6

FISCAL POLICY AND GOVERNMENT FINANCE

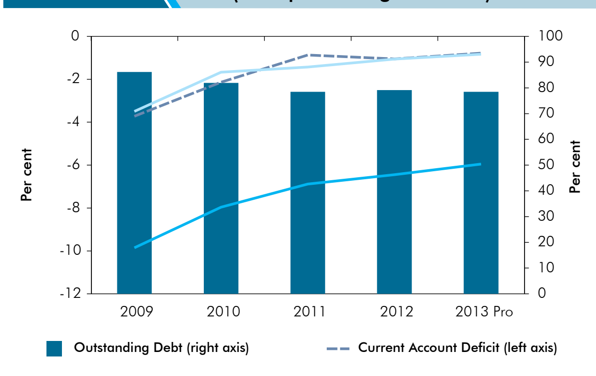
6.1 Overview

The fiscal policy strategy of the government was focused towards further consolidation of the fiscal deficit while supporting the medium term objective of achieving a sustainable and regionally balanced growth. Accordingly, fiscal reforms introduced in the recent past were further strengthened during the year. On the revenue front, tax reforms were introduced to broad base the tax system, rationalise tax exemptions and concessions, minimise opportunities for manipulation, improve efficiency and simplify the tax system, which would help to improve government revenue as a percentage of GDP. On the expenditure side, several measures were taken to rationalise recurrent expenditure while maintaining public investments at a desired level, complementing the improvement in the overall investment level of the country. Debt management strategy was focused on meeting the government financing requirement at a lowest possible cost while maintaining risks at a minimum level.

The fiscal policy strategy was formulated in line with the Medium Term Macro Fiscal Framework (MTMFF) for 2013-2016 in order to reduce the budget deficit further while creating a conducive environment for achieving accelerated economic growth. The budget deficit for 2013 was expected to be reduced to 5.8 per cent of GDP from 6.5 per cent of GDP recorded in 2012. Accordingly, an increase in government revenue to 14.5 per cent of GDP from 13.9 per cent in 2012 and a reduction in recurrent expenditure to 14.6 per cent of GDP from 14.9 per cent in 2012, with public investments maintained at around 6.1 per cent of GDP were targeted in the budget for 2013. However, lower than expected performance in government revenue during the first half of 2013 due to the decline in import related tax collections arising from the reduction of imports of motor vehicles and fuel, tax exemptions and concessions granted to support domestic economic activities and lower transfers of profit and dividends from government institutions, and the continuation of ongoing infrastructure projects were the major challenges of meeting fiscal targets during the year. The government successfully faced these challenges through rationalising its expenditure programme without disturbing the growth momentum of the economy.

The budget deficit was maintained at 5.9 per cent of GDP in 2013 reflecting a slight deviation from the budgetary target of 5.8 per cent of GDP envisaged for the year; nonetheless, a notable improvement from the deficit of 6.5 per cent recorded in 2012. Revenue as a percentage of GDP declined to 13.1 per cent in 2013 from 13.9 per cent in the previous year, mainly due to the decline in government revenue from import related taxes. However, the reduction in total expenditure and net lending of the government from 20.5 per cent of GDP in 2012 to 19.2 per cent of GDP in 2013 was a positive development reflecting the firm commitment of the government towards the fiscal consolidation process. Tight monitoring of recurrent expenditure outlays enabled the government to reduce recurrent expenditure to 13.9 per cent of GDP in 2013 from 14.9 per cent of GDP in 2012. Capital expenditure and net lending also declined as the government had to prioritise its public investment programme and public investment as a percentage of GDP was 5.5 per cent in 2013 in comparison to 5.9 per cent in 2012. The current account deficit, which reflects government dis-savings, improved to 0.8 per cent of GDP compared to 1 per cent of GDP in the previous year although it was expected to reduce to 0.1 per cent of GDP in the 2013 budget. Meanwhile, the primary deficit, which reflects discretionary fiscal policy of the government with the exclusion of interest payments from the overall deficit, declined to 0.8 per cent of GDP in 2013 from 1.1 per cent of GDP in the previous year, and it is marginally higher than the targeted level of 0.7 per cent of GDP. In financing the budget deficit, more reliance was placed on domestic sources, with the banking sector contributing 58 per cent to the total financing requirement. The debt to GDP ratio also declined to 78.3 per cent in 2013 from 79.2 per cent in 2012 continuing the declining trend observed in the recent past.

Chart 6.1 Major Fiscal Indicators (as a percentage of GDP)



6.2 Fiscal Policy Direction and Measures

The overall direction in the fiscal policy strategy of the government in 2013 was to further consolidate with the reduction in the budget deficit to 5.8 per cent of GDP through higher revenue mobilisation and proper management of public expenditures. Accordingly, government revenue was envisaged to increase with a favorable impact from recent tax reforms introduced to simplify and broad base the tax regime, while expenditure was expected to moderate through rationalisation of recurrent expenditure and maintenance of public investment at the desired level. Accordingly, as a percentage of GDP the current account deficit and primary account deficit were expected to reduce to 0.1 per cent and 0.7 per cent, respectively in 2013 from 1 per cent and 1.1 per cent in 2012. In addition, public investment was expected to be maintained at 6.1 percent of GDP in 2013 in comparison to 5.9 per cent of GDP in 2012.

Various income tax concessions were introduced in 2013 with a view of encouraging exporters, upgrading technology of certain industries and enhancing foreign investment flows while creating an investor friendly environment in the country. Accordingly, several

Table 6.1 Summary of Government Fiscal Operations

Item	2012	2013 Approved Estimates	2013 Provisional	2014 Approved Estimates
	Rs. million			
Total Revenue and Grants	1,067,532	1,277,544	1,153,306	1,469,493
Total Revenue	1,051,460	1,257,544	1,137,447	1,437,493
Tax Revenue (a)	908,913	1,131,041	1,005,895	1,274,600
Non Tax Revenue	142,547	126,503	131,552	162,893
Grants	16,071	20,000	15,859	32,000
Expenditure and Lending Minus Repayments	1,556,499	1,784,944	1,669,396	1,985,619
Current	1,131,023	1,267,390	1,205,180	1,328,283
Capital and Net Lending	425,476	517,554	464,216	657,336
o/w Public Investment	443,973	529,250	481,203	668,465
Current Account Surplus (+)/Deficit (-)	-79,563	-9,846	-67,733	109,210
Primary Account Surplus (+)/Deficit (-)	-80,469	-62,600	-72,083	-75,091
Overall Fiscal Surplus (+)/Deficit (-)	-488,967	-507,400	-516,090	-516,126
Total Financing	488,967	507,400	516,090	516,126
Foreign Financing (b)	286,455	148,000	123,700	286,850
Domestic Financing	202,512	359,400	392,390	229,276
Market Borrowings	202,512	359,400	379,390	229,276
Non Bank	70,985	289,400	82,414	129,276
Bank	131,527	70,000	296,977	100,000
Monetary Authority	16,101	n.a.	-164,836	n.a.
Commercial Banks	115,427	n.a.	461,813	n.a.
Non Market Borrowings	-	-	13,000	-
	As a percentage of GDP			
Total Revenue and Grants	14.1	14.7	13.3	14.8
Total Revenue	13.9	14.5	13.1	14.5
Tax Revenue (a)	12.0	13.0	11.6	12.8
Non Tax Revenue	1.9	1.5	1.5	1.6
Grants	0.2	0.2	0.2	0.3
Expenditure and Lending Minus Repayments	20.5	20.5	19.2	20.0
Current	14.9	14.6	13.9	13.4
Capital and Net Lending	5.6	6.0	5.4	6.6
o/w Public Investment	5.9	6.1	5.5	6.7
Current Account Surplus (+)/Deficit (-)	-1.0	-0.1	-0.8	1.1
Primary Account Surplus (+)/Deficit (-)	-1.1	-0.7	-0.8	-0.8
Overall Fiscal Surplus (+)/Deficit (-)	-6.5	-5.8	-5.9	-5.2
Total Financing	6.5	5.8	5.9	5.2
Foreign Financing (b)	3.8	1.7	1.4	2.9
Domestic Financing	2.7	4.1	4.5	2.3
Market Borrowings	2.7	4.1	4.4	2.3
Non Bank	0.9	3.3	1.0	1.3
Bank	1.7	0.8	3.4	1.0
Monetary Authority	0.2	n.a.	-1.9	n.a.
Commercial Banks	1.5	n.a.	5.3	n.a.
Non Market Borrowings	-	-	0.1	-

(a) This includes the amount of VAT exemptions granted for specified projects and the amount of tax concessions granted on import of vehicles by public servants.
(b) Includes rupee denominated Treasury bonds and Treasury bills issued to foreign investors, the Sri Lankan diaspora and migrant workers.

Source: Ministry of Finance and Planning

tax exemptions were granted for interest income and fees earned from investments made in foreign currency. Profit and income received from the export of goods manufactured in Sri Lanka was liable to income tax at 12 per cent to encourage manufacturing exports while triple reductions was given for research and development activities. In addition, the income tax rate applicable to unit trust management companies was reduced to 10 per cent to encourage the industry. Further, the cost of acquisition of any plant, machinery or equipment was allowed to be deducted when ascertaining profits of selected industries to encourage technology upgrades.

Several measures were introduced to broaden the tax base under the Value Added Tax (VAT) and the Nation Building Tax (NBT) while supporting selected domestic economic activities through exemptions and concessions. Accordingly, VAT was extended to wholesale and retail businesses with a view to enhancing the revenue collection. In addition, selected locally manufactured products were exempted from VAT to promote locally manufactured products while the Small and Medium Enterprises (SMEs) with an annual liable turnover not exceeding Rs. 12 million were exempted from VAT and NBT to encourage the SME sector. On the other hand, supplies made by the Central Bank of Sri Lanka and public corporations were exempted from VAT and NBT to simplify the tax system. Further, solar panel modules and solar home systems were exempted from NBT to encourage the use of renewable energy sources. In order to further streamline the Simplified Value Added Tax (SVAT) scheme, several amendments were incorporated to the VAT Act and relevant guidelines were issued for mandatory registration and the introduction of penal provisions for non compliance.

The four band tariff structure was further consolidated in line with the simplification of the tax system to facilitate production and trade. The existing tax rates of 0 per cent, 5 per cent, 15 per cent and 30 per cent were revised as 0 per cent, 7.5 per cent, 15 per cent and 25 per cent. The zero per cent rate is applicable on essential inputs which are not manufactured locally while the

7.5 per cent rate is for raw materials and semi raw materials. Tariff rates applicable for intermediate goods and end user products are 15 per cent and 25 per cent, respectively. Further, duties applicable on gold were revised twice with a view to discouraging gold imports which had surged during the first half of the year due to a decline in gold prices in the international market. Accordingly, Customs duty of 5 per cent and a surcharge of 100 per cent on Customs duty were levied on gold imports in June. In November the Customs duty was increased to 7.5 per cent and the surcharge was fully removed.

Several changes were made to the Special Commodity Levy (SCL) and other import related taxes during the year to protect domestic agriculture and encourage value addition in local industries while stabilising prices of essential commodities in the domestic market. Accordingly, the SCL on importation of sugar, potatoes, red onions and b'onions was revised periodically to support domestic producers by allowing them to maintain a higher producer margin. Further, the SCL was introduced for five new items namely yogurt, butter, margarine, Palm kernel and salt for a period of four months to encourage local production. Cess was imposed on importation of several goods such as poultry fats, mosquito coils, batteries etc. while Cess on some other imports of goods was revised upward to encourage domestic industries to enhance their value addition. Cess on exports of pepper, cinnamon, clove, nutmeg and cardamom was introduced to promote local value addition. Further, importation of solar panel modules and accessories or solar home systems was exempted from Ports and Airports Development Levy (PAL) to encourage renewable energy usage in the country while PAL was introduced for medicaments of Ayurveda/herbal preparations.

Several other measures were also introduced to the tax system to enhance the tax revenue collection. Excise duty on cigarettes and liquor was increased to enhance government revenue . The tax structure of the betting and gaming industry was rationalised with the introduction of an all-inclusive 5 per cent levy on gross collections in lieu of all indirect taxes levied on these activities. Further, the higher income tax rate of 40 per cent applicable on betting businesses was maintained while the annual levy payable was increased with a view to enhancing revenue from such businesses. The stamp duty, which is considered as a provincial council revenue, was revised upward on insurance policies, notary warrants, periodic licenses to carry on trade businesses etc.

On the non tax front, several initiatives were made to enhance the non tax revenue collection. Accordingly, the embarkation levy was increased from US dollars 10 to US dollars 25 and the visa fee increased by US dollars 5. Further, fees and charges of the Department of Registrar of Companies and the Registrar General's Department, day book entry registration fees and the annual revenue licensing fee for motor vehicles were revised upwards. However, the telecommunication levy applicable on internet broadband connections was reduced to 10 per cent from 20 per cent to encourage the use of internet broadband facilities in line with the 5 + 1 hubs strategy.

Revenue collection agencies upgraded their information and communication technologies to improve tax administration and revenue collection. Sri Lanka Customs implemented the "ASYCUDA" World (AW) computer system for on line clearing of imports and exports. The AW system increases the efficiency of international transactions by eliminating operational delays and minimising operational costs. In addition, the Sri Lanka Customs established reference values for commodities that are prone to undervaluation with values declared below the reference value flagged for further scrutiny helping to increase compliance.

In order to overcome the difficulties of manual tax filing system, the Department of Inland Revenue (IRD) is in the process of preparing an automated tax payment method - "Revenue Administration Management Information System" (RAMIS). Meanwhile, several steps were taken by the Excise Department to improve tax administration and collection through computerising and integration of Tax Information Collecting Centers.

On the expenditure front, the government introduced several measures to maintain a well managed public expenditure programme. Accordingly in 2013, several policy measures were made to ensure prudent management of both recurrent and capital expenditure. With regard to recurrent expenditure management, the National Budget Circular No.157 was issued requesting all spending agencies to adhere to the annual provision limits allocated for fuel, electricity, water and transportation. Further, payments for overtime were curtailed by limiting overtime payments to essentials. Line ministries were also encouraged to setup their expenditure programmes in line with the MTMFF. Public sector cadre management initiatives were carried out in order to ensure timely recruitment, better public service delivery and an optimum level of human resources in the public sector. In addition, several measures were taken during the year to inculcate best practices in public sector procurement. The reappointment of the Procurement Planning Committee and the introduction of a new procurement policy to enhance competition, transparency and accountability in the procurement process were some of the measures taken to improve public sector procurement in 2013. In terms of capital expenditure management, line ministries were not permitted to utilise budgetary provisions allocated for activities which were not initially identified. In order to limit requests for additional provisions from spending agencies and minimise unforeseen overruns in the expenditure programme, spending agencies were requested to explore the possibility of using unutilised allocations or allocations provided for activities which have not yet commenced.

Salaries and wages of public sector employees and the pension allowance were revised upward in 2013. A special allowance of 5 per cent of the basic salary was granted to all public servants subject to a minimum of Rs. 750 and a maximum of Rs. 2,500 per month. For staff grade employees, 50 per cent of the proposed increase was paid from July 2013 and the balance from October 2013; and for non staff grade employees, 50 per cent of the proposed increase was paid from May 2013 and the balance from September 2013. Further, the Cost-of-Living Allowance (COLA) was increased by Rs.750 per month for all public servants. Meanwhile, the COLA paid to pensioners was increased by Rs. 500 per month. Further, a special allowance of Rs.750 per month was granted to pensioners who retired before 2004 while a sum of Rs. 500 per month was granted to those who retired from 2005 to 2006 with a view to correcting pension anomalies. In addition, service related allowances paid to judges, university academic staff, medical practitioners and specialised categories were also revised upwards and 50 per cent of the proposed increase was paid from January 2013 and the balance paid from July 2013.

The government continued to enhance the support extended to vulnerable groups in the society through various subsidy schemes. Existing income support programmes continued during the year to support impoverished groups in the society. Simultaneously, with the implementation of programmes such as "Divi Neguma" and "Gama Neguma", government shifted its approach for poverty reduction from welfare oriented approach to an inclusive growth based approach with the provision of new means for livelihood development and improvement of infrastructure facilities at rural level. The establishment of a new department under the name of "Divi Neguma Development Department" with the amalgamation of the Samurdhi Authority, Southern Development Authority and the Udarata Development Authority will enhance government support initiatives with regard to poverty alleviation, providing micro-finance facilities and developing physical and social infrastructure and human capital to uplift the living standards and develop livelihoods of people.

The public investment programme of the country which focused on developing the 5+1 hubs accelerated the implementation of several strategic economic and social infrastructure projects. Public investment during the period under consideration mainly focused on expediting economic infrastructure development activities in the areas of roads and bridges, power generation, irrigation, water supply, seaport and airport development. In addition, priority was given for social infrastructure development activities such as education, health and social welfare development programmes. The government also continued to channel resources to rural development initiatives such as "Divi Neguma", "Gama Neguma" "Maga Neguma" and other regional development initiatives to ensure a more regionally balanced growth while urban development initiatives such as the "Pura Neguma" city development programme continued.

The financial position of major SOEs improved during 2013 reflecting the impact of policy measures taken to improve financial viability. Measures were taken during the year to strengthen the balance sheets of selected SOEs and reduce their exposure to the banking system. In order to achieve higher revenue and to curtail losses of the Ceylon Electricity Board (CEB), a cost reflective tariff structure was introduced during the year. Meanwhile, the administrative price revisions made with respect to petroleum products and the elimination of subsidies in the sale of furnace oil by Ceylon Petroleum Corporation (CPC) to CEB for thermal power generation reduced the operational losses of the CPC in 2013. Several other changes were implemented in other SOEs as well, with a view to improving their governance and business operations. Accordingly, the SriLankan Airlines (SLA) had a capital infusion of US dollars 235 million during the year.

The government placed a greater emphasis on diversifying financing arrangements for urban infrastructure development with a focus on leveraging private capital. The dependence on lease rentals for urban infrastructure financing increased with more prime lands in the city of Colombo being leased out to the private sector for commercial activities. These new financing avenues are being used to improve underserved settlements in the city with the construction of new apartment units as part of the overall city beautification programme. This programme is implemented by the Urban Settlement Development Authority (USDA) and the Urban Development Authority (UDA) in close co-operation with private sector developers. Accordingly, it serves the dual objectives of provisioning housing with modern amenities to urban underserved low income communities, while facilitating private sector real estate development initiatives.

The Fiscal Management (Responsibility) Act No. 3 of 2003 was amended in 2013. Accordingly, the Fiscal Management (Responsibility) (Amendment) Act No. 15 of 2013 came into operation from 01.01.2013. The limit on the issue of government guarantees for borrowings made by SOEs, which is given as a percentage of GDP, was increased from 4.5 per cent to 7 per cent with the GDP calculated as an average of the current and two preceding financial years. Further, this amendment stipulates a reduction in the debt to GDP ratio to 80 per cent by 2013 and 60 per cent by 2020.

The public debt management strategy was focused on meeting the government's financing requirements at the lowest possible cost while maintaining a minimum level of risk. Measures were taken to replace part of the maturing Treasury bills with longer tenure Treasury bonds to address the issue of bunching of maturities while reducing the debt rollover risk. Accordingly, Treasury bonds with a maturity period of 30 years were issued in 2013. In addition, Sri Lanka Development Bonds (SLDBs) were issued with longer maturities and lower yield margins taking advantage of the positive investor sentiment. Meanwhile, the SLDB issuance limit was increased from US dollars 750 million to US dollar 2,250 million.

International rating agencies have affirmed the country ratings reflecting improved macroeconomic environment and improved investor confidence. Accordingly, Standard & Poor's affirmed its "B+" long-term sovereign credit rating with a stable outlook, while Fitch Ratings affirmed Sri Lanka at "BB-" with a stable outlook. However, Moody's Investor Service changed its outlook on Sri Lanka's "B1" foreign currency sovereign rating from positive to stable and affirmed its "B1" foreign currency government bond rating.

BOX 8 Sri Lanka Moving Towards Investment Grade

Sovereign credit ratings play an important role in determining a countries' access to international capital markets. They present an assessment of rating agencies on the factors that would support a sovereign's ability and willingness to repay its debt in full and on time. Credit ratings are intended to be forward-looking measurements formulated by rating agencies based on their analysis of a broad set of economic, social, and political factors. Credit ratings are broadly in the threshold between investment-grade and speculative-grade, with important market implications for issuers' borrowing costs. Achieving investment grade status not only lowers financing costs of a country with access to international capital markets but also expands the pool of potential buyers of a country's bond issuances. Ratings given by major credit rating agencies - Moody's Investor Services (Moody's), Standard and Poor's (S&P), and Fitch Ratings (Fitch) - summarise a vast amount of information with an implicit meaning attached to each rating scale for recognition by investors. The rating scale of "BBB/Baa" and higher scales are recognised within the investment grade and command aggressive investor preference in capital markets.

Jaramillo (2010) in a detailed study based on number of empirical researches recognises major determinants of sovereign ratings. Accordingly, the important macroeconomic variables referred in literature as strong drivers of a country's sovereign rating are per capita income, GDP growth, inflation, external debt, level of economic development and default history of a particular sovereign. In addition, findings also suggest that investment to GDP ratio and political variables play an important role in sovereign ratings of emerging market economies.

The same study, focusing on long-term foreign currency sovereign ratings data from major rating agencies, identified a set of potential determinants of investment grade status, which include macroeconomic indicators relating to real sector, external sector, government sector and financial depth and other variables as presented in Table B 8.1 with the expected sign of the impact on sovereign ratings. The major findings of the study suggest that efforts to improve on all fronts are desirable for a rating upgrade, particularly the public debt level, exports, financial depth and political stability which remain as strong drivers for investment grade among emerging market economies.

Going by the potential determinants of the investment grade status, Sri Lanka performed satisfactorily across all fronts. Substantial improvements recorded across majority of potential determinants place Sri Lanka in a strong position to achieve its medium-term macroeconomic targets. The potential determinants and its medium-term targets are presented in Table B 8.2.

In recent years, Sri Lanka's economic performance witnessed a structural shift towards a higher growth trajectory with more diversification of economic activity into new thrust areas. The economy recorded an average growth of 7.5 per cent during 2010-2013 period. In 2013, the economy expanded by 7.3 per cent, defying a regional slowdown as the nation remained one of Asia's best performing economies. Potential GDP growth of the economy is in a trajectory of over 7.8 per cent over the 2014-16 period. On government sector, Sri Lanka's infrastructure investments were mainly financed via aggressive public investment push of an average 6.2 per cent of GDP over the 2006-2013

Table B 8.1 Explanatory Variables and Expected Sign

Macroeconomic Indicators		Government Sector	
GDP per capita (US$ dollars)	+	Primary balance	+
Real GDP growth	+	External public debt to GDP	-
Potential GDP growth	+	Domestic public debt to GDP	-
Inflation rate	-	**Financial Depth**	
Unemployment rate	-	Broad money to GDP	+
External Sector		**Other**	
Exports to GDP	+	Political risk index ICRG	+
Current account balance to GDP	-	(higher index implies lower risk)	
Private external debt to GDP	-	Default history	-
NIR to GDP	+	Regional and Time dummies	

Note: The sign of each explanatory variable is indicative of the influence on the investment grade status.

Table B 8.2 Sri Lanka: Economic Indicators

Indicator	2005	2012	2013 Provisional	2016 Projected
Real sector				
GDP per capita (US$ dollars)	1,241	2,922	3,280	4,825
Real GDP growth (%)	6.2	6.3	7.3	8.3
GDP Deflator (%)	10.4	8.9	6.7	5.0
Unemployment rate (%)	7.2	4.0	4.4	n.a
External Sector				
Exports to Goods and Services to GDP (%)	32.3	22.8	22.4	24.7
Current account balance to GDP (%)	-2.7	-6.7	-3.9	0.1
Government Sector				
Overall Budget Deficit to GDP (%)	-7.0	-6.5	-5.9	-3.8
Public debt to GDP (%)	90.6	79.2	78.3	65.0
Financial Depth				
Broad money growth (%)	19.1	17.6	16.7	14.0
Other				
Default history	none	none	none	n. a.

Source: Central Bank of Sri Lanka

period. Despite high public investment allocation, the government continued to meet its fiscal deficit targets by incremental reduction in fiscal deficit over the past 5 years. Similarly, Sri Lanka's public debt levels improved substantially over the last decade to record 78.3 per cent of GDP in 2013. Another key positive factor in Sri Lanka's credit worthiness is its impeccable debt servicing record. Sri Lanka never defaulted its sovereign debt obligations in its history. Over the medium term, Sri Lanka aims at strengthening its small positive primary balance expected in 2014 and substantially progressing to reduce its debt to GDP level to around 65 per cent by 2016.

Earnings from exports are expected to strengthen further, thereby improving the trade deficit to around 7.2 per cent of GDP by 2016 from the current level of 11.3 per cent of GDP. The current account deficit in 2013 is expected to return to a balance position by 2016, driven mainly by improvement in trade balance and trade in services receipts. The continuous investments in infrastructure and value-chain industries together with productivity improvements and enhanced business facilitation via open and free ports have enabled domestic industries to be more competitive. Further, Sri Lanka has a key advantage of higher political stability, along with the commitment to implement decisive policy adjustments as observed in recent years.

The improvements in all macroeconomic variables in recent years in the projected direction and the positive outlook enable Sri Lanka with prospects of becoming an investment grade sovereign with further consolidation of potential determinants as discussed in recent literature.

References

Archer, Candace C., Glen Biglaise, and Karl DeRouen Jr., 2007, "Sovereign Bonds and the Democratic Advantage: Does Regime Type Affect Credit Rating Agency Ratings in the Developing World" International Organization: 61.

Jaramillo, Laura, 2010, "Determinants of Investment Grade Status in Emerging Markets" IMF Working Paper 10/117.

Mellios, Constantin, and E. Paget-Blanc, 2006, "Which Factors Determine Sovereign Credit Ratings" The European Journal of Finance, Vol. 12, No. 4, pp. 361–377.

Rowland, Peter, 2004, "Determinants of Spread, Credit Ratings and Creditworthiness for Emerging Market Sovereign Debt: A Follow-up Study Using Pooled Data Analysis," Borradores de Economía No. 296, Banco de la República de Colombia.

The government facilitated the banking sector to raise long term foreign funds as a part of their capital formation to provide long term funding for the SME sector, plantations, construction industry and other manufacturing industries. Accordingly, the National Savings Bank (NSB) issued an international bond of US dollars 750 million with a maturity of 5 years. The government assisted the issuance by floating domestic bonds (SLDBs and Treasury bonds) enabling the NSB to invest their surplus funds until bond proceeds are fully utilised for SME lending.

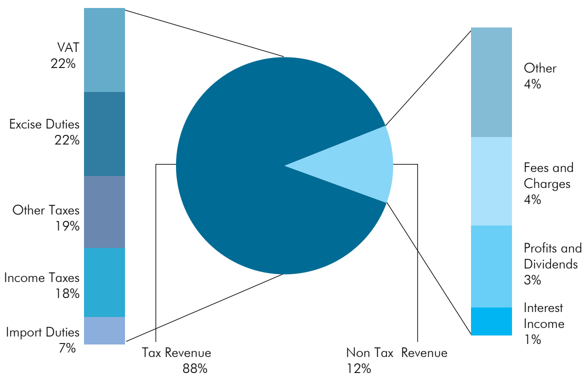
6.3 Government Budgetary Operations

Revenue and Grants

Revenue

Government revenue as a percentage of GDP declined to 13.1 per cent in 2013 in comparison to 13.9 per cent recorded last year due to a decline in both tax revenue and non tax revenue. However, total revenue in nominal terms increased by 8.2 per cent to

Chart 6.2 Composition of Government Revenue - 2013



Rs. 1,137.4 billion in 2013 from Rs. 1,051.5 billion in the previous year. This nominal increase in government revenue was due to the favorable performance in tax revenue during the second half of the year with a pickup in economic activity supported by the gradual recovery of the global economy. A considerable increase was also shown in revenue generated from corporate and non corporate income taxes including Pay-As-You-Earn

Table 6.2 Economic Classification of Revenue

Item	2012	2013 Approved Estimates	2013 Provisional	2014 Approved Estimates
	Rs. million			
Tax Revenue (a)	908,913	1,131,041	1,005,895	1,274,600
Income Taxes	172,563	221,984	205,666	283,318
VAT	229,604	283,354	250,757	303,232
Excise Taxes	223,960	247,256	250,700	266,333
Import Duties	80,155	97,303	83,123	94,556
Other Taxes	202,631	281,144	215,649	327,161
Non Tax Revenue	142,547	126,503	131,552	162,893
Total Revenue	1,051,460	1,257,544	1,137,447	1,437,493
	As a percentage of GDP			
Tax Revenue (a)	12.0	13.0	11.6	12.8
Income Taxes	2.3	2.6	2.4	2.9
VAT	3.0	3.3	2.9	3.1
Excise Taxes	3.0	2.8	2.9	2.7
Import Duties	1.1	1.1	1.0	1.0
Other Taxes	2.7	3.2	2.5	3.3
Non Tax Revenue	1.9	1.5	1.5	1.6
Total Revenue	13.9	14.5	13.1	14.5

(a) This includes the amount of VAT exemptions granted for specified projects and the amount of tax concessions granted on import of vehicles by public servants.

Source: Ministry of Finance and Planning

(PAYE), withholding tax, VAT on both domestic activities and imports, the SCL and excise tax on motor vehicles. Meanwhile a decrease in tax revenue was recorded specially from the Economic Service Charge (ESC) and PAL. The decline in tax revenue as a percentage of GDP was mainly due to a decline in total imports in comparison to 2012, extension of tax holidays given to businesses and the grant of exemptions and concessions for selected sectors to encourage production and value addition during the year. Non tax revenue declined as a percentage of GDP as well as in nominal terms due to a decline in profits and dividend transfers from state owned institutions including the Central Bank.

The declining trend in tax revenue as a percentage of GDP continued with tax revenue further declining to 11.6 per cent of GDP in 2013 from 12 per cent of GDP in 2012. In nominal terms, the actual tax revenue of Rs. 1,005.9 billion in 2013 deviated from the expected budgetary target of Rs. 1,131 billion due to a decline in revenue from ESC, PAL and lower revenue collection from excise tax on petroleum products. However, the share of tax revenue in total revenue increased marginally to 88.4 per cent from 86.4 per cent in 2012.

Revenue from income taxes increased reflecting increase in all income tax categories other than ESC mainly due to increased domestic economic activities and higher collection of withholding tax from issuance of government securities. The revenue from income taxes as a percentage of GDP increased marginally by 0.1 per cent to 2.4 per cent and in nominal terms by 19.2 per cent to Rs. 205.7 billion in 2013. Corporate and non corporate income tax increased by 23.1 per cent in 2013 amounting to Rs. 102.6 billion and commercial banking, finance and insurance, import and export trade, tobacco and alcoholic beverages and manufacturing sectors mainly attributed to this improvement. Revenue from withholding tax increased by 30.7 per cent in nominal terms to Rs. 77.9 billion increasing its share in tax revenue to 7.7 per cent in 2013 from 6.6 per cent in 2012 due to the substantial increase in issue of government securities with longer maturity. Further, tax revenue from the PAYE tax increased by more than 25 per cent in nominal terms recording Rs. 18.6 billion. However, revenue generated from the ESC decreased by 55.6 per cent to Rs. 6.6 billion in 2013 mainly due to exemptions introduced for businesses which are subject to income tax and the increase in the quarterly threshold to Rs. 50 million from Rs. 25 million with effect from April 01, 2012.

Expansion of VAT base in line with recent tax reforms mainly contributed to the increase in revenue collection from VAT. Revenue from VAT as a percentage of GDP slightly declined by 0.1 per cent to 2.9 per cent in 2013, although in nominal terms it increased by 9.2 per cent to Rs. 250.8 billion from Rs. 229.6 billion in 2012. This was achieved mainly due to expansion of the VAT base by imposing VAT on wholesale and retail business with quarterly turnover exceeding Rs. 500 million and expansion of domestic economic activities particularly during the second half of the year. VAT income generated from domestic economic activities as a percentage of GDP remained unchanged in 2013 although in nominal terms it increased by 13.8 per cent to Rs. 124.4 billion. In addition, VAT revenue from imports increased by 5.1 per cent to Rs. 126.3 billion in nominal terms.

Excise duties which are levied on goods with an inelastic demand generated more tax revenue with the upward revision of excise duty rates and growth in production and importation of these goods. Revenue from excise duties as a percentage of GDP slightly declined by 0.1 per cent to 2.9 per cent in 2013, although in nominal terms it increased by 11.9 per cent to Rs. 250.7 billion from Rs. 224 billion recorded in the previous year. An increase in excise duty rates and a surge in importation of motor vehicles by 17.6 per cent contributed to increase the excise duty collection from motor vehicles by 22.9 per cent to Rs. 96.5 billion. In addition, an upward revision of excise duty rates and increased malt liquor production by 21 per cent in 2013 compared to 2012 also positively contributed to enhance the revenue collection from the excise tax on liquor by 9.9 per cent to Rs. 66 billion. Excise duties on cigarettes and tobacco in nominal terms increased by 9.3 per cent to Rs. 58.6 billion in 2013 from Rs. 53.6 billion recorded in the previous year. Increased excise duties applicable on cigarettes led to an increase in tax revenue collection although cigarette sales declined by 6.4 per cent in 2013. Accordingly, the share of revenue generated from excise duties in tax revenue marginally increased to 24.9 per cent in 2013 from 24.6 per cent in 2012.

Import duties and SCL were used to generate more revenue while protecting local producers and consumers. Revenue from both import duties and SCL as a percentage of GDP remained unchanged at 1.5 per cent in 2013 while in nominal terms, revenue from both these two taxes increased by 14.1 per cent to Rs. 129.8 billion in 2013. Revenue from import duties increased only by 3.7 per cent to Rs. 83.1 billion mainly due to lower import duties and exemptions granted on selected items. Accordingly, import duties as a share of tax revenue decreased to 8.3 per cent in 2013 from 8.8 per cent in the previous year. However, revenue from SCL increased significantly by 38.7 per cent to Rs. 46.7 billion mainly due to upward revision of SCL applicable on certain items and the imposition of SCL on selected new items in order to protect domestic producers. Accordingly, the share of SCL in tax revenue increased to 4.6 per cent in 2013 from 3.7 per cent in 2012.

Revenue collection from NBT showed a slow growth mainly due to exemptions granted to SME sector and public corporations. Accordingly, revenue from NBT attributed to the central government remained unchanged at 0.5 per cent of GDP and in nominal terms it increased by 5.7 per cent to Rs. 40.9 billion in 2013 from Rs. 38.7 billion recorded in the previous year. Revenue from NBT through domestic goods and services increased by 9.4 per cent mainly due to a pickup in domestic economic activities in 2013. However, a marginal growth was recorded in revenue from NBT through imports reflecting a slower growth in imports. Accordingly, the share of NBT in total tax revenue marginally declined to 4.1 per cent in 2013 from 4.3 per cent in 2012.

Revenue from other taxes showed a mixed performance during 2013. PAL as a percentage of GDP, declined to 0.7 percent in 2013 from 0.9 per cent in 2012, and even in nominal terms it declined by 12.3 per cent to Rs. 61.5 billion from Rs. 70.1 billion mainly due to the removal of PAL on aviation fuel and a reduction in the applicable PAL rate on consumables for textile and apparel industry. Revenue collection from the Cess Levy increased by 10.2 per cent to Rs. 36.1 billion mainly due to the introduction of Cess on new items and an increase in the Cess Levy on selected items during the year. Revenue from the Telecommunication Levy increased by 9.7 per cent in nominal terms to Rs. 24.4 billion in 2013 although telephone density lowered compared to 2012. License taxes and other tax revenue also increased significantly by 17.2 per cent in nominal terms to Rs. 6 billion mainly due to increase in registration fees relevant to the Department of Registrar General.

Non tax revenue as a percentage of GDP as well as in nominal terms declined in 2013 compared to the previous year mainly due to lower profit and dividend generated from SOEs. Accordingly, non tax revenue as a percentage of GDP declined to 1.5 per cent from 1.9 per cent recorded in the previous year while in nominal terms it declined by 7.7 per cent to Rs.131.6 billion. However, it exceeded the budgetary target of Rs. 126.5 billion in 2013. Profit transfers from Central Bank declined significantly by 38.7 per cent to Rs. 26.4 billion from Rs. 43 billion recorded in 2012 while profits and dividend transfers from other SOEs declined to Rs. 35.2 billion from Rs. 46.8 billion in the previous year. However, revenue from fees and charges increased significantly by 54.3 per cent due to upward revision of selected fees and charges such as revenue licensing fee for motor vehicles while revenue from interest and rent also increased by 2.7 per cent. The share of non tax revenue in total revenue also declined to 11.6 per cent in 2013 compared to the 13.6 per cent in 2012.

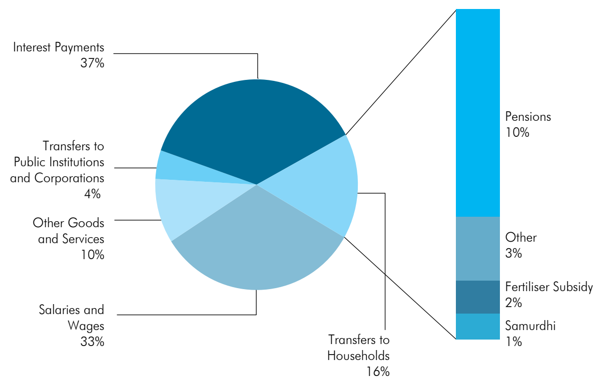
Grants

Disbursement of foreign grants declined marginally by 1.3 per cent in 2013 to Rs.15.9 billion compared to Rs. 16.1 billion recorded in the previous year and it was below the annual budgetary estimate of Rs. 20 billion. Foreign grants from multilateral donors significantly declined by 12.1 per cent to Rs. 6.5 billion in 2013 from Rs. 7.4 billion in 2012, and consequently the share of grants from multilateral sources in total grants declined to 41 per cent in 2013 from 46 per cent in 2012. In 2013 grants from bilateral sources slightly increased by 8 per cent to Rs. 9.3 billion from Rs. 8.6 billion in 2012.

Expenditure and Net Lending

Total expenditure and net lending as a percentage of GDP declined reflecting measures taken by the government to rationalise recurrent expenditure, while maintaining public investment to continue strategically important infrastructure development projects. As a percentage of GDP it declined to 19.2 per cent in

Chart 6.3 Composition of Government Current Expenditure - 2013



2013 from 20.5 per cent in 2012. The reduction of total expenditure and net lending as a percentage of GDP was the combined outcome of a reduction in recurrent expenditure by 1 percentage point and capital expenditure and net lending by 0.3 percentage points. However, in nominal terms total expenditure and net lending increased by 7.3 per cent (Rs. 112.9 billion) to Rs. 1,669.4 billion in 2013 from Rs. 1,556.5 billion in 2012.

Recurrent expenditure as a percentage of GDP declined demonstrating the government's commitment towards further rationalisation of recurrent expenditure over the medium term. According to the economic classification, as a percentage of GDP the recurrent expenditure declined significantly to 13.9 per cent in 2013 from 14.9 per cent in 2012. In nominal terms, recurrent expenditure in 2013 increased by 6.6 per cent to Rs.1,205.2 billion in comparison to Rs. 1,131 billion in 2012. However, recurrent expenditure in 2013 was lower than the original budgetary estimate of Rs.1,267.4 billion for the year. Despite the increase in expenditure recorded on salaries and wages, interest payments, and current transfers and subsidies, a decline in expenditure on other goods and services helped moderate the nominal increase in recurrent expenditure in 2013.

Interest expenditure as a percentage of GDP marginally declined owing to relatively low interest rates prevailed in the domestic market coupled with measures taken to reduce the share of short term debt in the total domestic debt stock. As a percentage of GDP the interest expenditure in terms of economic classification declined to 5.1 per cent of GDP in 2013 from 5.4 per cent of GDP in 2012. However, in nominal terms, interest expenditure increased by 8.7 per cent to Rs. 444 billion in 2013 from Rs. 408.5 billion in 2012. Meanwhile, interest payments continued to be the single largest recurrent expenditure item,

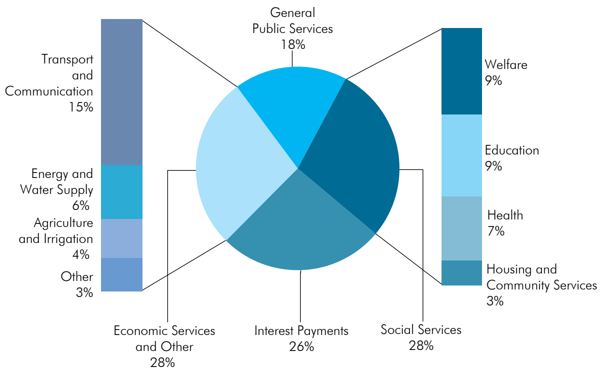
Table 6.3 Economic Classification of Expenditure and Lending Minus Repayments

Item	2012	2013 Approved Estimates	2013 Provisional	2014 Approved Estimates
	Rs. million			
Current Expenditure	**1,131,023**	**1,267,390**	**1,205,180**	**1,328,283**
Expenditure on Goods and Services	487,833	554,838	512,624	591,697
o/w Salaries and Wages	347,747	414,446	393,228	410,614
Interest Payments (a)	408,498	444,800	444,007	441,035
Foreign	90,839	85,000	100,985	76,000
Domestic	317,659	359,800	343,022	365,035
Current Transfers and Subsidies	234,692	267,752	248,549	295,551
o/w To Households and Other Sectors	187,895	215,966	195,288	233,526
Samurdhi	10,553	14,208	15,256	15,000
Pensions	111,682	129,100	122,813	136,210
Fertiliser Subsidy	36,456	37,800	19,706	38,000
Other	29,203	34,858	37,512	44,316
Capital Expenditure	**400,082**	**498,179**	**454,303**	**641,123**
Acquisition of Real Assets	197,350	297,318	252,535	406,697
Capital Transfers	202,732	209,462	201,768	234,426
Provision for Under Expenditure	-	-8,600	-	-
Lending Minus Repayments	**25,394**	**19,375**	**9,913**	**16,213**
Total Expenditure and Net Lending	**1,556,498**	**1,784,944**	**1,669,396**	**1,985,619**
	As a percentage of GDP			
Current Expenditure	**14.9**	**14.6**	**13.9**	**13.4**
Expenditure on Goods and Services	6.4	6.4	5.9	6.0
o/w Salaries and Wages	4.6	4.8	4.5	4.1
Interest Payments (a)	5.4	5.1	5.1	4.4
Foreign	1.2	1.0	1.2	0.8
Domestic	4.2	4.1	4.0	3.7
Current Transfers and Subsidies	3.1	3.1	2.9	3.0
o/w To Households and Other Sectors	2.5	2.5	2.3	2.4
Samurdhi	0.1	0.2	0.2	0.2
Pensions	1.5	1.5	1.4	1.4
Fertiliser Subsidy	0.5	0.4	0.2	0.4
Other	0.4	0.4	0.4	0.4
Capital Expenditure	**5.3**	**5.7**	**5.2**	**6.5**
Acquisition of Real Assets	2.6	3.4	2.9	4.1
Capital Transfers	2.7	2.4	2.3	2.4
Provision for Under Expenditure	-	-0.1	-	-
Lending Minus Repayments	**0.3**	**0.2**	**0.1**	**0.2**
Total Expenditure and Net Lending	**20.5**	**20.5**	**19.2**	**20.0**

(a) Interest paid in respect of the ongoing public investment projects amounting to Rs. 18.9 billion has been capitalised in 2013 (provisional) as per the State Account Circular No. 230/2013, dated 29.11.2013.

Source : Ministry of Finance and Planning

Chart 6.4 Total Expenditure by Function - 2013



accounting for 36.8 per cent of total recurrent expenditure which has increased from 36.1 per cent in the previous year. The interest payments on domestic debt in nominal terms increased by 8 per cent to Rs. 343 billion in 2013 compared to Rs. 317.7 billion in 2012 while interest payments on foreign debt increased by 11.2 per cent to Rs. 101 billion in 2013. Despite the decline in the average interest rate on domestic debt to 8.9 per cent in 2013 from 11.3 per cent in the previous year, the increase in interest payments on domestic debt was mainly due to an increase in the domestic debt stock by 18.6 per cent in 2013. Further, interest payments on Treasury bonds increased by 11.6 per cent to Rs. 254.1 billion in 2013 mainly due to the use of Treasury bonds as the main borrowing instrument which increased the outstanding Treasury bond stock by 17.1 per cent in 2013 and by 15.2 per cent in 2012. Interest payments on Treasury bills increased moderately by 7.2 per cent to Rs. 69.7 billion in 2013. Accordingly, this moderate increase is a combined outcome of the increase in the outstanding stock of Treasury bills by 6.5 per cent in 2012 and by 11.3 per cent in 2013, and the relatively low interest rates in the domestic market with the ease of the monetary policy since end of 2012. Interest payments on Rupee loans and SLDBs amounted to Rs. 6.1 billion and Rs. 10.8 billion, respectively. Meanwhile, the share of interest payments on domestic debt from the total interest payments declined marginally to 77.3 per cent in 2013 compared to 77.8 per cent in the previous year. The increase in interest payments on foreign debt was due to the increase in the foreign debt stock by 7 per cent in 2013, gradual reduction of concessional loans since the country graduated to lower middle income status and increased foreign commercial borrowings by way of international sovereign bonds and foreign investments in Treasury bills and Treasury bonds. However, the average interest rate on foreign debt declined to 3.4 per cent in 2013 from 3.9 per cent in the previous year.

Expenditure on salaries and wages for public sector employees increased mainly on account of increases in special allowances and COLA granted during the year. Accordingly, expenditure on salaries and wages increased by 13.1 per cent to Rs.393.2 billion in 2013. An increase in the special allowance given to all public servants by a further 5 per cent of the basic salary and an increase in the monthly COLA contributed to the nominal increase in expenditure on salaries and wages during 2013. However, as a percentage of GDP, it declined marginally to 4.5 per cent in 2013 from 4.6 per cent in 2012. Salaries and wages paid to central government employees, including defence personnel, increased by 11 per cent to Rs. 288.2 billion in 2013, while the central government contribution to salaries and wages of provincial council employees increased by 19.1 per cent to Rs. 105 billion. Expenditure on salaries and wages was the second largest recurrent expenditure item accounting for 32.6 per cent of total recurrent expenditure in 2013.

With committed efforts made by the government to rationalise recurrent expenditure, expenditure on other goods and services declined as a percentage of GDP. Accordingly, expenditure on other goods and services as a percentage of GDP declined to 1.4 per cent in 2013 from 1.8 per cent in 2012, while in nominal terms it declined by 14.8 per cent to Rs. 119.4 billion in 2013 from Rs.140.1 billion in 2012. Expenditure incurred by the central government (including defence) on other goods and services showed a significant decline of 15.3 per cent in 2013, while it accounted for 96.8 per cent of total outlays on other goods and services during the year.

Current transfers and subsidies, which include transfers to public corporations, public institutions, households and other sectors, declined in real terms. As a percentage of GDP it declined to 2.9 per cent of GDP in 2013 from 3.1 per cent in the previous year. However, in nominal terms, current transfers and subsidies increased by 5.9 per cent to Rs. 248.5 billion in 2013 from Rs. 234.7 billion in 2012. Households including pensioners continued to be the largest beneficiaries accounting for 78.6 per cent of total current transfers in 2013 followed by public institutions and public corporations accounting for 15.9 per cent and 5.6 per cent, respectively.

Current transfers to households increased mainly due to an increase in government spending on pensions and Samurdhi payments. In nominal terms it increased by 3.9 per cent to Rs. 195.3 billion in 2013. Pension payments, which account for 62.9 per cent of transfers to households, increased by 10 per cent to Rs. 122.8 billion in 2013 due to the increase in the monthly COLA for pensioners by Rs. 500 per month with effect from January 2013, measures taken to correct pension anomalies and the full impact of the addition of 13,134 new pensioners in 2012 and the partial impact of the addition of 22,112 new pensioners in 2013. The fertiliser subsidy declined by 45.9 per cent to Rs. 19.7 billion in 2013 from Rs. 36.5 billion in 2012 mainly due to a decline in fertiliser imports during the first half of 2013 owing to the availability of stocks and favourable long term credit facilities offered to government fertiliser companies. The adverse weather conditions that prevailed during 2012 lowered fertiliser utilisation resulting in the excess stocks. Expenditure on welfare programmes for disabled soldiers increased by 9.3 per cent to Rs. 16.2 billion in 2013 while another Rs. 2.5 billion was spent on the "Ranaviru Mapiya Rekawarana" programme. Despite a reduction in the number of families under the income supplementary programme, the welfare expenditure on the Samurdhi programme increased significantly to Rs. 15.3 billion in 2013 mainly due to an increase in Samurdhi allowance in April 2012. The existing Samurdhi allowances of Rs. 250 to Rs. 615 increased to Rs.750 and the allowance of Rs. 900 increased to Rs. 1200. Further, the government utilised Rs. 2.3 billion to provide financial support for the elderly over 70 years of age. Meanwhile, programmes targeting school children such as providing free school text books, uniforms, season tickets, free dhamma school books, and the school nutritional food programme were among the other major subsidies to households given by the government during 2013.

Current transfers to public institutions and public corporations increased in nominal terms during the year mainly due to the transfers to education sector and to cover operational losses of institutions in the transport sector. Current transfer to public institutions increased by 12.7 per cent to Rs. 39.4 billion in 2013, while current transfers to public corporations increased by 17.2 per cent to Rs. 13.9 billion. The increase in current transfers to public institutions was mainly on account of an increase in transfers to institutions engaged in higher education and tertiary education. Meanwhile, the increase in current transfers to public corporations was mainly due to an increase in the operational losses of the Department of Sri Lanka Railways and Sri Lanka Transport Board. The transfers to cover operational losses of the Sri Lanka Transport Board (Rs. 5.1 billion), the Department of Sri Lanka Railways (Rs. 5.2 billion) and the Department of Posts (Rs. 2.9 billion) accounted for around 98 per cent of total current transfers to public corporations in 2013.

During the year, capital expenditure and net lending as well as public investment was directed to strategically important projects on account of slower growth in revenue collection. Capital expenditure and net lending as a percentage of GDP declined to 5.4 per cent in 2013 from 5.6 per cent in the previous year with public investment at 5.5 per cent of GDP. However, in nominal terms, capital expenditure and net lending increased by 9.1 per cent to Rs. 464.2 billion in 2013, from Rs. 425.5 billion in 2012. Public investment, which comprises of capital expenditure and on-lending of the government that channels foreign funds to commercially oriented public enterprises such as the Ceylon Electricity Board and the Sri Lanka Ports Authority, increased by 8.4 per cent to Rs. 481.2 billion in 2013, although as a percentage of GDP it declined to 5.5 per cent in 2013 from 5.9 per cent in the previous year. Public investment in 2013 was also lower than the 6.1 per cent of GDP envisaged in the original budget for 2013. Expenditure incurred by the Ministries and Departments on acquisition of real assets (purchase of capital assets and construction and development of fixed assets) under capital expenditure, increased by 28 per cent to Rs. 252.5 billion in 2013. However, capital transfers declined marginally by 0.5 per cent to Rs. 201.8 billion during 2013 on account of a decline in transfers to public institutions by 1.7 per cent and public corporations by 9.6 per cent despite an increase in capital transfers to provincial councils by 17.5 per cent. Meanwhile, the on-lending programme disbursed a sum of Rs. 26.9 billion in 2013, comparison to Rs. 43.8 billion in 2012.

The public investment programme focused on the development of economic infrastructure in 2013. The momentum gathered in respect of key infrastructure development projects during the recent years continued in 2013, while several regional and rural infrastructure development projects were implemented to reduce disparities among the regions. Public investment in economic services at Rs. 369.4 billion continued to be the main component of the government's investment programme accounting for 76.8 per cent of total public investment in 2013. Accordingly, significant investments were made in roads, ports, power and energy, transportation, and water supply and irrigation sectors. The government gave prominence to the

Table 6.4 Functional Classification of Expenditure

Item	2012	2013 Approved Estimates	2013 Provisional	2014 Approved Estimates
	Rs. million			
Current Expenditure	**1,131,023**	**1,267,390**	**1,205,180**	**1,328,283**
General Public Services	254,371	303,263	270,554	313,946
Civil Administration	47,135	55,414	54,303	73,036
Defence	163,219	198,997	170,150	183,027
Public Order and Safety	44,017	48,852	46,101	57,883
Social Services	335,427	408,387	399,666	445,973
Education	107,271	121,189	119,819	127,004
Health	81,946	95,016	99,609	120,612
Welfare	128,451	166,724	159,787	173,942
Community Services	17,758	25,458	20,451	24,414
Economic Services	92,034	102,209	82,146	115,304
Agriculture and Irrigation	46,429	55,023	29,899	58,769
Energy and Water Supply	3,612	3,751	4,001	409
Transport and Communication	34,995	35,027	36,810	40,153
Other	6,998	8,408	11,435	15,973
Other	449,191	453,531	452,814	453,060
o/w Interest Payments (a)	408,498	444,800	444,007	441,035
Capital Expenditure and Lending	**443,973**	**529,250**	**481,203**	**668,465**
General Public Services	27,510	37,716	32,804	74,386
Civil Administration	26,565	35,603	31,631	67,701
Public Order and Safety	945	2,113	1,173	6,685
Social Services	71,176	95,228	77,643	121,335
Education	28,930	42,461	31,982	44,870
Health	17,155	23,363	19,920	41,523
Housing	7,823	7,383	8,014	9,487
Community Services	17,267	22,021	17,727	25,455
Economic Services	343,828	403,985	369,377	472,223
Agriculture and Irrigation	30,351	55,997	36,721	80,532
Energy and Water Supply	85,589	75,142	87,517	58,967
Transport and Communication	204,539	225,282	210,398	259,587
Other	23,350	47,564	34,741	73,137
Other	1,459	921	1,379	521
Under Expenditure	-	-8,600	-	-
Total Expenditure and Lending	**1,574,995**	**1,796,640**	**1,686,384**	**1,996,748**
	As a percentage of GDP			
General Public Services	3.7	3.9	3.5	3.9
Social Services	5.4	5.8	5.5	5.7
Economic Services	5.8	5.8	5.2	5.9
Other	5.9	5.2	5.2	4.6
o/w Interest Payments (a)	5.4	5.1	5.1	4.4
Total Expenditure and Lending	**20.8**	**20.7**	**19.4**	**20.1**

(a) Interest paid in respect of the ongoing public investment projects amounting to Rs. 18.9 billion has been capitalised in 2013 (provisional) as per the State Account Circular No. 230/2013, dated 29.11.2013.

Source : Ministry of Finance and Planning development of expressway and highway networks to support regional development and reduce urban-rural disparities. Accordingly, the Colombo - Katunayake Expressway was completed during 2013 and the first phase of the Colombo Outer Circular Highway Project and Southern Expressway extension project were opened to public in March 2014. Investments were also made to improve railway transport services in line with the government's strategy to improve mass transport activities by extending and rehabilitating the railway lines throughout the country. Further, significant investments were made on the construction and expansion of ports of Magam Ruhunpura Mahinda Rajapaksa Port and Colombo Port facilitating the government's vision of positioning Sri Lanka as a maritime hub in the region. Meanwhile, noteworthy investments were made in the power and energy sector as well in the water supply and irrigation sector during 2013.

Public investment in social services focused mainly on education and health sectors. Public investment in social services amounted to Rs. 77.6 billion in 2013, including Rs. 32 billion on education and Rs. 19.9 billion on the health sector. Improvement of capital assets in primary and secondary schools, knowledge enhancement and institutional development, uplifting of university infrastructure and improvement of vocational and technical education were the main areas for capital outlays in education. Similarly, public investment in the health sector was mainly directed towards the construction and improvement of hospitals, supply of lab apparatus and bio-medical equipment.

The government expedited the implementation of several regional and rural infrastructure development projects with a view to reducing rural-urban disparities. Expenditure under the "Divineguma" programme aimed at developing a self-reliant household economy amounted to Rs.1.5 billion in 2013. In addition, a sum of Rs. 30.7 billion was incurred as expenditure on the "Gamaneguma" programme and other community development initiatives including infrastructure improvement projects in the conflict affected areas during the period under consideration. Further, identifying the uniqueness of each region, their diverse resources, potential and development plans, specific regional development initiatives were undertaken in each province.

Key Fiscal Balances

Reflecting the government's continued commitment towards fiscal consolidation, the overall fiscal deficit in 2013 declined to 5.9 per cent of GDP from 6.5 per cent of GDP in 2012. Despite the lower than expected revenue collection, rationalisation of expenditure enabled the overall fiscal deficit to be maintained at a level closer to the budgetary target, narrowing the government's resource gap and reducing the government's financing requirement. The current account deficit, which reflects government dis-savings, declined marginally to 0.8 per cent of GDP in 2013 from 1 per cent of GDP in the previous year. However, it is considerably higher than the targeted level of 0.1 per cent of GDP in the original budgetary estimate for 2013 reflecting the shortfall in the revenue collection. Meanwhile, the primary deficit, which excludes interest payment from the overall deficit reflecting the discretionary fiscal policy of the government, improved to 0.8 per cent of GDP in 2013 from 1.1 per cent of GDP in the previous year, although it was marginally higher than the 2013 budgetary target of 0.7 per cent of GDP.

Financing the Budget Deficit

The greater reliance placed on domestic resources to finance the fiscal deficit in 2013 reduced borrowings from foreign sources. Accordingly, domestic financing contributed to 76 per cent of the total financing requirement of Rs. 516.1 billion in 2013 in comparison to 41 per cent in 2012 and 71 per cent targeted in the

Chart 6.5 Deficit Financing (as a percentage of GDP)

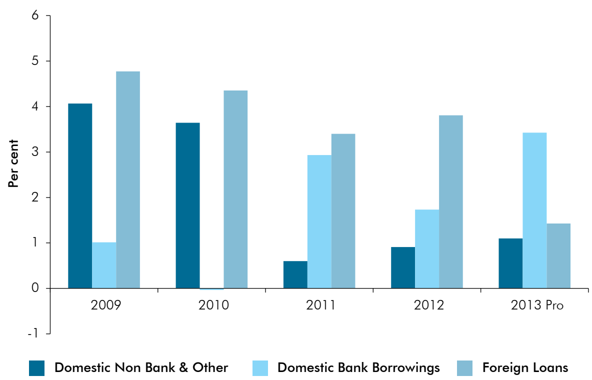
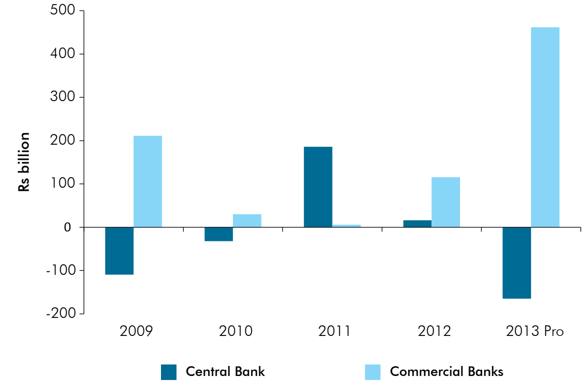


Chart 6.6 Sources of Bank Financing



budgetary estimate for 2013, while the balance was financed through foreign sources. Consequently, net domestic financing amounted to Rs. 392.4 billion in 2013 in comparison to an original estimate of Rs. 359.4 billion, while net foreign financing at Rs. 123.7 billion was lower than the original estimate of Rs. 148 billion.

In financing the deficit, the government relied heavily on borrowings from the banking sector, while borrowings from the non bank sector were significantly lower than the budgetary estimates. Consequently, net borrowings from the banking sector in 2013 amounted to Rs. 297 billion exceeding the original estimate of Rs. 70 billion targeted for the year and was higher than the sum of

Table 6.5 Sources of Domestic Financing

Rs. billion

Item	2010	2011	2012	2013 Provisional
By Instrument	**202.2**	**231.2**	**200.4**	**392.4**
Treasury Bonds (a)	140.4	168.4	154.5	252.1
Treasury Bills (b)	82.8	79.6	16.8	53.5
Rupee Loans	-24.6	-25.7	-3.6	-2.9
Sri Lanka Development Bonds	11.1	5.3	18.4	140.3
Central Bank Provisional Advances	4.0	16.9	16.5	-2.1
Other	-11.5	-13.2	-2.2	-48.5
By Source	**202.2**	**231.2**	**200.4**	**392.4**
Bank	-1.9	191.9	131.5	297.0
Non Bank	204.1	39.4	68.9	95.4

(a) Excludes rupee denominated Treasury bonds issued to foreign investors and to the Sri Lankan diaspora and migrant workers, and to CPC in 2012.
(b) Excludes rupee denominated Treasury bills issued to foreign investors and to the Sri Lankan diaspora and migrant workers.

Sources: Ministry of Finance and Planning
Central Bank of Sri Lanka

Rs. 131.5 billion borrowed from the banking sector in 2012. Despite a net repayment of Rs. 164.8 billion to the Central Bank, increased borrowings from commercial banks amounting to Rs. 461.8 billion contributed to this increase. Early retirement of Treasury bills held with the Central Bank amounting to Rs. 163 billion as a measure to absorb the excess liquidity in the domestic market, coupled with a reduction in provisional advances from the Central Bank by Rs. 2.1 billion contributed to the net repayment to the Central Bank during 2013. However, a significant increase in purchases of Treasury bills, Treasury bonds and SLDBs by commercial banks led to an increase in net credit provided to the government by the commercial banking sector during the year. Even though the borrowings from commercial banks were higher than expected during 2013, interest rates of government securities remained broadly stable due to high excess liquidity prevailed in the domestic money market. Meanwhile, borrowings from the non bank sector at Rs. 95.4 billion in 2013 were significantly lower than Rs. 289.4 billion envisaged in the 2013 budget. Consequently, non bank borrowings as a share of total domestic borrowings declined to 24 per cent in 2013 from 35 per cent in 2012.

The government increasingly relied on longer term marketable debt instruments to finance the budget deficit in 2013. Accordingly, net borrowings by way of longer term marketable instruments comprising Treasury bonds and SLDBs amounted to Rs. 392.4 billion, while Rupee loans which are long term but non marketable instruments recorded a net repayment of Rs. 2.9 billion. Meanwhile, borrowings made through non instruments recorded a net repayment Rs. 50.7 billion during 2013. Repayments made by the government in respect of overdrafts in the two state banks and provisional advances partly contributed to the reduction in non instrument borrowings.

Foreign currency denominated domestic borrowings increased in 2013 reflecting favourable investor sentiment. Gross borrowings from SLDBs with a maturity period ranging from 3 to 5 years amounted to Rs. 238 billion (US dollars 1,820 million), while repayments were Rs. 97.7 billion (US dollars 750 million). Meanwhile, the government borrowed Rs. 2.8 billion during 2013 from offshore banking units (OBUs) of commercial banks as counterpart funds for project financed development activities.

In bridging the resources gap for 2013, foreign sources contributed a lower quantity of financing than envisaged in the 2013 budget mainly due to reduced foreign project loan disbursements. Total gross borrowings from foreign sources amounted to Rs. 235.1 billion in 2013 against the budgetary estimate of Rs. 291 billion, while net foreign financing was Rs. 123.7 billion during this period. Accordingly, the share of foreign financing in total financing declined to 24 per cent in 2013 from 59 per cent in 2012. Project loans from bilateral and multilateral sources amounted to Rs. 164.2 billion in 2013 compared to Rs. 233.9 billion in the previous year. The Asian Development Bank (ADB), the International Development Association (IDA), the Government of Japan and the Export-Import Bank of China were the major creditors of foreign financing in 2013. Meanwhile, net foreign investments in rupee denominated Treasury bonds amounted to Rs. 62.5 billion, while a net repayment of Rs. 6.7 billion was made in respect of foreign investments in Treasury bills during 2013. Foreign investments in government securities in 2013 were considerably lower than the sum of Rs. 105.7 billion received in 2012, as the threshold for foreign investments in government securities was reached.

6.4 Government Debt and Debt Service Payments

Government Debt

In 2013, the government debt to GDP ratio declined to 78.3 per cent from 79.2 per cent recorded in 2012 continuing the declining trend observed in the recent past. Continued fiscal consolidation efforts coupled with the higher economic growth contributed to the reduction in the debt burden. However, the depreciation of the rupee against major foreign currencies and the increase in the discount factor (which is the net difference in the book value and the face value of issues and maturities of Treasury bills and Treasury bonds), mainly due to increased issuance of longer tenure government securities, had a negative impact on the outstanding debt stock. Domestic debt increased to 44.2 per cent of GDP in 2013 from 42.7 per cent of GDP in 2012, while foreign debt declined to 34.1 per cent of GDP in

Chart 6.7 Outstanding Government Debt

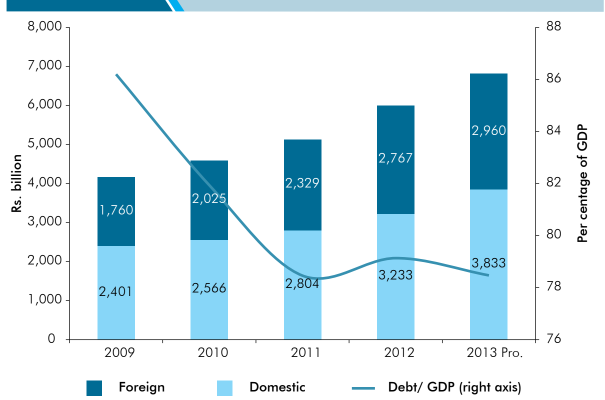


Table 6.6 Outstanding Government Debt (as at end year)

Rs. million

Item	2010	2011	2012	2013 Provisional
Total Government Debt	**4,590,245**	**5,133,365**	**6,000,112**	**6,793,249**
Domestic Debt (a)	**2,565,662**	**2,804,085**	**3,232,813**	**3,832,825**
By Maturity Period				
Short Term	619,549	698,190	813,272	909,156
Medium and Long Term	1,946,113	2,105,895	2,419,541	2,923,670
By Institution				
Bank	691,716	886,221	1,060,317	1,433,773
Non Bank	1,873,945	1,917,864	2,172,495	2,399,053
Foreign Debt	**2,024,583**	**2,329,280**	**2,767,299**	**2,960,424**
By Type				
Concessional Loans	1,266,910	1,328,797	1,369,568	1,492,842
Non Concessional Loans	147,241	235,923	455,069	460,475
Commercial (b)	610,433	764,560	942,662	1,007,107
By Currency				
SDR	572,354	601,691	682,065	711,935
US Dollars	476,490	678,983	853,832	1,009,937
Japanese Yen	508,802	560,456	575,196	485,325
Euro	142,371	146,711	174,563	185,606
Other	324,566	341,439	481,643	567,621
Memo: Exchange Rate Variation	-4,653	85,573	207,389	-25,498

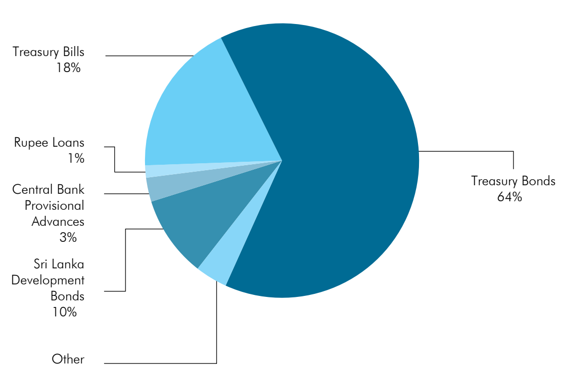
(a) Excludes government bonds of Rs. 4,397 million issued to CWE in November 2003, Rs. 78,447 million issued to settle dues to CPC in January 2012 and Rs. 13,125 million issued to capitalise SriLankan Airlines in March 2013.
(b) Includes outstanding amounts of foreign investments in rupee denominated Treasury bills and Treasury bonds.

Sources: Ministry of Finance and Planning
Central Bank of Sri Lanka

2013 from 36.5 per cent of GDP in the previous year. In nominal terms, the total outstanding government debt increased by 13.2 per cent to Rs. 6,793.2 billion as at end 2013.

The share of domestic debt in total government debt increased to 56.4 per cent in 2013 from 53.9 per cent in 2012. This was mainly due to a significant increase in the outstanding stock of SLDBs (by 65.6 per cent) and Treasury bonds (by 17.1 per cent) during 2013. Accordingly, the share of medium to long term debt to total domestic debt stock also increased to 76.3 per cent in 2013 from 74.8 per cent in the previous year. A major proportion of medium to long term debt consisted of Treasury bonds (83.9 per cent) and SLDBs (12.6 per cent), while Rupee loans accounted for 1.9 per cent of medium to long term debt. Meanwhile, Treasury bills and provisional advances from the Central Bank accounted for 77 per cent and 12 per cent of the short term debt stock, respectively. The average time to maturity of the domestic debt stock increased to 4.8 years in 2013 from 3.2 years in the previous year, reflecting the prudent management of the public debt, especially with the issuance of 30-year Treasury bonds for the first time in history.

Chart 6.8 Composition of Outsanding Domestic Debt - 2013



The share of domestic debt held by the non bank sector declined to 62.6 per cent in 2013 from 67.2 per cent at end 2012, even though in nominal terms domestic debt held by the non bank sector recorded an increase of 10.4 per cent to Rs. 2,399.1 billion. Treasury bills held by the non bank sector declined marginally by 0.9 per cent to Rs. 253.1 billion and the relative share of Treasury bills in total non bank sector debt stock declined to 10.6 per cent in 2013 from 11.8 per cent in the previous year. However, borrowings through Treasury bonds increased by 11.7 per cent to Rs. 2,066 billion and the relative share increased to 86.1 per cent in 2013 from 85.2 per cent in the previous year. Increased investor preference for longer term investments amidst the low interest rate environment contributed to this shift. The Employees' Provident Fund (EPF) and the NSB continued to be the major holders of government debt in the non bank sector accounting for 58 per cent and 15 per cent of the non bank sector debt stock, respectively.

Government debt held by the banking sector increased by 35.2 per cent to Rs. 1,433.8 billion in 2013 reflecting the heavy reliance placed on resources from the banking

sector to finance the government's budget deficit. Accordingly, the share of banking sector debt to total domestic debt increased to 37.4 per cent in 2013 from 32.8 per cent in 2012. The outstanding debt held by the Central Bank decreased to Rs. 112.4 billion as at end 2013 from Rs. 265.2 billion as at end 2012, with the early retirement of Treasury bills held by the Central Bank and the reduction in provisional advances given to the government. Accordingly, the Central Bank's ownership of government debt as a proportion of total domestic debt held by the banking sector declined to 7.8 per cent in 2013 from 25 per cent in the previous year. Meanwhile, a major portion of debt held by the Central Bank consisted of provisional advances (97.1 per cent), while the balance was on account of Treasury bills. Outstanding government debt held by commercial banks increased considerably by 66.2 per cent to Rs. 1,321.4 billion as at end 2013 with an increase in the holdings of Treasury bills (by 102 per cent), SLDBs (by 65.6 per cent) and Treasury bonds (by 57.9 per cent).

Foreign currency denominated domestic debt increased to Rs. 388.8 billion (US dollars 2,973.8 million) by end 2013 from Rs. 242.1 billion (US dollars 1,903.6 million) at end 2012. The issuance of SLDBs during 2013 amounting to Rs. 140.3 billion on a net basis coupled with the depreciation of the Sri Lanka rupee against the US dollar contributed to this increase. Foreign currency denominated domestic debt included outstanding borrowings from SLDBs amounting to Rs. 369.2 billion (US dollars 2,823.8 million) and OBUs amounting to Rs. 19.6 billion (US dollars 150 million).

Total outstanding foreign debt increased by 7 per cent to Rs. 2,960.4 billion at end 2013, although as a percentage of GDP it declined to 34.1 per cent from 36.5 per cent at end 2012. Borrowings from foreign sources to finance the budget deficit and the depreciation of the Sri Lanka rupee against the major foreign currencies during the year mainly contributed to the increase in the foreign debt stock. Non concessional debt increased by 5 per cent to Rs. 1,467.6 billion, while its share in the total foreign debt stock declined marginally to 49.6 per cent in 2013 from 50.5 per cent in 2012. Increased commercial borrowings of Rs. 1,007.1 billion solely on account of foreign investments in Treasury bills and Treasury bonds contributed to the increase in non concessional debt, as the government did not approach the international capital markets in 2013. Meanwhile, foreign debt from bilateral sources increased by 7.1 per cent to Rs. 1,049.8 billion, while foreign debt from multilateral sources increased by 7 per cent to Rs. 903.5 billion.

Total debt stock declined by Rs. 19 billion due to the impact of the variation in the exchange rate. The Sri Lanka rupee appreciated against the

Chart 6.9 Composition of Outsanding Foreign Debt - 2013

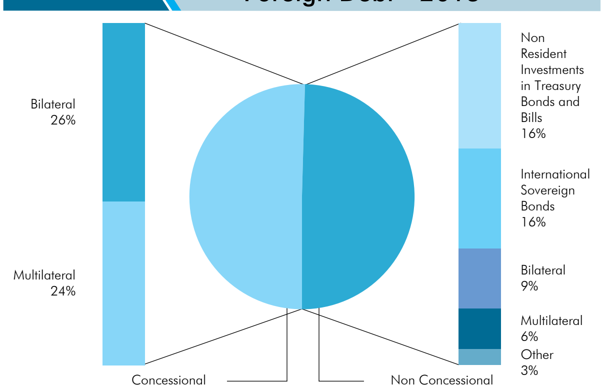
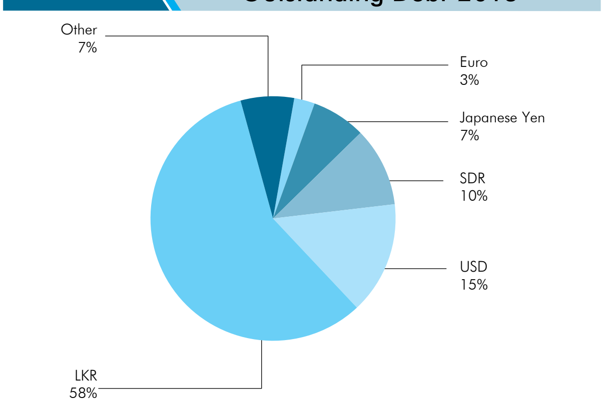


Chart 6.10 Currency Composition of Total Outstanding Debt-2013



Japanese yen by 18.8 per cent and the Indian rupee by 10.2 per cent, while it depreciated against the euro, the Special Drawing Rights (SDR) and the US dollar by 6.8 per cent, 3 per cent and 2.7 per cent, respectively. Further, the total outstanding foreign debt stock consisted of US dollars (34.1 per cent), SDR (24 per cent), Japanese yen (16.4 per cent), euro (6.3 per cent), Sri Lanka rupee (16.1 per cent) and other currencies (3 per cent). Consequently, the outstanding foreign debt stock declined by Rs. 25.5 billion due to the variations in exchange rate of the Sri Lanka rupee against major foreign currencies, while US dollar denominated domestic debt (SLDBs and OBUs) increased by Rs. 6.5 billion due to the depreciation of the Sri Lanka rupee against the US dollar.

Debt Service Payments

Debt service payments increased to Rs. 1,162.9 billion in 2013 from Rs. 1,017.5 billion in 2012. Amortisation payments increased by Rs. 91.1 billion to Rs. 700 billion accounting for 60.2 per cent of total debt service payments, while interest payments increased by Rs. 54.4 billion to Rs. 462.9 billion accounting for the balance. Debt service payments to domestic sources increased by Rs. 117.6 billion to Rs. 850.7 billion over 2012. That was a combined outcome of an increase in amortization payments by Rs. 80.6 billion to Rs. 496 billion and an increase in interest payments by Rs. 37 billion to Rs. 354.7 billion over the previous year. With regard to foreign debt service payments, interest payments increased by Rs. 17.3 billion to Rs. 108.2 billion, while amortization payments increased by Rs. 10.4 billion to Rs. 204 billion resulting in a net increase in debt service payments by Rs. 27.8 billion to Rs. 312.2 billion in comparison to 2012.

Chart 6.11 Government Debt Service Payments (as a percentage of GDP)

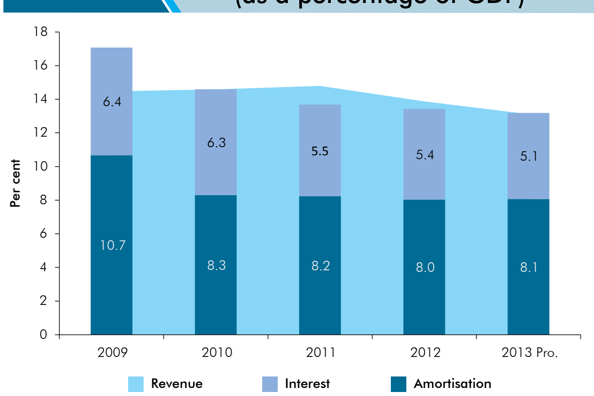


Table 6.7 Government Debt Service Payments

Rs. million

Item	2010	2011	2012	2013 Provisional
Debt Service Payments	**820,448**	**895,382**	**1,017,468**	**1,162,900**
Domestic	686,800	728,028	733,100	850,748
Foreign	133,648	167,354	284,368	312,152
Amortisation Payments	**467,856**	**538,683**	**608,970**	**700,035**
Domestic	389,672	439,894	415,441	496,042
Foreign	78,184	98,789	193,529	203,993
Interest Payments	**352,592**	**356,699**	**408,498**	**462,865**
Domestic	297,127	288,134	317,659	354,706
Short Term	58,943	46,257	65,049	69,712
Medium and Long Term	238,185	241,877	252,610	284,994
Foreign	55,464	68,565	90,839	108,159

Sources: Ministry of Finance and Planning
Central Bank of Sri Lanka

Debt service indicators showed mixed performance in 2013. The ratio of total interest payments to GDP improved marginally to 5.3 per cent in 2013 from 5.4 per cent in 2012, while debt

Table 6.8 Government Debt Indicators

Indicator	2010	2011	2012	2013 Provisional
Government Debt/GDP	81.9	78.5	79.2	78.3
Domestic Debt/GDP	45.8	42.9	42.7	44.2
Foreign Debt/GDP	36.1	35.6	36.5	34.1
Total Foreign Debt/Exports (a)	161.4	154.4	159.9	151.9
Total Debt Service/GDP	14.6	13.7	13.4	13.4
Total Debt Service/Government Revenue (b)	100.4	92.5	96.8	102.2
o/w Domestic Debt Service/ Government Revenue (b)	84.0	75.2	69.7	74.8
Total Debt Service/Government Expenditure (c)	46.9	45.4	47.0	49.1
o/w Domestic Debt Service/ Government Expenditure (c)	39.3	36.9	33.9	35.9
Foreign Debt Service/Exports (a)	10.7	11.1	16.4	16.0
Total Interest/GDP	6.3	5.5	5.4	5.3
Domestic Interest/GDP	5.3	4.4	4.2	4.1
Domestic Interest/Government Current Expenditure	31.7	28.1	28.1	29.4
Foreign Interest/Exports (a)	4.4	4.5	5.2	5.5

(a) Export of goods and services
(b) Government revenue is in economic format
(c) Government expenditure includes amortisation payments

Sources: Ministry of Finance and Planning
Department of Census and Statistics
Central Bank of Sri Lanka

service payments, which include interest payments and amortisation payments, as a percentage of GDP remained at the same level of 13.4 per cent as in 2012. Further, domestic interest payments to GDP decreased from 4.2 per cent in 2012 to 4.1 per cent in 2013. However, the ratio of debt service payments to government revenue deteriorated from 96.8 per cent in 2012 to 102.2 per cent in 2013 due to the moderate increase in the revenue collection by 8.2 per cent compared to a higher increase in debt service payments by 14.3 per cent in 2013.

6.5 Budgetary Operations in Sub National Governments

Policy Direction and Measures of Sub National Governments

Provincial Councils (PCs) and Local Governments constitute the Sub National Government system in Sri Lanka. There are nine PCs established under the thirteenth amendment to the constitution and the Local Government system in Sri Lanka is made up of 335 institutions. As at end 2013, the Local Government system comprised 23 municipal councils, 41 urban councils and 271 pradesheeya sabhas.

The Ministry of Local Government and Provincial Councils continued to play a vital role in developments at the sub national government level in 2013. The Ministry continued to work effectively with sub national government authorities, in order to identify the development needs at the provincial level and local government level and to facilitate investments through effective coordination with donor agencies. Further, infrastructure facilities and managerial abilities were improved to provide a better service to the public. Several programmes were initiated by the Ministry to provide an upgraded service delivery and to address the timely needs of the public. Accordingly, a waste management and dengue eradication programme was launched by the National Solid Waste Management Support Centre which comes under the Ministry. Further, a local government week was held under the theme of “A Prosperous Tomorrow by Providing Efficient Service” in 2013.

The “Pura Neguma” programme continued in 2013 with the objective of improving the infrastructure services in selected local authorities in less-developed areas and supporting the development of institutional capacity of the local authorities for improved and sustainable service delivery. Accordingly, 108 local authorities have been identified for improvement under the project. The project comprises three key components: improvement of the local government infrastructure and service delivery, local government policy reforms and capacity building, and project management and administration. Under this project, infrastructure facilities such as weekly fairs, child and maternity clinics, jogging tracks, roads and parks were developed. Further, regional service centres were also established to provide services for the urban public and for rural public traveling to urban areas for services unavailable in their villages.

Road development was given priority under the regional infrastructure development activities of the Ministry of Local Government and Provincial Councils in 2013. Accordingly, the Ministry implemented the Provincial Roads Project (Central and Sabaramaguwa provinces), Provincial Roads Improvement Project, Eastern and North Central Provincial Road Project, and Northern Road Connectivity Project with a view to improving connectivity of provincial roads. These projects funded by the Japan International Cooperation Agency (JICA), World Bank and ADB are to be completed by 2014/15. In addition, the Ministry continued the Greater Colombo Wastewater Management Project, Upgrading of the Disaster Response Network (Phase II), Iranamadu Irrigation Development Project and Jaffna and Kilinochchi Water Supply and Sanitation Project during the year 2013.

The Finance Commission continued to play a pivotal role in recommending central government transfers to the PCs to meet their budgetary requirements with the broader view of achieving a balanced regional growth. The implementation of the Agency Results Framework (ARF) approach took place during the year to improve the Results Based Monitoring (RBM) approach previously followed by the provinces. Under this programme, the Medium-Term Results Based Framework 2013-2017 commenced in 2013 in each province with the recommendation of the Finance Commission. Meanwhile, as per the commission, the insufficient fund allocation and actual release for capital projects and delays with regard to releasing of court fines to local government institutions are the key issues relating to provincial council operations.

Budgetary Operations in Provincial Councils

Total revenue collection of PCs increased by 2.5 per cent to Rs. 50.5 billion in 2013 from Rs. 49.2 billion in 2012. However, revenue collection as a percentage of GDP remained the same at 0.6 per cent in 2013 as in 2012. Tax revenue increased by 5.5 per cent to Rs. 43.9 billion in 2013, while non tax revenue declined by 13.8 per cent to Rs. 6.5 billion. The NBT transferred from the central government increased marginally by 3.4 per cent to Rs. 19.6 billion mainly due to an increase in total NBT as a result of improved domestic economic activities. The revenue from stamp duty increased by 3.6 per cent to Rs. 17.1 billion in 2013 mainly due to an increase in stamp duty applicable on affidavits, insurance policies, notary warrants, and credit card transactions. Similarly, the revenue from licence fees increased significantly by 27.2 per cent to Rs. 6.5 billion in 2013. The NBT transfers from the central government accounted for 44.5 per cent of the total tax revenue followed by stamp duties of 39 per cent during 2013. The Western Provincial Council continued to be the major contributor to the revenue collection of PCs accounting for 60.5 per cent of the total revenue collection in 2013 in comparison to 61.1 per cent in 2012. The Western Province was followed by the Central, the Southern and the North Western provinces accounting for around 9.5 per cent, 9.1 per cent and 5.8 per cent respectively, of the total revenue collection of PCs.

Recurrent expenditure of PCs as a percentage of GDP remained at 1.8 per cent in 2013 as in the previous year, although in nominal terms it increased by 12.7 per cent to Rs. 156.8 billion in 2013. Personal emoluments continued to be the single largest item under recurrent expenditure accounting for 74.5 per cent of the total recurrent expenditure of PCs in 2013, and personal emoluments of education and health sectors accounted for nearly 90 per cent of the total personal emoluments bill. On a functional basis, current expenditure on social infrastructure to Rs. 139.3 billion, mainly education and health, accounted for 88.8 per cent of total recurrent expenditure in 2013. The balance 11.2 per cent of recurrent expenditure was on account of expenses in relation to provincial administration and economic infrastructure. Meanwhile, the Western Province continued to be the largest spending unit accounting for 22 per cent of total recurrent expenditure.

Capital expenditure of PCs increased significantly by 31.7 per cent to Rs. 29.3 billion in 2013 from Rs. 22.2 billion in 2012. Accordingly,

Table 6.9 Budget Outturn for Provincial Councils

Rs. million

Item	2010	2011	2012 Revised	2013 Provisional
Total Revenue	**36,829**	**40,990**	**49,235**	**50,469**
Tax Revenue	31,049	34,658	41,657	43,937
Non Tax Revenue	5,780	6,332	7,578	6,532
Total Expenditure	**145,491**	**157,373**	**161,341**	**186,062**
Current Expenditure	119,162	129,600	139,121	156,799
o/w Personal Emoluments	91,644	101,886	108,246	116,757
Capital Expenditure	26,329	27,773	22,220	29,263
Central Government Transfers	**107,032**	**116,383**	**112,106**	**135,593**
Block Grants	85,299	94,603	91,892	108,801
Criteria Based Grants	2,612	3,854	2,861	2,264
Province Specific Development Grant	11,683	9,953	5,901	6,429
Foreign Grants for Special Projects	7,439	7,973	11,452	18,100

Sources: Ministry of Local Government and Provincial Councils
Ministry of Finance and Planning

as a percentage of GDP, capital expenditure of PCs remained at 0.3 per cent in 2013 as in the previous year, mainly due to the commitment of provincial councils to align capital expenditure plans with the broader government objective of improving infrastructure facilities at the rural level to reduce regional disparities. Finances amounting to Rs. 18.1 billion and Rs. 6.4 billion were spent on special projects and Province Specific Development Projects (PSDPs), respectively during the year under review, while other provincial level investments incurred amounted to Rs. 4.7 billion in 2013, and were mainly in the areas of acquisition and improvement of capital assets and capital transfers.

Central Government transfers to PCs increased by 21 per cent to Rs. 135.6 billion in 2013 in comparison to Rs. 112.1 billion in 2012. These transfers were in the form of block grants, Criteria Based Grants (CBGs), Province Specific Development Grants (PSDGs) and grants for special projects. Block grants to meet the resource gap in the current expenditure programme of PCs continued to be the major form of central government transfer amounting to Rs. 108.8 billion (80.2 per cent of total transfers). In addition, transfers under PSDGs to continue specific provincial development programmes and CBGs to fund discretionary expenditure requirements amounted to Rs. 6.4 billion and Rs. 2.3 billion, respectively in 2013. Meanwhile, 72.9 per cent of PC expenditure was financed by transfers from the central government in comparison to 69.5 per cent in the previous year. Therefore, increased mobilisation of revenue by PCs is necessity to reduce transfers to PCs and thereby lowering the reliance of PCs on the central government.