contented lives, influenced by the culture nurtured by the religious practices. However, this position has changed completely at present, and bribery and corruption have emerged as a growing challenge for the sustainable development initiatives of the country. The analysis of CIABOC cases in 2023 reveals bribery and corruption rooted across the majority of government institutions because result shows bribery or corruption from over 45 different segments of the public sector. These cases are related to education, administrative authorities, and politicians. This study analyses 66 convictions that were published in CIABOC and related to administrative matters, as shown in Figure 3².

The scope of the study will be limited to the identified themes in Figure 3. This study will not discuss bribery and corruption related to politicians due to the controversial nature of the incidents and the different views of the different segments of society. The corruption-related cases in the identified themes will be discussed to develop a methodology to provide a solution to reduce bribery and corruption in Sri Lanka.

5.1. Law enforcement

The analysis revealed that 24 convictions were related to law enforcement agencies, which included police, judicial officers, and other law enforcement agencies. The legal framework of a country needs to facilitate strengthening operational independence and autonomy for the effective law enforcement process. The structured mechanism, which focuses on developing the skills and competencies of law enforcement officials to act free from undue influence, maintain sufficient operational independence and autonomy, and display high professional standards and act with integrity, is a prerequisite in this process. Further, prompt actions are required to rectify the deficiencies and change the behavior of wrongdoers. Delays in addressing misconduct allegations against corrupt officers may undermine public confidence in the justice system. On the other hand, a close relationship between law enforcement officials and politically exposed persons may undermine the impartiality and credibility of investigations. According to Transparency International (2019), 73% of the public expressed moderate to high trust in the judiciary, compared to 57% for the police—highlighting concerns about the independence of law enforcement. In 2024, Sri Lanka ranked 121st on the

²Commission to Investigate Allegations of Bribery or Corruption. (2023). *Convictions*. <https://ciaboc.gov.lk/functions/prosecute/convictions>

Corruption Perception Index (CPI), with a score of 32 (Transparency International, 2024). The information revealed in CIA-BOC shows some instances of corruption related to the police. Some reports revealed instances where the high-ranked police officers were also part in corruption-related cases, which creates a serious concern over the integrity of the Sri Lankan Police.

5.2. Tax-related matters

Tax-related convictions also represent a sizable number of convictions reported on the CIABOC website. These convictions are related to the accumulation of undisclosed income, accepting bribes for tax manipulation, and non-submission of annual assets and liabilities, among others. The related cases suggest that the risk of tax-related corruption is moderate in Sri Lanka's tax administration. However, the corporate sector perceives that the tax regulatory framework is a major constraint to business and irregular payments and bribes are common in Sri Lanka. Therefore, it is essential to enhance the efficiency of the tax administrative system while reducing corruption to improve the revenue of the government. In such a context, anti-corruption initiatives coupled with technological advancement positively impact tax collection efficiency [18].

5.3. Land-related matters

A substantial portion (17%) of convicted cases are related to the corruption of government officials who were engaged in various approvals for land-related matters. A majority of lands, about 80% of all land, is state-owned, including waste, forest, unoccupied, or uncultivated lands, providing opportunities for corrupt officials. Therefore, there is a moderately high risk of corruption with respect to the process of land administration in Sri Lanka according to Gan Integrity (<https://www.ganintegrity.com/>).

5.4. Policy-related issues

Policymaking is another area where corruption could be observed. Jayasekara et al. [19] state that the policymaking of emerging economies is not effective due to conflicting interests of different government organs as agents of the principal, the public. Policymakers need to understand the needs of the public to protect their rights rather than protect the individual interests of policymakers. This proposition is supported by Ehrlich and Ziegert [20], stating that the center of gravity of legal development lies not in legislation, juristic science, or judicial decision but in society itself. This view is supported by Durkheim [21], who states that the nature of the social life of a society can be seen through its laws. According to him, the law mirrors society. In such a context, the law reproduces the principal forms of solidarity in society; hence, a corrupted society will not form a strong legal structure that supports social solidarity, and therefore, people will not enjoy what they are supposed to enjoy in a less corrupt society [21]. Corruption in policymaking happens when the statutory power entrusted to officials is abused for private gain [22]. Therefore, a strong governance system with modern technologies is a prerequisite to combat corruption [23]. In policymaking, corruption evolves because of the concentration of power with a limited number of people who can misuse the power to benefit personal gains. This happens due to a lack of a comprehensive mechanism

with systems and controls to monitor the activities of these people and deficiencies in the legal framework of the country.

5.5. Government approvals

The approval process of government agencies plays a vital role in granting permission to carry out restricted activities. These processors are not interconnected or integrated to improve timeliness and efficiency, which provides opportunities for corruption. Some reports from Gan Integrity (<https://www.ganintegrity.com/>) show that business entities face a moderate risk of corruption in obtaining approvals. These include some irregular payments or bribes, which are the most problematic factors for doing business in Sri Lanka [24]. This report reveals that the perception of about a quarter of Sri Lankans is that the majority or all local government officials are corrupt, and corruption is embedded in the government administration.

5.6. Education

Education is also affected by corruption. One of the main corrupt areas of education is related to the admission of children to reputed government schools. Even though the government provides a free education system by maintaining 8100 schools with a substantial number of staff of 250,000, which includes 150K teachers. These numbers represent about 20% of total government employees. However, the facilities available in each school are not equal, and some schools have emerged as reputed schools as a result of available facilities, reputation, and favorable treatment, among others, which has created huge competition for admissions. The government has also established a procedure for admission, which includes quotas for admission, that is, 25 % for old students, 50% for closed residents, and 10% for brothers/sisters. This mechanism has created a huge competition for school admissions. Convicted cases reported on the CIABOC website show examples of corruption related to inserting names fraudulently into the electoral register, accepting bribes by principals, and involvement of politicians, among others. This study adopts the human lifecycle to explore the origins of corruption within the country, forming the basis of the case study. The corruption lifecycle is modeled on the human lifecycle to emphasize its continuous nature among individuals engaged in corrupt practices. This approach is particularly relevant, as intent plays a critical role in establishing criminal liability during legal proceedings.

The above analysis of convicted cases, which are reported on the CIABOC website, proposes that corruption has grown hand in hand with the human lifecycle in the Sri Lankan context. In such a context, the corruption eradication process needs to be developed with minimal intervention from people. Therefore, these types of countries need to think of developing a comprehensive system where individuals cannot intervene and make changes to the system with an ulterior motive. Corruption in education is primarily due to a lack of transparency and minimal use of modern technology to administer operations. In such a context, Ibrahimy et al. [23] argue that corruption and lack of transparency remain critical challenges in governance systems around the world. They suggest that the adoption of smart contract blockchain technology is useful to reduce corruption and improve transparency, while reducing human interference. On the other hand, it can be argued that the blockchain can be used to improve governance mechanisms and reduce corruption.

However, this initiative is challenging in emerging economies because the prevailing legal framework does not support the agenda [25]. On the other hand, Jayasekara et al. [19] show that serious agency conflicts exist between the public and main government organs in weak regimes, which are detrimental to the crime-free society of people. Therefore, the principal, the public needs to influence the agents to make reforms in order to reduce corruption and make the country a crime-free country. However, this task is very challenging because corruption in most emerging economies goes hand in hand with the human lifecycle.

6. Policy Recommendations for Controlling Corruption

Eradicating corruption seems impossible due to the inherent nature of people. Hence, Firman et al. [26] suggest that the government and all of its institutions must play an active role in developing a culture to eradicate corruption. Providing early knowledge of the dangers and adverse implications of corruption is vital in this initiative. This strategy may work in countries where people strongly adhere to religious practices that are driven by moral and ethical values. However, moral values deteriorate in corrupt institutions, and restating is also challenging. In such a context, digitalization may help to control corruption due to minimal human intervention. Further, Hortal and Martínez [27] suggest replacing traditional approaches with nontraditional approaches such as nudges and sludge audits or leveraging digital choice architectures to minimize human-to-human interactions, which are known corruption enablers. Therefore, this study proposes to implement a nationwide payment ecosystem based on blockchain technology to link all economic actors of an economy, including individuals, businesses, and other legal people, and all government entities, considering the basic accounting equation as shown below.

$$\text{Assets} = \text{Equity} + \text{Liabilities} \tag{2}$$

Considering the above equation (2), all transactions of an economy can be categorized broadly into the categories concerning all economic actors, as shown in Table 5.

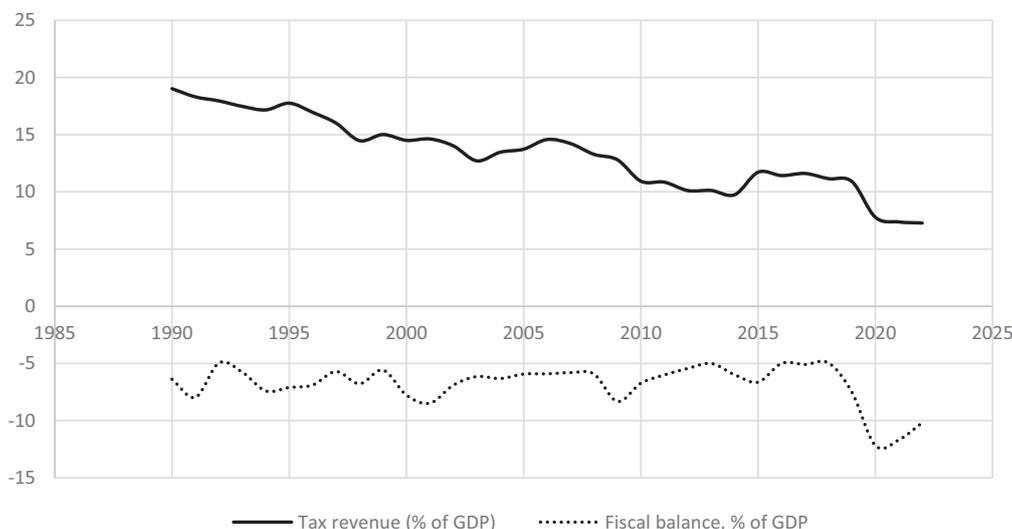
Table 5
Main categories of transactions for a payment ecosystem

Individuals	Businesses/Institutions	Government
Income	Income	Income
Expenditure	Expenditure	Expenditure
Assets	Assets	Assets
Liabilities	Liabilities	Liabilities
	Equity	Reserve

A payment ecosystem needs to be developed, considering the list of transactions that can be grouped into the above equation and facilitated through digital currency, which will reduce the cost of minting and printing currencies and promote sustainability in the long run. Having identified the issues related to corruption, the IMF [17] also proposes several reforms in different segments to reduce corruption while improving overall governance structures. These reforms may ensure a speedy recovery, changes in ownership structures, improved revenue mobilization, and safeguarding financial stability, among others. Hence, the payment ecosystem could work as the ideal framework for reforms in the country to eliminate bribery and corruption.

The legal framework, which is highly dependent on human intervention, has eroded the credibility of delivering justice to the citizens due to corruption. This perceived mentality has forced the public to avoid tax payments. Taxpayers are also keen on monitoring the transparency of the use of tax revenue, and they expect the government to manage fiscal affairs efficiently and without corruption. The primary issue of the country is the growing fiscal deficit, characterized by the decreasing trend of tax revenue as a percentage of gross domestic product (GDP), as shown in Figure 4 (World Bank, 2023). The increased level of corruption has aggravated the fiscal issues of the government.

Figure 4
Movement of tax revenue and fiscal balance as a percentage of GDP in Sri Lanka, 1990–2022



IMF [28] shows that systemic corruption in Sri Lanka is higher than the average in Asian countries and has increased during 2012–2022. Having reviewed the progress of the extended fund facility, IMF [17] also suggests implementing revenue-based fiscal consolidation reforms to address long-rooted fiscal issues due to limitations of previous policies. This clearly shows the level of corruption in policymaking. Also, the tax-to-GDP ratio of Sri Lanka is very low in comparison to the other lower-middle-income countries, as shown in Table 6 (World Bank, 2024), which indicates a need for structural reforms to improve the tax revenue of the government.

Table 6
GDP per capita and tax-to-GDP ratio of selected lower-middle-income countries, 2023

Country	GDP Per Capita (US\$)	Tax-to-GDP ratio (%)
Bhutan	3704.0	14.5
Lebanon	3350.3	15.4
Egypt	3512.6	12.5
Morocco	3672.1	22.11
Sri Lanka	3828.0	7.27

The current mechanism of tax collection is heavily criticized due to the corruption and inefficiencies in the institutional framework. There were malpractices in the administration process of the value-added tax regime, where, in some instances, tax levied by third parties from government institutions had not been recovered properly, or in other instances, there were delays in the recovery process [29]. It further reveals that these inefficiencies had paved the way for those parties to misappropriate the taxes.

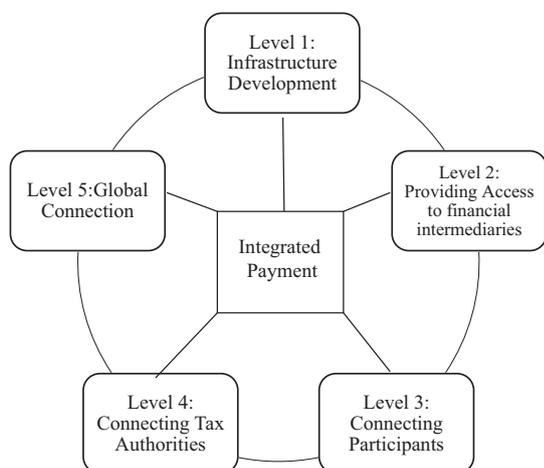
Therefore, this study proposes implementing a comprehensive payment ecosystem to improve the tax revenue of the government and reduce the level of corruption. This development needs to be structured in five levels as shown in Figure 5.

The first level involves developing a comprehensive database to capture information on natural persons and legal persons, and legal arrangements of the country. The Department for Registration of Persons (DRP), established under the Registration

of Persons Act No. 32 of 1968 (as amended), is the sole authority responsible for maintaining the National Persons Registry and issuing national identity cards. The registry is an electronic system based primarily on the demographic data of citizens aged 15 and above. However, it is appropriate to establish a mechanism to issue a unique identification number for each individual to build a database of assets and liabilities for each individual, which can be initiated with the birth certificate. The government expenditure that applies to individuals on health, education, and other welfare facilities should be assigned as a liability for each person, so that they will understand the responsibility of a citizen. DRP provides a “NIC Look Up” service that enables clients to verify the details on identity cards issued by the department. This current system is not a comprehensive and reliable system that is intended to verify the potential customers of reporting institutions. Further, DRP has provided limited access to financial institutions to verify the identity of clients. The current national identification system is inadequate for financial institutions due to outdated and incomplete database records. Biometrics are not available, and the non-availability of records for some national identity cards (NICs) in the DRP database, among others. Further, the Election Commission maintains an electoral register with the details of the eligible citizens. Therefore, the government needs to think of establishing a comprehensive central database in order to avoid duplication and improve efficiency in all economic activities through reduced costs. To ensure reporting institutions have access to independent and reliable information, a formal mechanism should be established. The Credit Information Bureau of Sri Lanka (CRIB), founded under Act No. 18 of 1990, serves shareholder lending institutions by collecting and disseminating credit and financial data on borrowers. CRIB provides this information upon request to both lending institutions and the respective borrowers, promoting credit discipline within the financial sector. Additionally, reporting institutions may verify customer information through previous employers or by requesting utility bills. This mechanism needs to be further improved to share the information with interested parties with proper systems and controls.

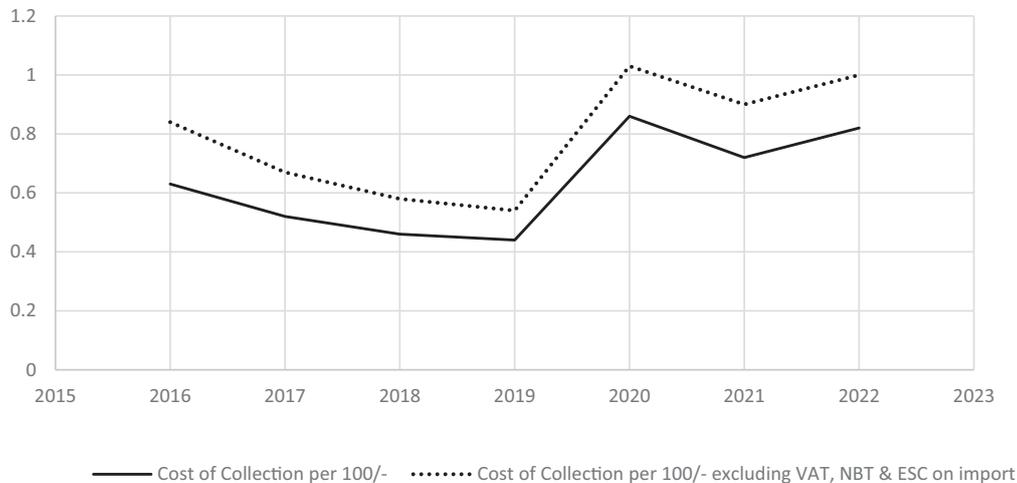
The Registrar of Companies is responsible for incorporating legal entities under the Companies Act No. 7 of 2007. Section 120 requires that incorporated companies maintain several specific records for public inspection, including the certificate of incorporation, articles of association, share register, registers of directors and secretaries, and details of the registered office. These records must be accurate and up-to-date. Under Section 483, competent authorities may access this information. However, Sri Lanka currently lacks a centralized repository for beneficial ownership data. Despite this, reporting institutions are required to collect beneficial ownership information during customer due diligence (CDD) processes³. The FIU-Sri Lanka has issued guidelines to reporting institutions regarding the identification of beneficial ownership. Level I requirements will be fulfilled upon the establishment of centralized databases for natural and legal persons. The second level expects financial intermediaries to use the developed infrastructure. Financial institutions incur a substantial cost for customer onboarding. The cost involved in strengthening the anti-money laundering and countering the financing of terrorism (AML/CFT) framework in financial institutions is rising due

Figure 5
Levels of payment ecosystem



³Guidelines on Identification of Beneficial Ownership for Financial Institutions, No. 04 of 2018, and Guidelines for Designated Non-Finance Businesses on Identification of Beneficial Ownership, No. 02 of 2019

Figure 6
Tax collection efficiency of the Inland Revenue Department of Sri Lanka



to global monitoring and hence increases the cost of businesses. Policymakers need to focus on reducing the cost of onboarding, allowing financial institutions to obtain the required information in a timely manner. Making easy access to central databases of natural persons and legal persons will facilitate the CDD process of financial institutions and reduce the cost of CDD, which will be beneficial for all stakeholders of the economy.

The third level involves connecting individuals, legal people, and various institutions of the government to the developed financial infrastructure of the payment ecosystem. Here, it is required to categorize all transactions in terms of the basic accounting equation. A government policy of restricting transactions through physical currencies will encourage the development of the payment ecosystem and reduce the cost of handling physical currencies. This motive will lay the foundation for a digital economy. Liu et al. [30] state that the digital economy in China has experienced rapid development due to the rapid rise of financial technology such as blockchain, big data, the internet, and cloud computing. A shift to digital currency facilitates a country to use printing and minting costs and other administrative costs for other important areas for sustainable growth. Printing and minting costs are substantially higher in the global context. For example, the projections of printing US\$ are shown in Table 7⁴.

Table 7
Variable cost of US\$ printing

Denomination (US\$)	Variable Cost per Note (US\$)
1 and 2	0.028
5	0.048
10	0.048
20	0.053
50	0.052
100	0.086

The move toward a digital currency-based payment ecosystem will save a substantial amount of cost while driving sustainability in the long run.

The fourth level suggests connecting tax revenue-collecting authorities to the payment ecosystem, which will reduce the cost of tax collection while improving the government’s tax revenue, tax base, and the efficiency of the process. The macroeconomic issues of Sri Lanka are built around fiscal inefficiencies. The efficiency of Sri Lanka is shown in Figure 6 [31].

The ecosystem automatically captures the eligible persons for direct and indirect taxes based on the predetermined thresholds. This process will improve the efficiency of the tax collection process due to minimal human intervention and less documentation and will result in a lower cost of collection. The level of corruption will also be reduced due to the transparency of the process.

The final level of the ecosystem is expected to integrate the infrastructure with international counterparts. Global adoption will improve the effectiveness of initiatives for combating financial crimes, providing all countries with inclusive, sustainable growth. The proposed payment ecosystem is structured in a way that the assets and liabilities of each person are recognized at any time, which will facilitate the sustainable development initiatives. The core of achieving sustainability is to allocate resources efficiently while preserving resources for future generations to come. The ecosystem will facilitate people to understand their responsibilities in a broader view. A common issue of many emerging economies is the migration of skilled human resources, which were developed using the limited resources. On the other hand, receiving countries enjoy competent and skilled resources at no cost, depriving the development goals of emerging economies. If a proper liability could have been assessed, the losing country could have recovered the cost of investment in the particular person. Therefore, the ultimate responsibility of an ethical person should be at least to contribute towards a net-zero level of obligations toward the liability of the government. On the other hand, a global initiative is needed to compensate for the loss of resources to the emerging economies from the developed nations to achieve sustainability.

⁴Federal Reserve Board. (2025). *How much does it cost to produce currency and coin?* https://www.federalreserve.gov/faqs/currency_12771.htm

7. Conclusion

The empirical analysis reveals that corruption poses a significant obstacle to Sri Lanka's economic development, refuting the "grease the wheels" hypothesis, which suggests that corruption may positively influence economic growth under certain conditions [7]. Bribery and corruption are inherent problems of many emerging economies, which are a barrier to achieving sustainable development goals. Rule or principle-based policymaking will not be an effective mechanism for combating corruption-related crime due to human intervention. On the other hand, conventional economists will not capture human behavior-related corruption in their econometric models due to the challenges of identifying and measuring variables. Therefore, the policymaking process will not capture the corruption and human behavior-related issues, which are a grave problem in policymaking in emerging economies. Often, this passive behavior of policymaking results in deviating from framing a fundamental infrastructure for the economy, where international pressure needs to be used for the benefit of citizens. For example, the IMF [17] proposed various reforms as prior actions for the 48-month extended fund facility granted to Sri Lanka. However, if the policymakers had addressed these issues in a timely manner, the gravity of the crisis might not have been so serious. Hence, passive policymaking also could be viewed as a part of corruption. On the other hand, as evidenced by our analysis of convictions reported on the CIABOC website suggests that the government administrative structure, as well as the law enforcement process, are corrupted, causing serious concerns over the reliability of the functions of such institutions. Therefore, it is required to reduce the manual intervention in the systems and procedures of these institutions to restore public confidence and reduce corruption. The payment ecosystem will provide solutions to reduce corruption as a result of minimal human intervention, and efficiency will be improved in all aspects. The payment ecosystem will enhance the traceability of transactions and, hence, improve the effectiveness of the law enforcement process. Therefore, implementing a payment ecosystem will improve the overall effectiveness of combating money laundering and terrorist financing in broader aspects compared to the implementation of the AML regime, which requires extensive human intervention. Finally, this study was conducted in the Sri Lankan context, where the cases referred may not be appropriate for other jurisdictions, particularly with regard to the components and qualitative data used to justify the findings of phase 1.

Ethical Statement

This study does not contain any studies with human or animal subjects performed by the author.

Conflicts of Interest

The author declares that he has no conflicts of interest to this work.

Data Availability Statement

The data that support the findings of this study are openly available in Transparency International at <https://www.transparency.org/en/gcb> and <https://www.transparency.org/en/cpi/2024> and the World Bank at <https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS> and <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD>.

Author Contribution Statement

Sisira Dharmasri Jayasekara: Conceptualization, Methodology, Software, Validation, Formal analysis, Investigation, Resources, Data curation, Writing – original draft, Writing – review & editing, Visualization, Supervision, Project administration.

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How to Cite: Jayasekara, S. D. (2026). Impact of Corruption-Driven Vulnerabilities of an Emerging Economy in Achieving Economic Prosperity and Strengthening the Anti-Money Laundering Legal Framework. *FinTech and Sustainable Innovation*. <https://doi.org/10.47852/bonviewFSI62027175>