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FISCAL POLICY AND GOVERNMENT FINANCE

6.1 Overview

Fiscal performance weakened in 2019 amidst a notable decline in government revenue, resulting mainly from the impact of the large import compression particularly of motor vehicles, and subdued economic activity exacerbated by the Easter Sunday attacks in April 2019, as well as the rise in recurrent expenditure mainly on account of subsidies and transfers, and salaries and wages. Accordingly, revenue from indirect taxes declined significantly in 2019, offsetting the noteworthy gains in income tax revenue supported by the implementation of the new Inland Revenue Act. Meanwhile, the postponement of the government Budget 2019, which was subsequently approved in April 2019, and the execution of fiscal operations on a Vote on Account in the first four months in 2019 prior to the approval of the Budget 2019 also weighed on revenue mobilisation to some extent in 2019. Consequently, the major fiscal balances in 2019 deviated significantly from the budget estimates as well as from the levels recorded in 2018 The deficit in the government current account widened substantially despite a surplus being envisaged in the Budget 2019, implying increased dissavings of the government. The primary balance, which is the difference between government revenue and non-interest expenditure and an important indicator of debt sustainability, returned to negative levels, compared to the surplus balance recorded in the preceding two years. The overall budget deficit expanded significantly in 2019, compared to the budget estimates and the deficit recorded in 2018.

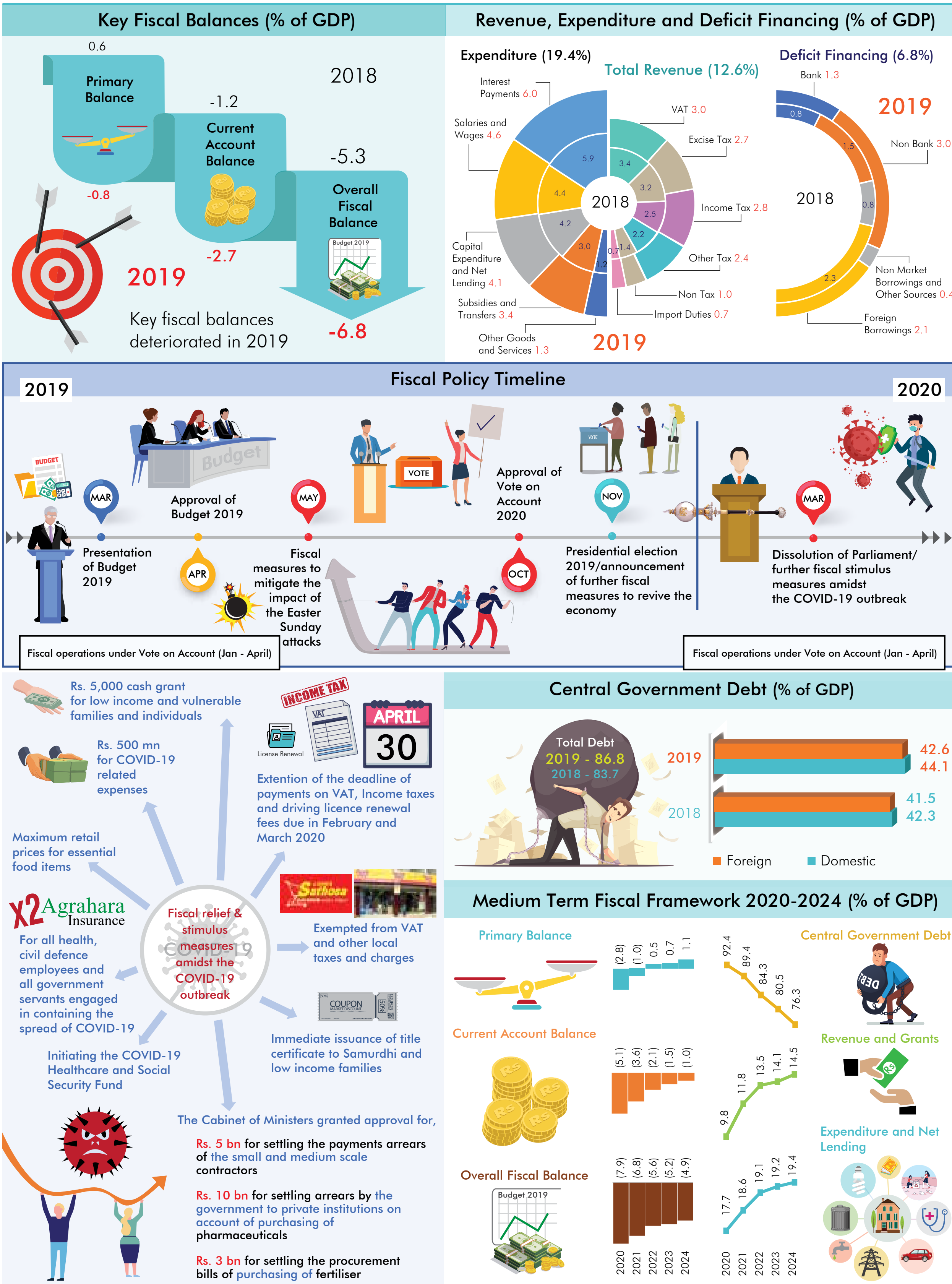
Government revenue declined to 12.6 per cent of GDP in 2019 from 13.4 per cent of GDP in 2018, mainly due to the reduction in tax revenue from excise duties on motor vehicle imports, while a lower revenue collection was recorded from Value Added Tax (VAT), Cess and Ports and Airports Development Levy (PAL) as well. Revenue from direct taxes rose to 2.8 per cent of GDP in 2019 from 2.2 per cent of GDP in 2018, reflecting the increase in revenue mainly from corporate taxes under the new Inland Revenue Act. However, the reduction in indirect tax revenue due to lower imports and the overall moderation of activity outweighed the gains in income tax in 2019. Further, non tax revenue declined to 1.0 per cent of GDP in 2019 from 1.4 per cent of GDP in 2018 due to lower revenue from fees and charges, non-availability of distributable profits from the Central Bank and the reduction in profit and dividend transfers from State Owned Business Enterprises

(SOBEs). Meanwhile, government expenditure and net lending as a percentage of GDP increased to 19.4 per cent in 2019 from 18.7 per cent in 2018 due to the increase in recurrent expenditure amidst a decline in public investment. Recurrent expenditure, as a percentage of GDP, increased to 15.3 per cent in 2019 from 14.5 per cent in 2018, while capital expenditure and net lending declined to 4.1 per cent in 2019 from 4.2 per cent in 2018. Accordingly, the government's current account deficit rose to 2.7 per cent of GDP, compared to the expected surplus of 0.2 per cent and the deficit of 1.2 per cent in 2018. The primary balance recorded a deficit of 0.8 per cent of GDP in 2019 compared to the surplus of 0.6 per cent of GDP in 2018, reversing the improvements recorded since 2017. Accordingly, the budget deficit increased to 6.8 per cent of GDP in 2019, compared to the deficit of 5.3 per cent of GDP in 2018 and the estimated 4.4 per cent of GDP in the Budget 2019. Deficit financing relied mainly on domestic sources, which accounted for 69.1 per cent on net basis in 2019. In net domestic financing, both bank and non bank sources recorded an increase during the year. The central government debt to GDP ratio rose to 86.8 per cent of GDP by end 2019 from 83.7 per cent at end 2018, mainly reflecting the impact of the increased budget deficit and the relatively modest growth in nominal GDP in 2019.

The government initiated two rounds of fiscal stimulus in 2019. The first round of easing measures commenced in response to the devastating impact of the Easter Sunday attacks, while the second round of easing measures commenced after the Presidential election, aimed at addressing persistent subpar economic growth. Major fiscal easing measures in the first round included the reduction of the VAT rate from 15 per cent to 7 per cent on hotels and tour operators, to support the revival of the tourism industry and tax exemptions on the importation of security equipment following the Easter Sunday attacks. The second round of fiscal easing measures comprised significant tax concessions and simplifications, aimed at increasing the disposable income of economic agents, thereby encouraging investment and consumption, which would help enhance revenue growth over the medium term. Such major measures included amendments to the Inland Revenue Act, No. 24 of 2017; a broadbased reduction of the VAT rate to 8 per cent, except for financial services; and removal of Nation Building Tax (NBT) and Withholding Tax (WHT). In addition, measures were also taken to curtail government expenditure of both recurrent and capital nature, recouping in part the negative impact of revenue reforms in the near term. Meanwhile, the government introduced several health policy and fiscal measures in response to the spread of the COVID-19 pandemic in the country, including the provision of necessary expenditure allocations for health facilities, imposing maximum retail prices for essential food items and facilitating the distribution of food items during periods of social distancing, and other regulatory measures to contain the spread of the pandemic further in the country.

The suboptimal outcome in fiscal operations in 2019 underscores the necessity for strengthening fiscal consolidation in the period ahead, supported by prudent expenditure rationalisation and revenue enhancement. The ongoing fiscal stimulus could help boost economic activity albeit fiscal slippages could be expected in the near term. However, as economic activity recovers in the period ahead, government revenue can be impacted positively. In this context, efforts to improve the tax administration and compliance would need to continue in order to help realise the benefits of revenue mobilisation. Further, curtailing the fast rising recurrent expenditure of the government would also help strengthen fiscal balances over the medium term. Widening of the deficit in the government's current account and reversal of

Figure 6.1
Fiscal Sector Performance



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gains in the primary balance, if continued, could undermine fiscal consolidation efforts and seriously challenge debt sustainability in the period ahead unless real economic activity boosts up significantly. Further, the expanded budget deficits, unless contained, could result in narrowing the fiscal space needed for public investment in the areas of health, education and social protection, thereby resulting in a deterioration of productivity and dampened economic growth, endangering poverty alleviation efforts of the government. Against this backdrop, it is imperative that government spending is directed towards growth-enhancing sectors, while strengthening governance to contain and eliminate any inefficient and unproductive use of resources as envisaged by the government. Further, the effective use of active liability management operations and adherence to the Medium-Term Debt Management Strategy (MTDS) are vital to smoothen debt service payments over the medium term, and ensure debt sustainability.

6.2 Fiscal Policy Direction and Measures[1]

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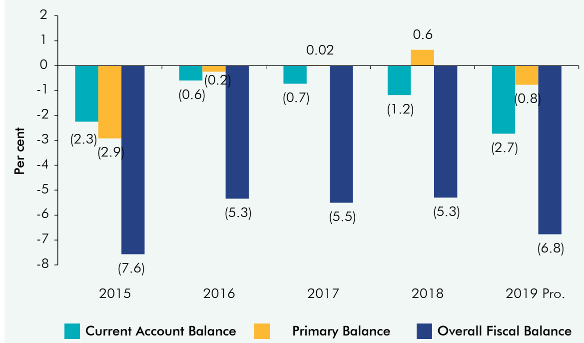
Fiscal consolidation encountered significant challenges in 2019 amidst the notable decline in government revenue and the rise in recurrent expenditure. Government revenue declined mainly due to significantly low revenue from indirect taxes amidst the contraction of imports, and persistent subpar economic activity particularly following the Easter Sunday attacks. The reduction in revenue from indirect taxes overshadowed the noteworthy increase in income tax revenue under the newly implemented Inland Revenue Act. Meanwhile, recurrent expenditure grew substantially on account of rising expenditure on subsidies and transfers and salaries and wages, while public investment

Figure 6.2
Major Fiscal Indicators
(as a percentage of GDP)



Sources: Ministry of Finance, Economic and Policy Development

moderated in light of the substandard revenue performance. Accordingly, the major fiscal indicators deviated significantly from the estimates as reflected in the increase in the deficit of the government's current account balance and the overall budget balance, while the primary balance also recorded a deficit following the surplus balance maintained in the preceding two years. Amidst concerns of moderation of activity in the aftermath of the Easter Sunday attacks, the government lowered the Value Added Tax (VAT) rate applicable in the tourism industry, while granting exemptions on the importation of security equipment. Meanwhile, another round of fiscal stimulus was launched towards the end of 2019, to address persistently low economic growth by offering a series of tax concessions, along with other reforms, aimed at increasing disposable income, and encouraging private consumption and investment. Further, the government took several measures to curtail both recurrent and non-priority capital expenditure, thereby attempting to minimise the impact of tax revisions on government revenue in the near term.

Fiscal operations were conducted on a Vote on Account (VoA) during January through early April 2019, due to the delay in presenting the government Budget for 2019 amidst the

1 Policy measures announced by the government to be implemented during 01 December 2019 and 01 April 2020 and published as notices to the public on the website of Inland Revenue Department are subject to the approval by the Parliament.

unforeseen political developments in the latter part of 2018. Accordingly, a VoA for the first four months of 2019 was approved by the Parliament in December 2018. Consequently, the Appropriation Bill for 2019 was submitted to the Parliament on 05 February 2019, and the government Budget for 2019 was presented on 05 March 2019 and approved by the Parliament on 05 April 2019. Meanwhile, the submission of the Budget for 2020 was also delayed amidst the Presidential election held in November 2019. Accordingly, a VoA for the first four months of 2020 was approved by the Parliament in October 2019, by postponing the preparations of the government Budget for 2020.[2] Meanwhile, the Parliament was dissolved on 03 March 2020 and the nominations of candidates were accepted by the Election Commission for the general election, which was scheduled to be held on 25 April 2020. However, the general election was postponed by the Election Commission due to the COVID-19 outbreak.[3] Accordingly, the submission of the government Budget for 2020 could be delayed, which would limit the space for implementing new fiscal measures for 2020.

Following the Presidential election in November 2019, revisions were introduced to the Inland Revenue Act, No. 24 of 2017, aimed at simplifying the tax structure and providing tax concessions, thereby enhancing disposable income and supporting the revival of subdued economic activity.[4] Accordingly, revisions were introduced to the personal income tax rates, tax free threshold and tax slabs with effect from 01 January 2020. The annual tax free threshold was increased to Rs. 3.0 million per annum for any source of income from Rs. 1.2 million per annum for employment income and Rs. 500,000 per annum for personal income. The income tax slabs applicable for tax payable above the tax free threshold was increased to Rs. 3.0 million per annum from Rs. 600,000 per annum. Personal

Table 6.1
Summary of Government Fiscal Operations

Item	2018	2019 Approved Estimates	2019 Provisional
	Rs. million		
Total Revenue and Grants	**1,932,459**	**2,357,000**	**1,898,808**
Total Revenue	1,919,973	2,344,000	1,890,899
Tax Revenue	1,712,318	2,077,000	1,734,925
Non Tax Revenue	207,656	267,000	155,974
Grants	12,486	13,000	7,909
Expenditure and Net Lending	**2,693,228**	**3,042,000**	**2,915,291**
Recurrent	2,089,713	2,308,000	2,301,155
Capital and Net Lending	603,515	734,000	614,136
o/w Public Investment	624,970	756,000	631,235
Current Account Balance	**-169,740**	**36,000**	**-410,256**
Primary Balance	**91,421**	**228,000**	**-115,130**
Overall Fiscal Balance	**-760,769**	**-685,000**	**-1,016,483**
Total Financing	**760,769**	**685,000**	**1,016,483**
Foreign Financing (a)	323,535	235,000	314,076
Domestic Financing	437,234	450,000	702,407
Market Borrowings	329,351	450,000	642,713
Non Bank	219,885	182,000	449,629
Bank	109,466	268,000	193,084
Monetary Authority	246,068	n.a.	-108,116
Commercial Banks	-136,601	n.a.	301,199
Non Market Sources (b)	107,883	-	59,694
	As a percentage of GDP (c)		
Total Revenue and Grants	**13.5**	**15.1**	**12.6**
Total Revenue	13.4	15.0	12.6
Tax Revenue	11.9	13.3	11.6
Non Tax Revenue	1.4	1.7	1.0
Grants	0.1	0.1	0.1
Expenditure and Net Lending	**18.7**	**19.5**	**19.4**
Recurrent	14.5	14.8	15.3
Capital and Net Lending	4.2	4.7	4.1
o/w Public Investment	4.4	4.8	4.2
Current Account Balance	**-1.2**	**0.2**	**-2.7**
Primary Balance	**0.6**	**1.5**	**-0.8**
Overall Fiscal Balance	**-5.3**	**-4.4**	**-6.8**
Total Financing	**5.3**	**4.4**	**6.8**
Foreign Financing (a)	2.3	1.5	2.1
Domestic Financing	3.0	2.9	4.7
Market Borrowings	2.3	2.9	4.3
Non Bank	1.5	1.2	3.0
Bank	0.8	1.7	1.3
Monetary Authority	1.7	n.a.	-0.7
Commercial Banks	-1.0	n.a.	2.0
Non Market Sources (b)	0.8	-	0.4

(a) Includes rupee denominated Treasury bonds and Treasury bills issued to foreign investors
(b) Includes proceeds from the long lease of Hambantota port in 2018
(c) For 2018, revised GDP estimates were used, as released by the Department of Census and Statistics on 31 March 2020.

Source: Ministry of Finance, Economic and Policy Development

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2 Before the expiration of the approved period of the VoA, if Parliament is in session, the government has to obtain an approval for an annual Budget or a VoA from the Parliament to utilise funds from the Consolidated Fund for the use of public services. However, as the Parliament was dissolved on 03 March 2020 without approving an annual Budget or a VoA, H.E. the President was vested with the powers to authorise government expenditure for public services under paragraph 3 of Article 150 of the Constitution of the Democratic Socialist Republic of Sri Lanka until the expiry of three months from the date on which the Parliament is summoned. In this regard, H.E. the President empowered the Secretary to the Treasury with powers regarding spending monies from the Consolidated Fund to continue public services and development activities initially during the three months starting from 06 March 2020.

3 Meanwhile, on 20 April 2020, the Election Commission announced that the general election will be scheduled for 20 June 2020.

4 Policy measures announced by the Inland Revenue Department, which were implemented with effect from 01 January 2020, are subject to the approval of the Parliament.

income tax rates were simplified and revised to 6 per cent, 12 per cent and 18 per cent, compared to the previous structure of 4 per cent, 8 per cent, 12 per cent, 16 per cent, 20 per cent and 24 per cent. Moreover, Pay-As-You-Earn (PAYE) tax on any employment receipts to any resident or non-resident person was removed with effect from 01 January 2020. Accordingly, an employee whose income exceeds Rs. 3.0 million per annum is liable to pay personal income tax at 6 per cent, 12 per cent and 18 per cent subject to the tax slabs of Rs. 3.0 million for each step. Meanwhile, the corporate income tax rate applicable for the construction industry was reduced to 14 per cent from 28 per cent, and the same for the banking, finance, insurance industries and trading activities was reduced to 24 per cent from 28 per cent with effect from 01 January 2020. Further, Withholding Tax (WHT) and Economic Service Charge (ESC) were removed with effect from 01 January 2020. Nevertheless, the applicability of WHT would continue on the amounts paid for winning lotteries, rewards, betting and gambling, sale of any gem at an auction conducted by the National Gem and Jewellery Authority, and payments made to any non-resident person.

Revisions were made to the VAT and the Nation Building Tax (NBT) in 2019 in further support of businesses and economic growth prospects. In an immediate response to help the tourism industry following the Easter Sunday attacks, the VAT rate was reduced to 7 per cent from 15 per cent on the supply of services by a hotel, guest house, restaurant or other similar business providing similar services, and supply of services in respect of inbound tours by a travel agent registered with the Sri Lanka Tourism Development Authority (SLTDA), for the period from 01 June 2019 until 31 March 2020. However, amidst concerns of persistent slowdown of economic activity in the recent years, the VAT rate was reduced to 8 per cent from 15 per cent across the board, except for financial services, with effect from 01 December 2019, aimed at stimulating investment and consumption over the medium term. Moreover, VAT exemptions were granted for the importation of fabrics, supply of residential accommodation by way of sale of condominium housing units by any person, and supply of services by a hotel, guest house, restaurant or other similar business providing similar services registered with the SLTDA, which uses 60 per cent or more of their inputs from local suppliers with effect from 01 December 2019. Further, the VAT registration threshold was increased substantially to Rs. 300 million per annum from Rs. 12 million per annum with effect from 01 January 2020. In addition, the NBT was removed with effect from 01 December 2019.

Revisions were made to excise duty in view of easing pressure on the balance of payments especially on account of motor vehicle imports, while discouraging the consumption of sweetened beverages and cigarettes owing to health concerns. As announced in the Budget 2019, excise duty on motor vehicles of an engine capacity less than 2,000 cm^3 was increased with effect from 06 March 2019. However, excise duty on electric vehicles was reduced to promote environmentally friendly transport modes. Meanwhile, excise duty on beverages was increased on the basis of the sugar content of the product. Further, with effect from 06 March 2019, excise duties on cigarettes and locally manufactured liquor were increased based on an indexation method with a minimum annual duty increase reflecting annual inflation and GDP growth. In addition, excise duty on cigarettes was increased in December 2019, which could help in part offset any revenue reduction that may be caused due to the revision to the VAT.

The Customs duty structure was revised in 2019 mainly in response to changes in commodity prices in global markets. Accordingly, several revisions were introduced to fuel prices in accordance with the fuel pricing formula that was in force until October 2019. Consequently, at end December 2019, Customs duties applicable on the importation of auto diesel, super diesel, petrol (92 Octane) and petrol (95 Octane) remained at Rs. 2.85 per litre, Rs. 15 per litre, Rs. 18 per litre and Rs. 35 per litre, respectively. In addition, under the Extraordinary Gazette No. 2113/2, Customs duty on undenatured ethyl alcohol and tyre tubes was increased, while Customs duty on go-karts was exempted. Moreover, the unit rate of the Customs duty on the importation of 261 items of goods was increased by 10 per cent with effect from 06 March 2019.

The Special Commodity Levy (SCL) was revised along with the revisions to Cess and Ports and Airports Development Levy (PAL) during the year in order to support domestic producers while reducing any price volatility in the domestic market. SCL on the importation of black gram, dates (fresh and dried), oranges (fresh), apples (fresh) and vegetable oil was revised upward, while an SCL of Rs. 8 per kg on wheat flour imports was imposed during the year. SCL on the importation of b'onions, maize, fish (fresh, chilled or frozen), potatoes and chillies (dried, neither crushed nor ground) was reduced to curtail price volatility in the domestic market. Moreover, Cess on the importation of 25 items was removed in March 2019, while PAL on selected items was reduced to 2.5 per cent from 7.5 per cent in March 2019. However, PAL on selected items was revised upward to 10 per cent with effect from 06 December 2019 in order to support the revenue mobilisation efforts of the government.

Amendments to the Finance Act as proposed in the government Budget 2019 were approved by Parliament in October 2019. Accordingly, the luxury tax on motor vehicles was amended to the effect that the tax payable is determined purely on the cost, insurance and freight (CIF) value or the manufacturer's price (in case of domestic production, in excess of a prescribed tax free threshold) irrespective of the engine capacity. This amendment helped support the government revenue while curtailing the excessive expenditure on motor vehicle imports. Meanwhile, the carbon tax was removed with effect from 01 December 2019.

Fees and charges, which have not been revised since 2016, were changed as proposed in the government Budget 2019 in view of enhancing government revenue. Accordingly, passport processing fees on regular basis, urgent basis, and alterations were increased by Rs. 500, Rs. 5,000 and Rs. 500 respectively to Rs. 3,500, Rs. 15,000 and Rs. 1,000. Under the Extraordinary Gazette No. 2116/62, the embarkation levy was increased by US dollars 10 to US dollars 60 per passenger effective from April 2019. However, as per the Extraordinary Gazette No. 2134/5 issued in August 2019, the increase of the embarkation levy was revoked and the previous rate of US dollars 50 per passenger was made applicable during August 2019 through January 2020 considering the adverse impact on the tourism industry following the Easter Sunday attacks, while the increased rate of US dollars 60 per passenger was made effective from February 2020 onwards.

Measures were taken to strengthen tax administration during the year. The Revenue Administration Management Information System (RAMIS) of the Inland Revenue Department (IRD) was upgraded in order to incorporate the provisions of the Inland Revenue Act, No. 24 of 2017. With the inclusion of VAT on financial services and personal income tax registrations, the RAMIS monitors all tax categories, except the ESC, stamp duty and the betting and gaming levy. Several programmes were conducted to enhance public awareness on the RAMIS, which helped, together with new registrations, increase the number of registered tax files in IRD by 38,622 to 1,220,178 in 2019. Moreover, the IRD commenced the implementation of organisational and business procedure reforms to modernise tax administration. Such measures included restructuring of the IRD along the functional lines, creating a Design and Monitoring Unit, introducing a more efficient management structure to speed up interaction with taxpayers, strengthening the Large Taxpayer Unit, introducing mandatory e-filing, and enhancing the use of taxpayer identification numbers. Meanwhile, the Sri Lanka Customs initiated measures to establish a National Single Window (NSW) for facilitating importers and exporters. In this regard, 12 technical reports pertaining to different categories of NSW were handed over to the Ministry of Finance (MOF)[5] in July 2019.

Measures were introduced to improve the management of public expenditure during the year. As announced in the Budget 2019, the MOF instructed all ministries and departments in April 2019 to curtail their capital expenditure by 15 per cent in 2019. In addition, the MOF, in September 2019, advised all ministries and departments to curtail their capital expenditure by a further 10 per cent by postponing non-priority projects, new projects and purchases of non-essential goods. Moreover, by the National Budget Circular No. 04/2019, all government institutions were advised to implement prudent expenditure control measures while rationalising recurrent expenditure, particularly on electricity, telephone, water supply, fuel consumption and stationery. Following the Presidential election in November 2019 and subsequent tax concessions announced to support the revival of economic activity, the MOF instructed all ministries and departments to implement expenditure control measures to ensure effective management of public expenditure, especially in consideration of the decline in revenue collection in the near term. Moreover, under the National Budget Circular No. 06/2019, instructions were issued to all ministries and departments to submit their supplementary budgetary requests through the Integrated Treasury Management Information System (ITMIS).

Public sector salaries were increased with effect from July 2019, and pension anomalies were rectified as proposed in the Budget 2019. An interim allowance of Rs. 2,500 per month was granted to public sector employees with effect from 01 July 2019. Further, measures were taken to rectify pension anomalies for those who retired before 01 January 2016. Therefore, a revision was made incorporating the first two phases of the Public Administration Circular No. 03/2016 to the basic salary of the pensioner at the time of retirement effective from 01 July 2019. Under the Pension Circular No. 03/2015 (Revision III), the automation process of the pension payment procedure was further strengthened by improving the efficiency and standards of public service delivery. Under the Public Administration Circular No. 02/2019, instructions were issued to prevent any fraudulent activities with regard to pension payments, especially in relation to demised pensioners. Meanwhile, Divisional Secretaries were instructed to keep the register of pensioners up-to-date. Further, the National Pay Commission was established in February 2020 with a view to maintaining sustainability of salaries and wages in both public and private sectors. This special

5 The scope of the MOF was expanded and referred to as the Ministry of Finance, Economic and Policy Development as per the Gazette Notification No. 2153/12 issued on 10 December 2019.

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agency consists of 15 members, who are expected to revisit all remuneration structures of the public sector as well as the private sector, and advise and assist the government in formulating and implementing a national wage policy.

The government embarked on a targeted recruitment programme aimed at uplifting the living standards of underprivileged households, while ensuring their productive contribution to the economy. Accordingly, the government commenced a programme in January 2020 to recruit 100,000 unskilled individuals with low levels of education from low income families. These recruits are expected to receive targeted training in the first six months with an allowance of Rs. 22,500 per month, before they are recruited in to the public-sector cadre. Moreover, the government commenced another recruitment programme in February 2020 to provide employment opportunities for all unemployed graduates and diploma holders who had remained unemployed during the preceding three years. These recruits are to be given suitable training for one year, with a monthly allowance of Rs. 20,000, after which they would be deployed across Sri Lanka.

Measures were taken to enhance the transparency of welfare benefit schemes with the aim of streamlining the major welfare programmes. Accordingly, the Welfare Benefits Board (WBB) published a selection methodology in June 2019 for the identification of low income families for welfare benefit payments in respect of four main welfare programmes.[6] Moreover, measures were taken to expand the number of Samurdhi beneficiaries by 433,594 in August 2019, in line with the Budget proposal in 2019 to expand the number of Samurdhi beneficiaries by 600,000.

6 Samurdhi programme, financial support for elderly over 70 years of age, support for low income disabled persons and financial support for kidney patients

Several initiatives were taken to improve the financial viability of major State Owned Business Enterprises (SOBEs), thereby reducing the burden on the central government budget. Performance reports for the first half of 2018 of the five SOBEs, which had signed Statements of Corporate Intent (SCIs) in March 2017, were forwarded to the Cabinet of Ministers in August 2019. Further, eight SCIs[7] were signed in June 2019 with selected SOBEs to improve the efficiency of their operations. Approval was granted by the Cabinet of Ministers in March 2019 to implement a pricing formula for imported milk powder in line with the changes in international milk powder prices and fluctuations in the exchange rate in order to reflect the actual market costs, while safeguarding the local milk industry. In addition, approval was granted by the Cabinet of Ministers in October 2019 to implement a pricing formula for Liquefied Petroleum (LP) gas. Moreover, a special committee was established in early 2020 to appoint qualified and talented personnel for key positions of SOBEs, in order to strengthen the financial viability of those institutions.

In 2019, measures were taken to make use of the Active Liability Management Act (ALMA), No. 8 of 2018, while the Medium-Term Debt Management Strategy (MTDS) was formulated with the aim of strengthening debt sustainability. In June 2019, a resolution was passed in Parliament to raise Rs. 480 billion for liability management purposes. Accordingly, Treasury bonds amounting to Rs. 15 billion in October 2019 and another Rs. 15 billion in December 2019 were raised to build buffers for liability management purposes. Such funds raised in 2019 were utilised for the settlement of debt service obligations during early 2020. Meanwhile,

7 Sri Lanka State Plantation Corporation, Lanka Sathosa (Pvt.) Limited, Central Engineering Consultancy Bureau, State Timber Corporation, State Pharmaceuticals Corporation, Milco (Pvt.) Limited, National Livestock Development Board and Geological Survey and Mines Bureau.

opportunities to raise funds from foreign markets including the SAMURAI bond market were explored with the aim of diversifying the international capital market issuance base while building buffers for debt management. Moreover, the MTDS for the period 2019-2023 was launched in April 2019, formulated collectively by the Central Bank and the Ministry of Finance. The MTDS mainly focuses on containing the foreign currency exposure of central government debt, improving the average time to maturity (ATM) of the debt portfolio, and minimising the share of debt maturing within the period of the next twelve months. In line with the envisaged targets in the MTDS, the share of foreign currency debt and debt maturing within one year were maintained at favourable levels at end 2019, and the ATM of foreign currency debt portfolio increased in 2019.

Measures were taken during 2019 to improve the transparency and efficiency of the government securities market. In order to facilitate investment and enhance investor awareness on government securities, the LankaSecure system was upgraded to deliver a real time notification to customers registered in the Central Depository System by Dealer Direct Participants (Licensed Commercial Banks and Primary Dealers) for every debit and credit record of scripless securities. A circular was issued to participants of the LankaSettle System requesting information on the settlement value, price and interest rate of every securities transaction in the LankaSecure System with effect from 01 January 2020. Meanwhile, in view of limiting the possible impact of the increased volatility in global financial markets, the Central Bank reduced the threshold for foreign investment in rupee denominated government securities from 10 per cent of the outstanding government securities stock to 5 per cent with effect from 18 January 2019.

The primary balance target set under the Quantitative Performance Criteria (QPC) of the International Monetary Fund's Extended Fund Facility (IMF-EFF) programme was missed in 2019. The IMF-EFF programme was obtained in June 2016 with the aim of strengthening the country's external sector while supporting the government's economic reform agenda. The programme included measures to rebuild foreign exchange reserves and reduce fiscal deficits, thereby containing the government debt accumulation while restoring overall macroeconomic stability.

The government announced several urgent measures amidst the spread of the COVID-19 pandemic in the country during March 2020. With the view of providing relief particularly for low income households, maximum retail prices (MRP) were announced for selected consumer goods such as dhal, canned fish, broiler chicken, maize, b'onions and certain medical items. Meanwhile, the Cabinet of Ministers granted approval for the allocation of funds on an urgent basis for various purposes, including Rs. 5 billion for settling payment arrears of small and medium scale contractors; Rs. 10 billion for settling arrears to private institutions on account of purchasing of pharmaceuticals; and Rs. 3 billion for settling procurement bills of purchasing of fertiliser. Further, the government allocated additional Rs. 500 million for COVID-19 preventive activities. Moreover, several concessions were granted to the tourism, textile and garments and wholesale and retail trade sectors, which were largely affected by the impact of the COVID-19 pandemic. Meanwhile, the government initiated measures in March 2020 to establish a fuel price stabilisation fund (FPSF), thereby aiming to raise a sum of Rs. 200 billion within 6 months by utilising the benefit of lower fuel prices prevailing in the global market. Moreover, the government introduced a cash grant of Rs. 5,000 as a lump sum payment for the low income and vulnerable families and individuals, who were affected by the COVID-19 outbreak.

Major international rating agencies affirmed Sri Lanka's sovereign credit rating although their outlook for Sri Lanka was revised. Fitch Ratings and S&P Global Ratings affirmed Sri Lanka's rating at "B", while revising the outlook from "Stable" to "Negative" in December 2019 and January 2020, respectively. Such revision of the outlook was mainly attributed to risks stemming from deteriorated fiscal position of the country. However, Moody's Investors Service (Moody's) maintained its ratings at "B2" with "Stable" outlook in 2019.

In view of strengthening the medium term fiscal framework, further measures are needed to ensure the effective implementation of revenue enhancement and expenditure rationalisation measures. Despite several reform measures initiated to enhance government revenue in the recent past, the level and structure of government revenue remain highly susceptible to aggregate demand management measures implemented from time to time. For instance, a major part of the revenue decline 2019 can be attributed to the moderation of excise duty collection, reflecting mainly the impact of import curtailing measures introduced amidst the surge in personal motor vehicle imports began in 2018. Despite such decline in government revenue, recurrent expenditure increased notably in 2019 mainly reflecting a rise in expenditure on subsidies and transfers and salaries and wages. Consequently, key fiscal balances and outstanding debt levels deviated sharply from the envisaged levels in 2019, underscoring the need for strengthening fiscal consolidation measures. Interest payments have become the single largest component in recurrent expenditure, while the wage bill of the government employees and pension payments continue to rise, limiting the fiscal space for much needed public investment. Meanwhile, the rising levels of expenditure on welfare payments and subsidies continue to weigh on the government budget. Moreover, the financially constrained SOBEs with large debt liabilities continue to pose risks on the government budget. In this backdrop, it is important that adequate measures are initiated to strengthen government revenue mobilisation, particularly in the context of renewed risks to economic recovery amidst the widespread COVID-19 outbreak globally and its adverse impact on fiscal policy and debt sustainability in Sri Lanka. The measures initiated in 2019 to curtail non-priority government expenditure are commendable. It is important that the benefits accrued from such measures are sustained, particularly amidst rising pressures in the near term due to bulk recruitments to the public sector. Moreover, reforms to transform loss-making SOBEs need to be expedited to ease pressure on the government budget and strengthen fiscal consolidation over the medium term. Further, an effective use of active liability management operations and adherence to the MTDS could prove critical to help smooth debt service payment obligations, while reducing government debt to a sustainable level over the medium term. In this context, measures to strengthen fiscal discipline by adopting stringent and binding fiscal rules remain essential to bolster investor confidence and improve the country's macroeconomic outlook in the period ahead.

6.3 Government Budgetary Operations

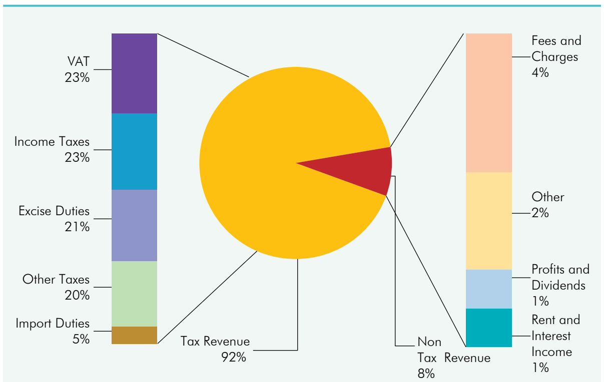
Revenue and Grants

Revenue

In 2019, total revenue as a percentage of GDP declined due to the reduction in both tax and non tax revenue. Accordingly, total government revenue declined to 12.6 per cent of GDP in 2019 from 13.4 per cent of GDP in 2018. Tax revenue declined to 11.6 per cent of GDP in 2019 from 11.9 per cent of GDP in 2018 as a result of the lower revenue collection from excise duties, VAT, SCL, Cess, and PAL despite a significant increase in revenue collection from income taxes. Similarly, non tax revenue declined to 1.0 per cent of GDP in 2019 from 1.4 per cent of GDP in 2018 due to lower revenue from fees and charges, non-availability of distributable profits from the Central Bank and reduction in profit and dividend transfers from SOBEs.

In nominal terms, total revenue declined to Rs. 1,890.9 billion in 2019 from Rs. 1,920.0 billion in 2018 as the reduction in non tax revenue outweighed the marginal increase in tax revenue collection. Tax revenue increased by 1.3 per cent to Rs. 1,734.9 billion reflecting the

Figure 6.3
Composition of Government Revenue - 2019



Source: Ministry of Finance, Economic and Policy Development

significant increase in revenue from income taxes, although revenue collection from excise duties, VAT, SCL, Cess, PAL and NBT declined during the year. Revenue from indirect taxes continued to be the major contributor to the government coffers, accounting for 75.3 per cent of total tax revenue in 2019. However, a notable increase was observed in the share of revenue from direct taxes which rose to 24.7 per cent in 2019 from 18.1 per cent in the previous year, reflecting the impact of the implementation of the new Inland Revenue Act, No. 24 of 2017, with effect from 01 April 2018. Meanwhile, non tax revenue declined to Rs. 156.0 billion in 2019 from Rs. 207.7 billion in 2018, resulting in the share of tax revenue in total revenue increasing to 91.8 per cent in 2019 from 89.2 per cent in 2018.

Revenue from income tax increased during the year both as a percentage of GDP and in nominal terms mainly due to the increase in revenue collection from corporate and non

Table 6.2
Economic Classification of Government Revenue

Item	2018	2019	
		Approved Estimates	Provisional
	Rs. million		
Tax Revenue	**1,712,318**	**2,077,000**	**1,734,925**
Income Taxes	310,449	385,000	427,700
VAT	461,740	529,000	443,924
Excise Taxes	484,287	593,045	399,511
Import Duties	96,991	140,000	98,427
Other Taxes	358,851	429,955	365,364
Non Tax Revenue	**207,656**	**267,000**	**155,974**
Total Revenue	**1,919,973**	**2,344,000**	**1,890,899**
	As a percentage of GDP (a)		
Tax Revenue	**11.9**	**13.3**	**11.6**
Income Taxes	2.2	2.5	2.8
VAT	3.2	3.4	3.0
Excise Taxes	3.4	3.8	2.7
Import Duties	0.7	0.9	0.7
Other Taxes	2.5	2.8	2.4
Non Tax Revenue	**1.4**	**1.7**	**1.0**
Total Revenue	**13.4**	**15.0**	**12.6**

(a) For 2018, revised GDP estimates were used, as released by the Department of Census and Statistics on 31 March 2020.

Source: Ministry of Finance, Economic and Policy Development

corporate income taxes. Accordingly, revenue from income taxes as a percentage of GDP increased to 2.8 per cent in 2019 from 2.2 per cent in 2018, while in nominal terms, income tax revenue collection increased significantly by 37.8 per cent to Rs. 427.7 billion during the year. Revenue from corporate and non corporate income taxes increased by 60.4 per cent to Rs. 272.6 billion in 2019, reflecting the impact of the implementation of the new Inland Revenue Act as well as administrative improvements in the tax payment and return monitoring process of the IRD. Revenue from PAYE tax also improved during the year by 19.5 per cent to Rs. 49.4 billion in 2019. Further, revenue from withholding tax increased to Rs. 50.4 billion in 2019 from Rs. 46.4 billion in 2018, while revenue from ESC increased to Rs. 55.3 billion in 2019 from Rs. 53.0 billion in 2018, reflecting also the impact of awareness programmes conducted by the IRD to increase the WHT and ESC registrations during 2019. Further, revenue collection from Capital Gains Tax (CGT) increased to Rs. 602.4 million in 2019 from Rs. 104.1 million in 2018.

In 2019, revenue from VAT declined both as a percentage of GDP and in nominal terms due to dampened economic activity during the year. Accordingly, as a percentage of GDP, revenue from VAT declined to 3.0 per cent in 2019 from 3.2 per cent in 2018, while in nominal terms VAT revenue declined by 3.9 per cent to Rs. 443.9 billion in 2019. The revenue collection from VAT on domestic economic activities declined by 3.0 per cent to Rs. 274.0 billion in 2019, while revenue from VAT on import related activities declined by 5.2 per cent to Rs. 169.9 billion. Accordingly, VAT revenue as a percentage of total tax revenue declined to 25.6 per cent during the year from 27.0 per cent in 2018. Accordingly, the contribution of VAT revenue to total revenue declined marginally to 23.5 per cent in 2019 from 24.0 per cent in 2018.

Revenue from excise duties declined as a percentage of GDP as well as in nominal terms in 2019. Revenue from excise duties as a percentage of GDP declined to 2.7 per cent during the year from 3.4 per cent in the previous year, while declining by 17.5 per cent in nominal terms to Rs. 399.5 billion in 2019 mainly on account of lower revenue from excise duty on motor vehicles, petroleum products and cigarettes. Annual revenue collection from excise duty on motor vehicles declined significantly by 36.1 per cent (0.9 per cent of GDP) to Rs. 130.4 billion in 2019 from Rs. 204.1 billion in 2018. This was mainly due to the decline in motor vehicle imports amidst the imposition of higher excise duties in March 2019 and the restrictions that were in place until April 2019, on opening of Letters of Credit (LCs) for the importation of motor vehicles. Revenue from excise duty on petroleum products declined by 6.9 per cent to Rs. 61.7 billion due to the decline in petrol imports during the year and the reduction of excise duty on the importation of auto diesel during the latter part of 2018. Moreover, revenue from excise duty on cigarettes and tobacco declined by 5.3 per cent to Rs. 87.4 billion mainly due to the decline in cigarette sales. However, revenue from excise duty on liquor increased marginally by 1.3 per cent to Rs. 115.4 billion in 2019 due to the increase in excise duty on both locally manufactured and imported liquor. Meanwhile, the share of excise tax revenue in total tax revenue declined to 23.0 per cent in 2019 from 28.3 per cent recorded in the previous year.

In nominal terms in 2019, revenue collection from import duties increased while revenue from SCL declined in comparison to 2018. Revenue from import duties, in nominal terms, increased by 1.5 per cent to Rs. 98.4 billion in 2019 reflecting the increase in applicable duty rates on petrol and diesel, and the increase in import duty on selected 261 items as proposed in the Budget 2019. However, revenue from SCL declined, in nominal terms, by 7.2 per cent to Rs. 70.4 billion during the year. The share of import duties in tax revenue remained unchanged at 5.7 per cent during the year while the share of SCL in tax revenue declined to 4.1 per cent in 2019 from 4.4 per cent in the previous year.

Revenue collection from PAL, Cess and NBT also declined, reflecting the impact of tax exemptions and concessions granted on the importation of several goods during the year. Accordingly, revenue from PAL declined by 1.6 per cent to Rs. 112.2 billion in 2019 mainly due to the exemptions granted on the importation of security equipment in May 2019 following the Easter Sunday attacks. Revenue from Cess also declined to Rs. 50.7 billion in 2019 from Rs. 53.4 billion in 2018 mainly due to the removal of Cess on 25 selected items with effect from 06 March 2019. Revenue from NBT declined in nominal terms by 1.0 per cent to Rs. 70.7 billion reflecting mainly the impact of the contraction in imports in 2019. Accordingly, NBT revenue from import related activities declined by 9.6 per cent to Rs. 18.2 billion while revenue from domestic economic activities increased by 2.4 per cent to Rs. 52.4 billion during the year. However, as a percentage of GDP, revenue from NBT remained unchanged at 0.5 per cent as in the previous year. Further, revenue from Debt Repayment Levy (DRL), which was introduced with effect from 01 October 2018, increased to Rs. 28.7 billion in 2019 from Rs. 4.5 billion, in 2018 while revenue from the Telecommunication Levy declined by 35.5 per cent Rs. 18.3 billion during the year.

During 2019, non tax revenue declined both in terms of GDP share and in nominal terms. Accordingly, non tax revenue as a percentage of GDP declined to 1.0 per cent in 2019 from 1.4 per cent in 2018. Similarly, in nominal terms, non tax revenue declined significantly by 24.9 per cent to Rs. 156.0 billion in 2019 from Rs. 207.7 billion in 2018 due to lower revenue from fees and charges, non-availability of distributable profits from the Central Bank and the reduction in profit and dividend transfers from SOBEs. Although upward revisions were made to certain fees and charges in the Budget 2019, revenue from fees and charges declined by 28.8 per cent to Rs. 72.0 billion in 2019 due to the moderation in economic activity followed by the Easter Sunday attacks. Meanwhile, profit and dividend transfers from major SOBEs also declined to Rs. 27.9 billion in 2019 from Rs. 41.8 billion in the previous year. Distributable profits from the Central Bank were not available in 2019 in comparison to the profit transfer of Rs. 15.0 billion recorded in 2018. However, revenue from rent and interest income increased by 35.1 per cent to Rs. 18.5 billion in 2019 while revenue from social security contributions increased by 15.0 per cent to Rs. 29.0 billion during the year. Overall, the share of non tax revenue in total revenue declined during the year to 8.2 per cent from 10.8 per cent in 2018.

Grants

Total foreign grants received from bilateral and multilateral sources declined to Rs. 7.9 billion in 2019 from Rs. 12.5 billion in 2018. Foreign grants from bilateral sources declined by 41.2 per cent to Rs. 5.1 billion in 2019, while foreign grants from multilateral sources declined by 27.2 per cent to Rs. 2.8 billion during the year. The major development partners who provided grants during the year were the Government of Japan, the Government of India and the Asian Development Bank (ADB).

Expenditure and Net Lending

Total expenditure and net lending as a percentage of GDP increased to 19.4 per cent in 2019 from 18.7 per cent in 2018 due to the increase in recurrent expenditure despite the

Table 6.3
Economic Classification of Expenditure and Lending Minus Repayments

Item	2018	2019 Approved Estimates	2019 Provisional
	Rs. million		
Recurrent Expenditure	2,089,713	2,308,000	2,301,155
Expenditure on Goods and Services	806,002	856,874	894,396
o/w Salaries and Wages	626,045	690,000	686,452
Interest Payments	852,190	913,000	901,352
Foreign	212,708	220,000	248,557
Domestic	639,482	693,000	652,795
Current Transfers and Subsidies	431,521	538,126	505,407
o/w To Households and Other Sectors	342,546	441,284	410,123
Samurdhi	39,239	50,000	44,660
Pensions	194,495	222,220	227,669
Fertiliser Subsidy	26,948	35,000	34,966
Other	81,864	134,064	102,828
Capital Expenditure	612,561	741,355	619,069
Acquisition of Real Assets	355,763	622,386	384,959
Capital Transfers	256,798	290,264	234,110
Provision for Under Expenditure	-	-171,296	-
Lending Minus Repayments	-9,046	-7,355	-4,933
Total Expenditure and Net Lending	2,693,228	3,042,000	2,915,291
	As a percentage of GDP (a)		
Recurrent Expenditure	14.5	14.8	15.3
Expenditure on Goods and Services	5.6	6.1	6.0
o/w Salaries and Wages	4.4	4.4	4.6
Interest Payments	5.9	5.9	6.0
Foreign	1.5	1.4	1.7
Domestic	4.5	4.4	4.3
Current Transfers and Subsidies	3.0	3.4	3.4
o/w To Households and Other Sectors	2.4	2.8	2.7
Samurdhi	0.3	0.3	0.3
Pensions	1.4	1.4	1.5
Fertiliser Subsidy	0.2	0.2	0.2
Other	0.6	0.9	0.7
Capital Expenditure	4.3	4.8	4.1
Acquisition of Real Assets	2.5	4.0	2.6
Capital Transfers	1.8	1.9	1.6
Provision for Under Expenditure	-	-1.1	-
Lending Minus Repayments	-0.1	...	...
Total Expenditure and Net Lending	18.7	19.5	19.4

(a) For 2018, revised GDP estimates were used, as released by the Department of Census and Statistics on 31 March 2020.

Source : Ministry of Finance, Economic and Policy Development

decline in public investment. Accordingly, recurrent expenditure, as a percentage of GDP, increased to 15.3 per cent in 2019 from 14.5 per cent in 2018 while capital expenditure and net lending declined to 4.1 per cent in 2019 compared to 4.2 per cent in 2018. Public investment, which includes capital expenditure and on lending of the government, declined to 4.2 per cent of GDP in 2019 from 4.4 per cent of GDP in 2018. However, in nominal terms, total expenditure and net lending increased to Rs. 2,915.3 billion in 2019 from Rs. 2,693.2 billion in 2018.

During the year, recurrent expenditure increased both in terms of GDP and in nominal terms. Accordingly, recurrent expenditure, as a percentage of GDP, increased to 15.3 per cent in 2019 from 14.5 per cent in 2018, while in nominal terms, recurrent expenditure increased to Rs. 2,301.2 billion in 2019 from Rs. 2,089.7 billion in 2018. Higher expenditure on subsidies and transfers, salaries and wages and interest payments contributed to this increase in recurrent expenditure.

In 2019, expenditure on interest payments increased both in terms of GDP and in nominal terms. Accordingly, interest payments, as a percentage of GDP, increased marginally to 6.0 per cent in 2019 from 5.9 per cent in 2018 while in nominal terms, interest expenditure increased to Rs. 901.4 billion in 2019 from Rs. 852.2 billion in 2018. Interest payments on domestic debt, which increased by 2.1 per cent to Rs. 652.8 billion in 2019, accounted for 72.4 per cent of total interest payments in 2019. Interest expenditure on Treasury bonds declined by 1.3 per cent to Rs. 494.8 billion in 2019 mainly due to the lower interest rates that prevailed in the domestic market during the year. Interest payments on Treasury bills rose by 8.7 per cent to Rs. 81.0 billion in 2019 from Rs. 74.5 billion in 2018 due to the increase in net issuance of Treasury bills in 2019. In addition, interest payments on Sri Lanka Development Bonds (SLDBs) and Rupee loans amounted to Rs. 35.4 billion and

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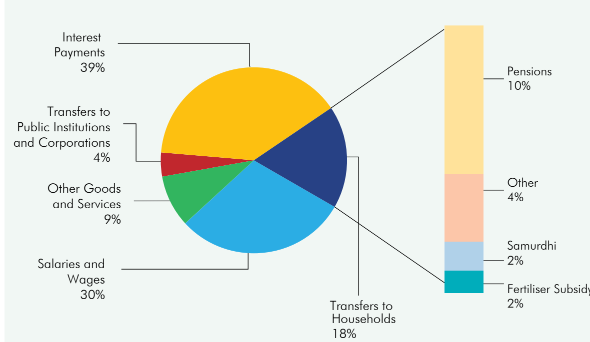
Figure 6.4
Composition of Government Recurrent Expenditure - 2019



Source: Ministry of Finance, Economic and Policy Development

Rs. 2.9 billion, respectively, in 2019. Interest payments on foreign debt increased by 16.9 per cent to Rs. 248.6 billion in 2019 from Rs. 212.7 billion in 2018 due to the rise in foreign commercial borrowings during the year. Interest payments continued to be the single largest recurrent expenditure item, accounting for 39.2 per cent of total recurrent expenditure, and equivalent to 47.7 per cent of the government revenue in 2019.

During the year, expenditure on goods and services increased both in terms of GDP share and in nominal terms. Accordingly, as a percentage of GDP, expenditure on goods and services increased to 6.0 per cent in 2019 from 5.6 per cent in 2018 while in nominal terms expenditure on goods and services increased by 11.0 per cent to Rs. 894.4 billion in 2019. Salaries and wages, the largest expenditure item in this category, increased to 4.6 per cent of GDP in 2019 from 4.4 per cent of GDP in the previous year. Similarly, in nominal terms, outlays on salaries and wages increased to Rs. 686.5 billion in 2019 from Rs. 626.0 billion in 2018. Salaries and wages paid to central government employees, including defence personnel, increased by 9.2 per cent to Rs. 506.5 billion, while the central government contribution towards the salaries and wages of employees of provincial councils increased by 11.0 per cent to Rs. 180.0 billion during the year. The increase in salaries and wages was mainly due to the inclusion of an interim allowance on a progressive basis to the basic salary with the implementation of the new salary structure from January 2016 for public sector employees and granting an interim allowance of Rs. 2,500 per month to public sector employees with effect from 01 July 2019 as proposed in the Budget 2019. The share of salaries and wages in total recurrent expenditure was 29.8 per cent in 2019 compared to 30.0 per cent in 2018, and this continued to be the second largest recurrent expenditure item.

Table 6.4
Functional Classification of Expenditure

Item	2018	2019	
		Approved Estimates	Provisional
	Rs. million		
Recurrent Expenditure	**2,089,713**	**2,308,000**	**2,301,155**
General Public Services	422,432	504,675	440,420
Civil Administration	107,847	160,093	108,024
Defence	228,235	256,324	244,430
Public Order and Safety	86,350	88,258	87,965
Social Services	685,739	792,623	807,446
Education	195,168	230,109	234,392
Health	180,568	191,943	211,555
Welfare	276,773	326,978	319,906
Community Services	33,230	43,592	41,592
Economic Services	127,052	199,109	142,358
Agriculture and Irrigation	63,451	75,888	77,033
Energy and Water Supply	1,483	1,270	1,147
Transport and Communication	41,805	53,386	39,908
Other	20,313	68,565	24,270
Other	854,490	899,298	910,931
o/w Interest Payment	852,190	913,000	901,352
Provision for Under Expenditure	-	-87,704	-
Capital Expenditure and Lending	**624,970**	**756,000**	**631,235**
General Public Services	50,261	63,163	40,473
Civil Administration	44,275	58,709	37,633
Public Order and Safety	5,986	4,454	2,839
Social Services	133,233	209,912	112,890
Education	71,748	97,607	55,845
Health	37,893	50,899	32,752
Housing	9,493	22,635	12,062
Community Services	14,098	38,770	12,231
Economic Services	437,897	652,391	475,922
Agriculture and Irrigation	58,895	86,723	56,662
Energy and Water Supply	39,107	76,934	75,938
Transport and Communication	216,147	244,538	197,068
Other	123,748	244,196	146,254
Other	3,579	1,830	1,951
Provision for Under Expenditure	-	-171,296	-
Total Expenditure and Lending	**2,714,683**	**3,064,000**	**2,932,390**
	As a percentage of GDP (a)		
General Public Services	3.3	3.6	3.2
Social Services	5.7	6.4	6.1
Economic Services	3.9	5.5	4.1
Other	6.0	5.8	6.1
o/w Interest Payment	5.9	5.9	6.0
Provision for Under Expenditure	-	-1.7	-
Total Expenditure and Lending	**18.9**	**19.6**	**19.5**

(a) For 2018, revised GDP estimates were used as released by the Department of Census and Statistics on 31 March 2020.

Source : Ministry of Finance, Economic and Policy Development

In nominal terms, expenditure on other goods and services increased by 15.6 per cent to Rs. 207.9 billion while its relative share increased to 1.4 per cent of GDP in 2019 from 1.3 per cent of GDP in 2018.

Expenditure on current transfers and subsidies increased during the year both in nominal terms and as a percentage of GDP mainly due to the increase in current transfers

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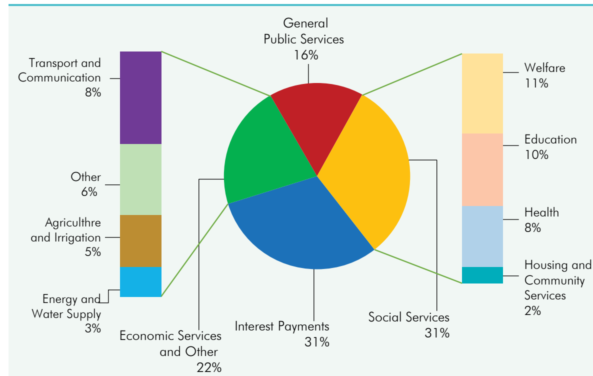
to the household sector. Accordingly, total current transfers and subsidies, as a percentage of GDP, increased to 3.4 per cent in 2019 from 3.0 per cent in 2018, while in nominal terms, current transfers and subsidies increased by 17.1 per cent to Rs. 505.4 billion in 2019. Current transfers to households and other sectors accounted for 81.1 per cent of total current transfers, while transfers to public institutions and public corporations accounted for 15.0 per cent and 3.9 per cent, respectively, in 2019.

Current transfers to households, which include pension payments, increased to 2.7 per cent of GDP in 2019 from 2.4 per cent of GDP in 2018. In nominal terms, current transfers to households increased to Rs. 410.1 billion in 2019 from Rs. 342.5 billion in 2018. Pension payments, the single largest item in transfers to households, increased by 17.1 per cent to Rs. 227.7 billion in 2019 mainly due to the impact of the rectification of pension anomalies, effective from 01 July 2019, by incorporating the first two phases of the Public Administration Circular No. 03/2016 to the basic salary of pensioners as well as the rise in the number of pensioners by 18,079 to 639,984 during the year. Meanwhile, expenditure on the Samurdhi programme increased to Rs. 44.7 billion in 2019 from Rs. 39.2 billion in 2018. Expenditure on welfare programmes for disabled soldiers increased by 10.8 per cent over the previous year to Rs. 33.6 billion in 2019. Expenses incurred on the fertiliser subsidy increased to Rs. 35.0 billion in 2019 from Rs. 26.9 billion in 2018.

As a percentage of GDP, current transfers to public institutions increased while current transfers to public corporations declined during the year. Accordingly, current transfers to public institutions increased to 0.5 per cent of GDP in 2019 from 0.4 per cent of GDP in 2018, while current transfers to public corporations declined

Figure 6.5
Total Expenditure by Function - 2019



Source: Ministry of Finance, Economic and Policy Development

to 0.1 per cent of GDP from 0.2 per cent of GDP recorded in the previous year. In nominal terms, current transfers to public institutions increased to Rs. 75.8 billion in 2019 from Rs. 61.6 billion in 2018 due to the increase in current transfers to the education sector. Meanwhile, current transfers to public corporations declined to Rs. 19.5 billion in 2019 from Rs. 27.3 billion, mainly due to the reduction in current transfers to the transport sector. Transfers provided to cover operational losses of the Department of Sri Lanka Railways and the Department of Posts increased during the year to Rs. 7.6 billion and Rs. 5.3 billion, respectively.

As a percentage of GDP, capital expenditure and net lending declined in 2019 reflecting the impact of prioritisation of capital expenditure amidst the shortfall in government revenue. Accordingly, as a percentage of GDP, capital expenditure and net lending declined to 4.1 per cent in 2019 from 4.2 per cent in 2018. However, in nominal terms, capital expenditure and net lending increased to Rs. 614.1 billion during the year from Rs. 603.5 billion in the previous year. Meanwhile, public investment, which includes capital expenditure and on lending of the government, declined as a percentage of GDP to 4.2 per cent in 2019 from 4.4 per cent in the previous year. However, in nominal terms, public

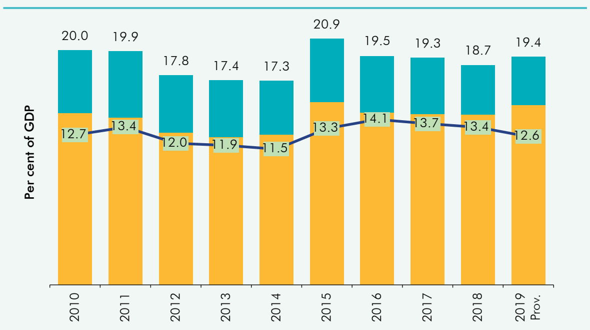
BOX 10

The Importance of Effective Management of Government Expenditure amidst Subdued Revenue Mobilisation

Overview

Sri Lanka's fiscal operations reflect a large structural budget deficit almost throughout the post-independence period amidst subdued revenue collection and growing government expenditure. In fact, government revenue is insufficient to cover even the expenses of a recurrent nature, resulting in a persistent deficit in the government current account (Figure B 10.1). In spite of this, government recurrent expenditure continues to increase, often at a faster pace than the growth of government revenue, worsening the fiscal position further. As recurrent expenditure rises continuously, capital expenditure tends to fall short of the estimates, adversely impacting long term growth prospects of the economy. Nevertheless, the rigidity in primary expenditure of the government (i.e., total expenditure net of interest payments) leaves a constant deficit in the primary balance, except in a few years in the post-independence budgetary operations of Sri Lanka. As the deficits in fiscal operations persisted and were continuously financed through borrowed funds, government debt accumulated over the years, raising concerns about debt sustainability in the period ahead. Unless managed prudently, the management of recurrent expenditure could be challenging in the years ahead, as the government debt stock remains large, and expenditure on interest payments would continue to rise. Other large expenditure categories in recurrent expenditure, such as salaries and wages, and pension payments would make significant pressures on fiscal operations, especially when more cadre is added to the public sector. Moreover, the non-funded pension scheme of the public sector along with an excessive social safety net programmes could exert pressure on fiscal operations, particularly in the backdrop of an increasingly ageing population in the country. Meanwhile, transfer payments to State Owned Business Enterprises (SOBEs) could escalate unless prudent measures are taken to address issues such as management inefficiencies and lack of cost-reflective tariff structures for their products and services. Further, the increased incidence of natural disasters could weigh heavily on expenditure management efforts of the government. While some efforts have been already taken to address these issues, continued focus on the progress of such efforts is essential for fiscal sustainability.

Figure B 10.1
Government Revenue and Expenditure

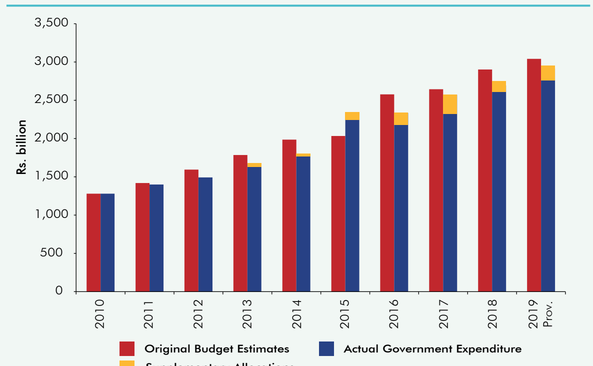


Source: Ministry of Finance, Economic and Policy Development

Government Expenditure: Budgeted vs Actual

Although the actual government expenditure remained below the budget estimates, the effectiveness of the management of government expenditure is called into question by the frequent submission of supplementary allocations[1] in the recent years (Figure B 10.2).[2] The government has raised supplementary allocations continuously for the past seven years and the major portion of them was on account of debt service payments.[3] The submission of supplementary allocations to cover such mandatory expenses of the government does not augur well for prudent management of public expenditure. Such practice often demands a curtailment of expenditure from other areas, mostly capital expenditure, thereby affecting the country's growth prospects. Therefore, it is often argued that issues relating to fiscal operations of Sri Lanka are not only related to revenue shortfall; rather, they also represent the impact of sub optimal management of expenditure.

Figure B 10.2
Government Expenditure - Budgted vs Actual



Source: Ministry of Finance, Economic and Policy Development

Management of Recurrent Expenditure

The rising share of mandatory fiscal expenses such as interest payments, salaries and wages, and pension payments continues to add pressure on fiscal operations, as these three sub components collectively utilised 96 percent of government revenue in 2019

1 Funds that are raised in addition to the budgeted expenditure for a particular year to fulfill the additional fund requirements of the government.

2 Assuming that the funds raised through supplementary allocations were fully utilised during the year.

3 As per the Performance Reports of the National Budget Department.

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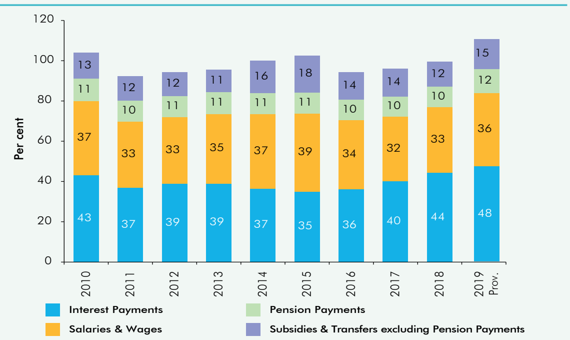
(Figure B 10.3). Meanwhile, expenditure on salaries and wages alone utilised about 36 per cent of government revenue in 2019. Moreover, expenditure on subsidies and transfers including pension payments, which has shown a rising trend in recent years, accounted for 26.7 per cent of government revenue in 2019. Such large expenditure on personal emoluments, and subsidies and transfers leave little room for the provision of other recurrent expenditure on social and economic services such as health, education, agriculture and irrigation, let alone resources required for capital expenditure.

Figure B 10.3
Recurrent Expenditure as a percentage of Government Revenue

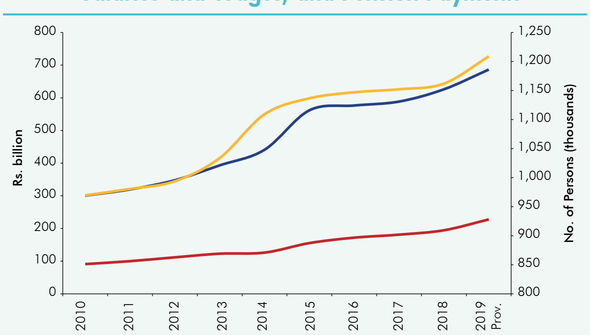


Source: Ministry of Finance, Economic and Policy Development

Expenditure on Personal Emoluments

Expenditure on salaries and wages and pension payments has increased significantly over the years. The increase in public sector recruitments and upward revisions in salary and pension payments contributed to the increase in salaries and wages and pension payments by 11.4 per cent in 2019 over the previous year (Figure B 10.4). During the period 2010-2019, salaries and wages and pension payments, on average, accounted for around 45 per cent of government revenue. As Sri Lanka's population is ageing faster and the size of the government employment tends to be larger in spite of the unfunded pension scheme, fiscal burden on account of expenditure on salaries and wages and pension payments could rise significantly in the period ahead.

Figure B 10.4
Government Employees (a) and Expenditure on Salaries and Wages, and Pension Payments



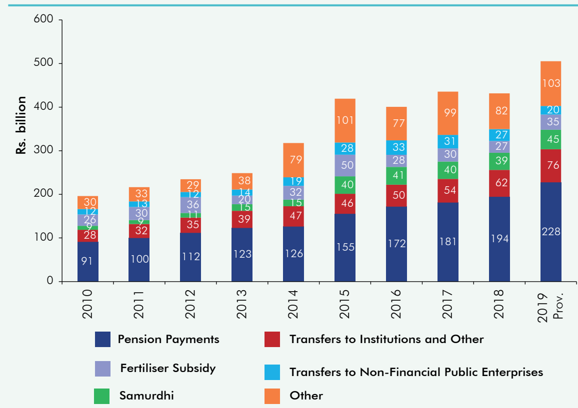
(a) Include employees of the Central Government, Local Government and Provincial Councils

Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

Expenditure on Subsidies and Transfers

The government spends about 3-4 per cent of GDP (equivalent to about 15 per cent of government revenue) on subsidy and transfer programmes. Although such subsidies are provided with the aim of uplifting the living standards of economically vulnerable groups, it is often observed that some of the subsidy and transfer programmes are ineffective in reducing poverty and inequality due to inefficiencies stemming from ill-targeting and a high level of leakages. For instance, although the Samurdhi programme is implemented with the objective of uplifting the living standards of vulnerable people in the society, it is often observed that the beneficiaries continue to remain in the programme for years, while ineligible persons could also enter the programme under the current selection process. With regard to the fertiliser subsidy programme, issues such as the overuse of subsidised fertliser hinder the effectiveness and sustainability of the programme while raising concerns over soil and water pollution and food safety of the country. Further, with an ageing population,

Figure B 10.5
Expenditure on Subsidies and Transfers



Source: Ministry of Finance, Economic and Policy Development

the country's expenditure needs tend to increase in areas such as health, education and provision of social safety nets. Further, Sri Lanka experiences frequent natural hazards commonly caused by floods, landslides and droughts with increasing losses of life and property while causing additional pressure on the government budget. The recent spread of the COVID-19 pandemic has also highlighted the need for fiscal space to address such catastrophes as well as an improved system to disburse subsidies to affected businesses and individuals when required. Therefore, unplanned expenditure emanating from increased incidence of natural disasters on account of costs incurred on compensation and mitigation measures could exacerbate pressure on managing public expenditure. Moreover, transfers to SOBEs could rise further in the period ahead unless appropriate measures are initiated to revive their weak financial performance on a sustainable basis and improve their financial strength.

Expenditure on Public Investment

The rising share of recurrent expenditure limits the space available for public investment (Figure B 10.6). However, curtailing public investment is counter-productive and will dampen economic growth over the medium to long term. A moderation in public investment, mainly

Figure B 10.6
Relative Share of Recurrent Expenditure and Public Investment

Source: Ministry of Finance, Economic and Policy Development

in the areas of economic and social infrastructure, was observed in the last decade or so (Figure B 10.7). Expenditure on economic infrastructure, the largest item in public investment, which includes agriculture and

Figure B 10.7
Composition of Public Investment

Source: Ministry of Finance, Economic and Policy Development

irrigation, energy and water supply, and transport and communication reflects significant variations over the years with a general downward trend, while expenditure on social infrastructure that includes education, health, housing, and community services remains low. Maintaining such low levels of public investment in order to offset overruns in recurrent expenditure would hinder long term development prospects of the country.

Way Forward

Strengthening fiscal consolidation requires effective management of government expenditure while maintaining an appropriate balance between government revenue and economic growth. Expenditure management requires commitment to fiscal discipline and maintain the budget outturn in line with the annual budget estimate. In this regard, several aspects warrant special emphasis of the government including a well planned policy of recruitment to the public sector, thereby containing the rising expenditure on salaries and wages and pension liabilities. The introduction of a nationwide contributory pension scheme and a possible extension of the retirement age could be considered as alternatives. Meanwhile, the National Pay Commission, which was established in early 2020, could provide guidance and assistance to the government in formulating and executing a National Salaries Policy by revisiting the remuneration structures of the public and private sectors. Further, expenditure on subsidies and transfers could be rationalised by ensuring better targeting of safety net programmes while curtailing the unnecessary administrative expenses. In this regard, identifying the economically vulnerable segments of the society through a carefully designed methodology would help exclude unintended beneficiaries. Moreover, strengthening the monitoring process of SOBEs will enable the government to develop loss making SOBEs as profitable entities while enhancing the profitability of existing profit making entities, thereby reducing the burden on the central government budget. Further, ensuring effective adherence to the Statements of Corporate Intent (SCIs) signed by 13 SOBEs would enhance the effectiveness of SOBEs. Meanwhile, essential investment in physical infrastructure and human capital would need to continue in order to realise the envisaged growth in the medium to long term. In this regard, curtailing or postponing of planned public investment in priority areas need to be avoided while identifying alternative funding arrangements, such as Public Private Partnerships (PPPs) on a sustained basis.

investment increased by 1.0 per cent to Rs. 631.2 billion in 2019. Expenditure incurred by Ministries and Departments on the acquisition of real assets, including the purchase of capital assets, and construction and development of fixed assets, increased by 8.2 per cent to Rs. 385.0 billion in 2019. Capital transfers declined by 8.8 per cent to Rs. 234.1 billion due to the reduction in transfers to public corporations. Meanwhile, on lending of the government to public corporations amounted to Rs. 12.2 billion in 2019, a decline of 2.0 per cent from Rs. 12.4 billion recorded in 2018.

Public investment in economic services increased, while public investments in social services declined during the year. Accordingly, public investment in economic services increased to Rs. 475.9 billion in 2019 from Rs. 437.9 billion in 2018 while public investment in social services declined to Rs. 112.9 billion in 2019 from Rs. 133.2 billion in 2018. Public investment in economic services was largely directed towards improving the quality of the transport network of the country. Public investment in social services focused mainly on upgrading the quality of education and health sectors. During the year, actions were taken to improve the infrastructure of the education sector with the aim of improving the quality of education while public investment in the health sector focused mainly on constructing and upgrading hospitals to enhance the quality of service delivery in the health sector.

Key Fiscal Balances

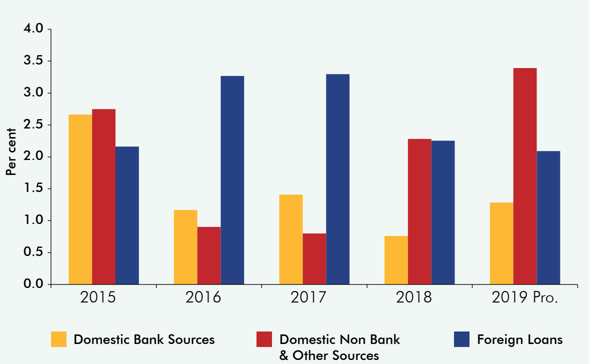
Key fiscal balances deteriorated in 2019, amidst a notable decline in government revenue resulted mainly from the impact of large import compression, prolonged moderation of economic activity that was exacerbated by the Easter Sunday attacks, and the rise in recurrent expenditure mainly on account of subsidies and transfers and salaries and wages. Accordingly, the overall budget deficit as a percentage of GDP increased to 6.8 per cent (Rs. 1,016.5 billion) in 2019 from 5.3 per cent (Rs. 760.8 billion) in the previous year. The current account deficit, which reflects dissavings of the government, expanded to 2.7 per cent of GDP (Rs. 410.3 billion) in 2019 from 1.2 per cent of GDP (Rs. 169.7 billion) in 2018. Meanwhile, the primary balance, which excludes interest payments from the overall deficit and reflects the discretionary component of fiscal policy, turned to a deficit of 0.8 per cent of GDP (Rs. 115.1 billion) compared to a surplus of 0.6 per cent of GDP (Rs. 91.4 billion) in 2018, reversing the favourable trend observed during the last two years.

Financing of the Budget Deficit

The government relied more on domestic sources in financing the budget deficit in 2019. Net financing through domestic sources accounted for 4.7 per cent of GDP in 2019 in comparison to 3.0 per cent of GDP in 2018. Further, net domestic financing contributed 69.1 per cent (Rs. 702.4 billion) of the total financing requirement in 2019 in comparison to 57.5 per cent (Rs. 437.2 billion) in 2018. Accordingly, the share of net financing through foreign sources declined significantly to 30.9 per cent (Rs. 314.1 billion) in 2019 from 42.5 per cent (Rs. 323.5 billion) in 2018. Net financing through foreign sources, as a percentage of GDP, declined to 2.1 per cent in 2019 from 2.3 per cent in 2018.

In the composition of net domestic financing, borrowing from non expansionary sources increased and continued to be the largest in 2019. Accordingly, government borrowings from the non banking sector increased significantly to Rs. 509.3 billion, accounting for 72.5 per cent of total net domestic financing in 2019, compared to 75.0 per cent (Rs. 327.8 billion) in 2018. Financing from the banking sector amounted to Rs. 193.1

Figure 6.6
Deficit Financing (Net)
(as a percentage of GDP)



Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

billion in 2019, representing 27.5 per cent of total net domestic borrowings, compared to 25.0 per cent (Rs. 109.5 billion) recorded in 2018. Financing from the Central Bank recorded a net repayment of Rs. 108.1 billion in 2019 compared to net financing of Rs. 246.1 billion in 2018, mainly due to net repayment in Treasury bills held by the Central Bank. However, net borrowings through provisional advances from the Central Bank increased to Rs. 38.0 billion in 2019

Table 6.5
Sources of Domestic Financing (Net)

Rs. billion

Item	2016	2017	2018	2019 (a)
By Instrument	**248.4**	**294.3**	**437.2**	**702.4**
Treasury Bonds (b)(c)	349.8	109.1	374.5	429.0
Treasury Bills (d)	98.5	-81.7	52.9	123.8
Sri Lanka Development Bonds	-120.5	53.3	-129.5	-50.0
Central Bank Provisional Advances	-67.8	116.5	-1.2	38.0
Other (e)	-11.5	97.0	140.4	161.6
By Source	**248.4**	**294.3**	**437.2**	**702.4**
Bank	140.0	187.7	109.5	193.1
Non Bank (e)	108.5	106.5	327.8	509.3

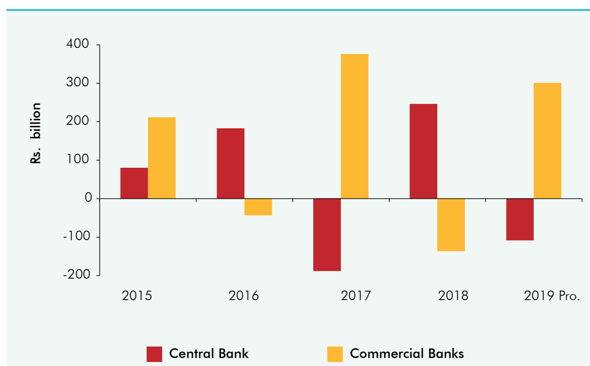
(a) Provisional
(b) Excludes rupee denominated Treasury bonds issued to foreign investors
(c) Includes Treasury bonds of Rs. 4,397 million issued to CWE in November 2003 (matured on 14 November 2016), Rs. 13,125 million issued to capitalise SriLankan Airlines in March 2013 (matured on 01 June 2018) and Rs. 78,441 million issued to CPC in January 2012 (of which Rs. 21,778 million matured on 01 January 2017 and the outstanding as at end 2019 is Rs. 56,662 million).
(d) Excludes rupee denominated Treasury bills issued to foreign investors.
(e) Includes proceeds from the long lease of Hambantota port in 2017 and 2018

Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

compared to a marginal net repayment of Rs. 1.2 billion in 2018. Meanwhile, net financing from commercial banks also increased significantly to Rs. 301.2 billion during 2019, compared to a net repayment of Rs. 136.6 billion in 2018. An increase in Treasury bills and Treasury bonds holdings of commercial banks coupled with an increase in borrowings from Foreign Currency Banking Units (FCBUs) mainly contributed to the net increase in borrowings from the banking sector in 2019.

Net financing from foreign sources declined marginally in 2019 owing to the net repayments of Foreign Currency Term Financing Facility (FCTFF) and foreign investment in Treasury bonds despite the notably high gross issuances of International Sovereign Bonds (ISBs) during 2019. Accordingly, net financing of the budget deficit through foreign sources reduced to Rs. 314.1 billion in 2019 from Rs. 323.5 billion in 2018. Net borrowings through ISBs increased to Rs. 461.4 billion (US dollars 2.6 billion) during 2019, which is the difference between the new issuances of Rs. 782.5 billion (US dollar 4.4 billion) and repayment of Rs. 269.8 billion (US dollars 1.5 billion) together with the unutilised balance of Rs. 51.4 billion (US dollars 0.3 billion) at the end of 2019. In 2018, net financing from ISBs amounted to Rs. 390.4 billion (US dollars 2.5 billion). Borrowings through FCTFF recorded a net repayment of Rs. 83.5 billion

Figure 6.7
Sources of Bank Financing (Net)



Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

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(US dollars 467.0 million) during 2019 in comparison to the net borrowings of Rs. 66.6 billion (US dollars 372.5 million) in 2018. A net outflow of Rs. 59.3 billion was recorded in respect of foreign holdings of Treasury bonds, while net foreign investment in Treasury bills amounted to Rs. 10.6 billion during the year. Foreign project loans recorded a net repayment of Rs. 15.2 billion in 2019 compared to the net financing of Rs. 7.7 billion in the previous year. On the basis of gross financing, the Export-Import Bank of China (Exim Bank), International Development Association (IDA) and ADB were the main sources of financing in 2019, on account of foreign funded projects.

With regard to instrument-wise net domestic financing, borrowings through Treasury bills and Treasury bonds increased significantly, while SLDB borrowings declined in 2019. Accordingly, domestic instrument-based borrowings increased to Rs. 502.8 billion in 2019 from Rs. 298.0 billion in 2018 due to higher borrowings through rupee denominated government securities. Borrowings through Treasury bonds increased to Rs. 429.0 billion in 2019 from Rs. 374.5 billion in 2018, while borrowings through Treasury bills increased to Rs. 123.8 billion in 2019 from Rs. 52.9 billion in 2018. However, borrowings through SLDBs recorded a net repayment of Rs. 50.0 billion compared to a net repayment of Rs. 129.5 billion in 2018. Meanwhile, non instrument borrowings also increased to Rs. 199.6 billion in 2019 compared to Rs. 139.2 billion in 2018 due to the increase in borrowings through FCBUs and provisional advances obtained from the Central Bank during the year, amounting to Rs. 67.9 billion and Rs. 38.0 billion, respectively.

Foreign currency denominated domestic borrowings increased in 2019 mainly due to higher borrowings from FCBUs. Accordingly, borrowings through FCBUs increased, on a net basis, to Rs. 67.9 billion in 2019 from Rs. 19.1 billion recorded in 2018. However, borrowings through SLDBs recorded a net repayment of Rs. 50.0 billion in 2019, while gross borrowings amounted to Rs. 61.9 billion (US dollars 345.2 million) and repayments amounted to Rs. 111.8 billion (US dollars 621.8 million). On a net basis, foreign currency denominated domestic borrowings increased to Rs. 18.0 billion in 2019 compared to a net repayment of Rs. 110.4 billion in 2018, while rupee denominated net domestic financing amounted to Rs. 684.4 billion in 2019 compared to Rs. 547.6 billion in 2018.

The government raised US dollars 4.4 billion through the issuance of ISBs twice during 2019. The government issued its 13th ISB and raised US dollars 2.4 billion in March 2019. This issuance comprised two tenures of US dollars 1.0 billion with a 5 year maturity at a yield of 6.85 per cent and US dollars 1.4 billion with a 10 year maturity at a yield of 7.85 per cent. In June 2019, ISBs amounting to US dollars 2.0 billion were issued, which comprised US dollars 500 million with a 5 year maturity at a yield of 6.35 per cent and US dollars 1.5 billion with a long 10 year maturity at a yield of 7.55 per cent per annum.

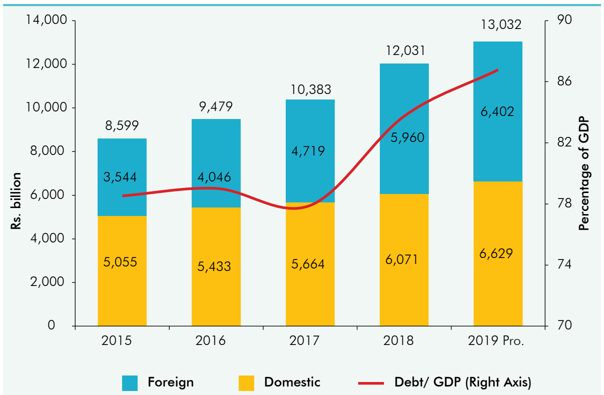
6.4 Government Debt and Debt Service Payments

Central Government Debt

The central government debt to GDP ratio increased to 86.8 per cent at end 2019 from 83.7 per cent at end 2018, reflecting the impact of higher net borrowings to finance the enlarged budget deficit, while the relatively low nominal GDP also contributed to increase the debt to GDP ratio. In absolute terms, the outstanding central government debt increased by 8.3 per cent (Rs. 1,001.0 billion) to Rs. 13,031.5 billion at end 2019 in comparison to the increase of 15.9 per cent (Rs. 1,647.7 billion) recorded at end 2018. The share of domestic and foreign debt as a percentage of GDP rose to 44.1 per cent and 42.6 per cent, respectively, at end 2019 from 42.3 per cent and 41.5 per cent, respectively, at end 2018. Of the increase of the debt stock, a sum of Rs. 93.6 billion can be attributed to the discount factor, which is the net amount of the difference between the book value and the face value of issuances of Treasury bills and Treasury bonds in 2019. Meanwhile, the parity variation contributed to an increase of Rs. 12.4 billion of the central government debt stock in 2019 compared to the notable increase of Rs. 1,063.2 billion in 2018.

The relative share of domestic debt in the total outstanding debt rose marginally to 50.9 per cent at end 2019 from 50.5 per cent at end 2018, reflecting the increased dependence on domestic sources to finance the budget deficit during the year. In nominal terms, domestic debt increased by 9.2 per cent to Rs. 6,629.1 billion at end 2019 in comparison to the increase of 7.2 per cent in 2018. The share of short term debt in total domestic debt increased to 19.2 per cent at end 2019 from 18.7 per cent at end 2018, due to the increase in the outstanding stock of Treasury bills and provisional advances to the government by the Central Bank. Outstanding Treasury bills increased by 17.0 per cent to Rs. 873.9 billion by end 2019 from Rs. 746.9 billion at end 2018. Meanwhile, the outstanding balance of provisional advances increased by 19.1 per cent to Rs. 236.6 billion at end

Figure 6.8
Outstanding Central Government Debt



Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

2019 from Rs. 198.6 billion at end 2018. However, the share of medium to long term debt in the domestic debt stock declined marginally to 80.8 per cent as at end 2019 from 81.3 per cent at end 2018. The outstanding balance of Treasury bonds continued to dominate the domestic debt portfolio, accounting for 69.5 per cent (Rs. 4,606.2 billion) at end 2019 in comparison to 69.1 per cent (Rs. 4,197.3 billion) at end 2018. Meanwhile, outstanding stock of SLDBs declined by 8.8 per cent to Rs. 560.2 billion at end 2019, while the outstanding balance of debt from FCBUs rose to Rs. 168.0 billon at end 2019 from Rs. 100.5 billion at end 2018.

The outstanding debt of the central government owed to the domestic banking sector increased by 16.5 per cent to Rs. 2,739.5 billion as at end 2019, reflecting a significant increase in the outstanding debt held by both the Central Bank and commercial banks. The share of the banking sector debt in total domestic debt increased to 41.3 per cent at end 2019 from 38.7 per cent at end 2018. The outstanding debt owed to the Central Bank increased by 27.4 per cent to Rs. 310.9 billion at end 2019, due to the increase in provisional advances to the government to Rs. 236.6 billion at end 2019 from Rs. 198.6 billion at end 2018. The government debt held by commercial banks also increased by 15.2 per cent to Rs. 2,428.7 billion at end 2019 compared to end 2018 due to the increase of holdings of both Treasury bills and Treasury bonds, and increase in FCBU loans, despite the decline in outstanding holdings of SLDBs to Rs. 560.2 billion at end 2019 from Rs. 614.2 billion at end 2018. The stock of Treasury bills held by commercial banks increased significantly by 40.0 per cent to Rs. 684.7 billion at end 2019 from Rs. 489.2 billion at end 2018, while the stock of Treasury bonds held by commercial banks increased by 20.2 per cent to Rs. 839.5 billion at end 2019. Domestic debt held by the non bank sector increased by 4.6 per cent to Rs. 3,889.4 billion by end 2019 from Rs. 3,719.1 billion at end 2018, reflecting

Table 6.6
Outstanding Central Government Debt (as at end year)

Rs. million

Item	2016	2017	2018	2019 (a)
Total Government Debt	**9,478,869**	**10,382,832**	**12,030,548**	**13,031,543**
Domestic Debt (b)	**5,433,073**	**5,664,215**	**6,071,001**	**6,629,104**
By Maturity Period				
Short Term	968,396	1,031,181	1,134,553	1,270,374
Medium and Long Term	4,464,677	4,633,033	4,936,447	5,358,731
By Institution				
Bank	2,198,909	2,383,663	2,351,940	2,739,583
Non Bank	3,234,164	3,280,552	3,719,061	3,889,521
Foreign Debt	**4,045,796**	**4,718,618**	**5,959,547**	**6,402,439**
By Type				
Concessional Loans	1,897,680	2,130,482	2,705,836	2,767,459
Non Concessional Loans	538,859	560,207	268,556	311,676
Commercial (c)	1,609,257	2,027,928	2,985,156	3,323,304
By Currency				
SDR	755,614	829,537	954,761	927,372
US Dollars	2,207,431	2,650,431	3,781,626	4,277,745
Japanese Yen	496,852	516,218	622,852	624,956
Euro	183,561	208,075	225,831	228,713
Other	402,338	514,356	374,477	343,653
Memo: Total Exchange Rate Variation	186,650	225,223	1,063,218	12,401
On Foreign Debt	161,697	211,868	963,181	16,857
On Foreign Currency Denominated Domestic Debt	24,953	13,355	100,037	-4,456

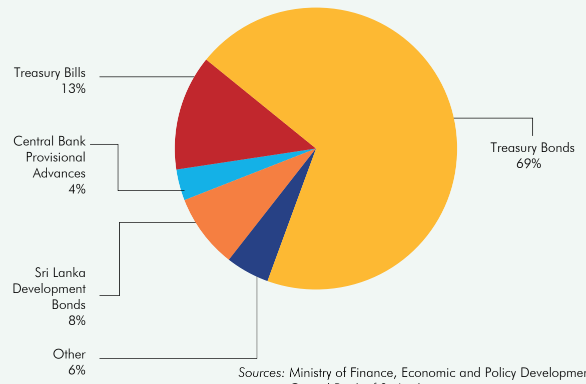
(a) Provisional
(b) Includes Treasury bonds of Rs. 4,397 million issued to CWE in November 2003 (matured on 14 November 2016), Rs. 13,125 million issued to capitalise SriLankan Airlines in March 2013 (matured on 01 June 2018) and Rs. 78,441 million issued to CPC in January 2012 (of which Rs. 21,778 million matured on 01 January 2017 and the outstanding as at end 2019 is Rs. 56,662 million).
(c) Includes outstanding amounts of foreign investment in rupee denominated Treasury bills and Treasury bonds.

Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

an increase in financing from non bank sources in 2019, although the share of non bank sector debt in total domestic debt declined to 58.7 per cent by end 2019 from 61.3 per cent at end 2018.

The foreign currency denominated domestic debt increased to Rs. 728.2 billion (US dollars 4,009.4 million) at end 2019 from Rs. 714.7 billion (US dollars 3,911.0 million) at end 2018. The outstanding balance of FCBU loans rose notably to Rs. 168.0 billion (US dollars 925 million) at end 2019 in comparison to Rs. 100.5 billion (US dollars 550.0 million) at end 2018. The outstanding balance of SLDBs declined to Rs. 560.2 billion (US dollars 3,084.4 million) at end 2019 from Rs. 614.2 billion (US dollars 3,361.0 million) at end 2018. Meanwhile, rupee denominated

Figure 6.9
Composition of Outstanding Central Government Domestic Debt - 2019

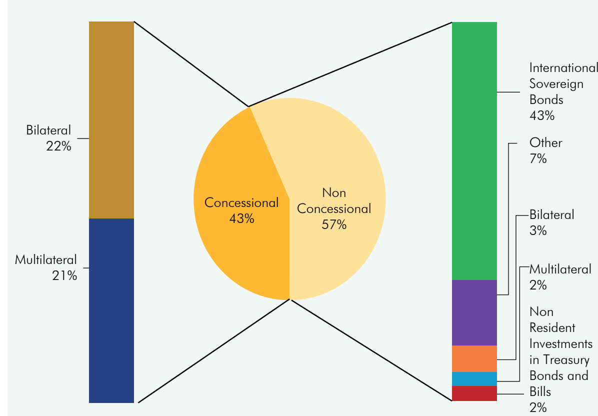


Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

domestic debt (excluding the foreign holdings) increased by Rs. 544.6 billion to Rs. 5,900.9 billion at end 2019, mainly comprising Treasury bonds amounting to Rs. 4,606.2 billion and Treasury bills amounting to Rs. 873.9 billion.

The total outstanding foreign debt in rupee terms increased by 7.4 per cent to Rs. 6,402.4 billion at end 2019, while the relative share of foreign debt in the total debt stock declined marginally to 49.1 per cent at end 2019 from 49.5 per cent at end 2018. The outstanding non concessional debt increased by 11.7 per cent to Rs. 3,635.0 billion in 2019, raising the share of non concessional debt in total foreign debt to

Figure 6.10
Composition of Outstanding Central Government Foreign Debt - 2019



Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

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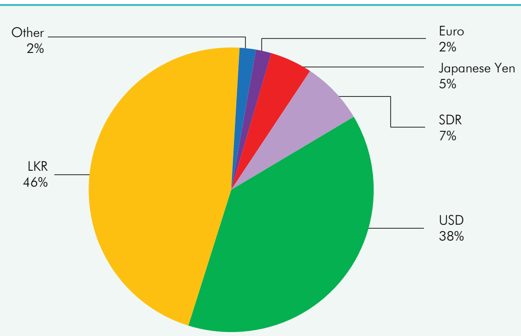
56.8 per cent at end 2019 from 54.6 per cent at end 2018. The increase in non concessional debt was mainly due to further foreign commercial borrowings during the year, which included the issuance of ISBs (US dollars 4.4 billion) that raised the outstanding stock of ISBs notably to Rs. 2,733.6 billion (US dollars 15.1 billion) at end 2019. However, the outstanding stock of FCTFFs declined to Rs. 242.2 billion at end 2019 due to a repayment of Rs. 83.5 billion (US dollars 467.0 million) during the year. The outstanding balance of Treasury bonds held by foreign investors declined by Rs. 66.6 billion to Rs. 80.3 billion by end 2019, reflecting the impact of outflows of foreign investment from the Treasury bond market, especially during the second and third quarters of 2019. The outstanding balance of Treasury bills held by foreign investors, however, increased by Rs. 11.8 billion to Rs. 23.7 billion at end 2019. Meanwhile, the outstanding balance of concessional debt in the stock of foreign debt increased marginally by 2.3 per cent to Rs. 2,767.5 billion at end 2019 from Rs. 2,705.8 billion at end 2018 although the share of concessional debt in foreign debt declined to 43.2 per cent at end 2019.

The rupee value of outstanding debt increased by Rs. 12.4 billion due to the impact of the exchange rate variation at end 2019. The Sri Lankan rupee recorded an appreciation

Figure 6.11
Currency Composition of Total Outstanding Central Government Debt - 2019



Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

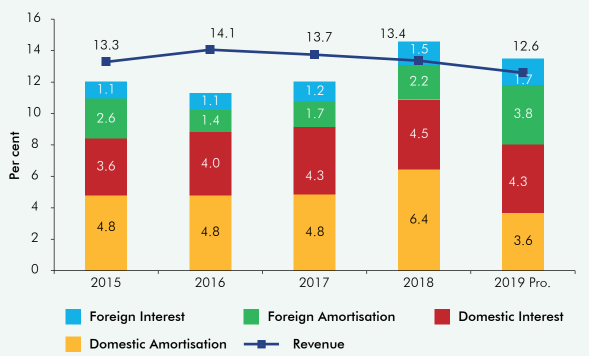
against the euro, the Indian rupee, Special Drawing Rights (SDR) and the US dollar by 2.62 per cent, 2.61 per cent, 0.93 per cent and 0.61 per cent, respectively, while depreciating by 2.77 per cent and 1.02 per cent, respectively, against the Pound Sterling and the Japanese yen during the year. The currency-wise composition of central government foreign debt stood as US dollars (66.8 per cent), SDR (14.5 per cent), Japanese yen (9.8 per cent), euro (3.6 per cent) and other currencies (5.4 per cent) at end 2019. Consequently, the outstanding stock of foreign debt increased by Rs. 16.9 billion, while the foreign currency denominated domestic debt (SLDBs and loans from FCBUs), which is denominated in US dollars, declined by Rs. 4.5 billion due to the impact of exchange rate variation at end 2019. As a comparison, in 2018, the outstanding stock of foreign debt increased by Rs. 963.2 billion mainly due to the depreciation of the Sri Lankan rupee against major foreign currencies, while the foreign currency denominated domestic debt stock also increased by Rs. 100.0 billion due to the depreciation of the Sri Lankan rupee against the US dollar. Although the impact of depreciation of the Sri Lankan rupee would be reflected as an increase in the government foreign currency debt stock in rupee terms, the outstanding debt stock denominated in foreign currency would remain unchanged in terms of foreign currency, irrespective of such depreciation. As the debt denominated in foreign currency would be serviced using foreign currency inflows to the government, the impact of such a nominal increase in the outstanding balance due to the depreciation of the rupee would be less material in the context of foreign currency debt servicing.

Central Government Debt Service Payments

Total debt service payments in 2019 amounted to Rs. 2,022.5 billion, recording a decline of 3.2 per cent in comparison to Rs. 2,088.6 billion in 2018, reflecting the decline

in amortisation payments on domestic debt during the year. Repayments of domestic debt declined by 40.7 per cent to Rs. 546.3 billion in 2019 from Rs. 921.9 billion in 2018, mainly due to the decline in SLDB maturities by 69.2 per cent (Rs. 251.7 billion) year-on-year, and the decline in maturities of Treasury bonds and FCBUs by Rs. 82.8 billion and Rs. 45.2 billion year-on-year, respectively. However, repayments of foreign loans rose significantly by 82.8 per cent to Rs. 574.8 billion in 2019, reflecting the maturity of ISBs of US dollar 1,500 million and FCTFFs (US dollars 473 million). Consequently, amortisation payments, which accounted for 55.4 per cent of total debt service payments, declined by 9.3 per cent to Rs. 1,121.2 billion in 2019 from Rs. 1,236.4 billion in 2018. Meanwhile, interest payments increased by 5.8 per cent to Rs. 901.4 billion in 2019 from Rs. 852.2 billion in 2018 due to the increase in interest payments on both domestic and foreign outstanding debt. Interest payments on foreign debt rose by 16.9 per cent (Rs. 35.8 billion) to Rs. 248.6 billion in 2019 in comparison to Rs. 212.7 billion in 2018 mainly due to the increase in interest payments on ISBs. Interest payments on domestic debt increased by 2.1 per cent to Rs. 652.8 billion in 2019 from Rs. 639.5 billion in 2018, mainly due to the increase in interest payments on Treasury bills

Figure 6.12
Central Government Debt Service Payments (as a percentage of GDP)



Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

Table 6.7
Central Government Debt Service Payments

Rs. million

Item	2016	2017	2018	2019 (a)
Debt Service Payments	1,352,443	1,603,049	2,088,551	2,022,507
Domestic	1,056,624	1,213,498	1,561,363	1,199,111
Foreign	295,820	389,551	527,188	823,396
Amortisation Payments	741,549	867,484	1,236,361	1,121,155
Domestic	572,442	642,875	921,881	546,315
Foreign	169,107	224,609	314,480	574,839
Interest Payments	610,895	735,566	852,190	901,352
Domestic	484,182	570,623	639,482	652,795
Short Term	78,787	81,275	74,525	81,029
Medium and Long Term	405,394	489,348	564,957	571,766
Foreign	126,713	164,942	212,708	248,557

(a) Provisional

Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

and FCBU loans. Overall, domestic debt service payments declined by 23.2 per cent to Rs. 1,199.1 billion, while foreign debt service payments rose by 56.2 per cent to Rs. 823.4 billion during 2019.

Most debt service payments related indicators showed an improvement in 2019, while certain indicators such as the ratio of debt service payments to government revenue, remained a concern. Total debt service payments declined to 13.5 per cent of GDP in 2019 from 14.5 per cent of GDP in the previous year. Amortisation payments on domestic debt as a percentage of GDP declined to 3.6 per cent in 2019 from 6.4 per cent in 2018, while amortisation payments on foreign debt increased to 3.8 per cent of GDP in 2019 from 2.2 per cent of GDP in 2018. Total interest payments as a percentage of GDP increased marginally to 6.0 per cent in 2019 from 5.9 per cent in 2018. Interest payments on domestic debt declined to 4.3 per cent of GDP in 2019 from 4.5 per cent of GDP in 2018, while interest payments on foreign debt increased to 1.7 per cent of GDP in 2019 from 1.5 per cent of

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Table 6.8
Central Government Debt Indicators

Indicator	2016	2017 (a)	2018 (a)	2019 (b)
Central Government Debt/GDP	79.0	77.9	83.7	86.8
Domestic Debt/GDP (c)	45.3	42.5	42.3	44.1
Foreign Debt/GDP	33.7	35.4	41.5	42.6
Total Foreign Debt/Exports (d)	159.3	162.2	181.0	184.4
Total Debt Service/GDP	11.3	12.0	14.5	13.5
Total Debt Service/Government Revenue (e)	80.2	87.5	108.8	107.0
o/w Domestic Debt Service/Government Revenue (e)	62.7	66.3	81.3	63.4
Total Debt Service/Government Expenditure (f)	44.0	46.6	53.1	50.1
o/w Domestic Debt Service/Government Expenditure (f)	34.4	35.3	39.7	29.7
Foreign Debt Service/Exports (d)	11.6	13.4	16.0	23.7
Total Interest/GDP	5.1	5.5	5.9	6.0
Domestic Interest/GDP	4.0	4.3	4.5	4.3
Domestic Interest/Government Recurrent Expenditure	27.5	29.6	30.6	28.4
Foreign Interest/Exports (d)	5.0	5.7	6.5	7.2

(a) For 2017 and 2018 , revised GDP estimates were used, as released by the Department of Census and Statistics on 31 March 2020.
(b) Provisional
(c) Includes Treasury bonds of Rs. 4,397 million issued to CWE in November 2003 (matured on 14 November 2016), Rs. 13,125 million issued to capitalise SriLankan Airlines in March 2013 (matured on 01 June 2018) and Rs. 78,441 million issued to CPC in January 2012 (of which Rs. 21,778 million matured on 01 January 2017 and the outstanding as at end 2019 is Rs. 56,662 million).
(d) Export of goods and services
(e) Government revenue is in economic format
(f) Government expenditure includes amortisation payments

Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka
Department of Census and Statistics

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GDP in the previous year. Although the ratio of debt service payments to government revenue improved to 107.0 per cent in 2019 from 108.8 per cent in 2018, the level of debt service payments in excess of the level of government revenue remained a concern. Meanwhile, the ratio of foreign debt service payments to exports of goods and services rose to 23.7 per cent in 2019 from 16.0 per cent in 2018.

Outstanding Public Debt

The outstanding public debt, which includes the debt of central government, foreign project loans received by SOBEs[8] and public guaranteed debt, increased to 94.3 per cent of GDP at end 2019 from 91.7 per cent of GDP at end 2018. This was mainly due to an increase in central government debt during 2019. In absolute terms, the total outstanding public debt increased to Rs. 14,155.3 billion at end 2019 from Rs. 13,178.4 billion at end 2018. The outstanding central government debt, which is the largest share of public debt, increased by 8.3 per cent to Rs. 13,031.5 billion at end 2019, accounting for 92.1 per cent of the total public debt. Public guaranteed debt declined marginally by 0.4 per cent to Rs. 778.3 billion at end 2019 from Rs. 781.7 billion at end 2018, accounting for 5.5 per cent of the total outstanding public debt. The foreign project loans received by SOBEs declined to Rs. 345.5 billion at end 2019 from Rs. 366.1 billion at end 2018 due to the repayment of outstanding loans by the Ceylon Electricity Board (CEB) and the Sri Lanka Ports Authority (SLPA) during 2019.The outstanding debt of CEB and the Airport and Aviation Services Limited declined by 10.8 per cent and 10.6 per cent, respectively, at end 2019, although the outstanding debt of SLPA increased marginally by 0.1 per cent. The SLPA and CEB were the major holders of SOBE's debt accounting for 50.0 per cent and 43.5 per cent, respectively, at end 2019.

8 Foreign project loans received by SOBEs without public guarantee

6.5 Budgetary Operations in Sub National Governments

Policy Directions and Measures taken by Sub National Governments

The Ministry of Public Administration, Home Affairs, Provincial Councils and Local Government[9] continued to work in close coordination with the sub national governments in 2019. The sub national government system

9 The functions of the sub national governments in 2019 were carried out under the Ministry of Internal and Home Affairs and Provincial Councils and Local Government until 09 December 2019. With effect from 10 December 2019, the functions of the sub national governments come under the purview of the Ministry of Public Administration, Home Affairs, Provincial Councils and Local Government as per the Gazette Notification No. 2153/12 issued on 10 December 2019.

Table 6.9
Outstanding Public Debt (as at end year)

	2016	2017	2018	2019 (a)
	Rs.million			
Total Outstanding Central Government Debt (b)	**9,478,869**	**10,382,832**	**12,030,548**	**13,031,543**
Foreign Project Loans Received by SOBEs without Public Guarantee	**332,305**	**330,221**	**366,130**	**345,453**
Airport & Aviation Services (Sri Lanka) Ltd.	23,791	23,955	24,964	22,317
Ceylon Electricity Board	166,613	155,535	168,649	150,418
Sri Lanka Ports Authority	141,901	150,730	172,517	172,717
Public Guaranteed Debt (c) (d)	**523,274**	**590,492**	**781,741**	**778,305**
Airport & Aviation Services (Sri Lanka) Ltd.	1,386	9,330	10,829	16,532
Ceylon Electricity Board	19,927	15,153	21,376	25,212
Ceylon Petroleum Corporation	74,363	207,622	333,869	297,220
Ceylon Shipping Corporation Ltd.	11,331	11,436	13,098	12,613
General Sir John Kotelawala Defence University	20,187	28,060	36,843	35,311
Lanka Coal Company (Pvt.) Ltd.	6,000	5,886	11,000	5,398
National Water Supply & Drainage Board	20,365	63,836	85,541	102,339
Paddy Marketing Board	5,377	11,087	11,436	11,420
Road Development Authority	141,948	162,701	189,022	206,563
SriLankan Airlines Ltd.	26,215	26,750	31,981	32,083
Other Corporations	196,176	48,631	36,746	33,615
Public debt	**10,334,448**	**11,303,545**	**13,178,418**	**14,155,301**
	As a Percentage of GDP (e)			
Total Outstanding Central Government Debt (b)	79.0	77.9	83.7	86.8
Foreign Project Loans Received by SOBEs without Public Guarantee	2.8	2.5	2.5	2.3
Public Guaranteed Debt (c) (d)	4.4	4.4	5.4	5.2
Public debt	**86.1**	**84.8**	**91.7**	**94.3**

(a) Provisional
(b) Includes Treasury bonds of Rs. 4,397 million issued to CWE in November 2003 (matured on 14 November 2016), Rs. 13,125 million issued to capitalise SriLankan Airlines in March 2013 (matured on 01 June 2018) and Rs. 78,441 million issued to CPC in January 2012 (of which Rs. 21,778 million matured on 01 January 2017 and the outstanding as at end 2019 is Rs. 56,662 million).
(c) Includes only non financial public corporations
(d) Includes an international bond amounting to US dollars 175 million issued by the SriLankan Airlines in June 2014. This was matured in June 2019 and reissued a bond at the same amount.
(e) For 2017 and 2018, revised GDP estimates were used, as released by the Department of Census and Statistics on 31 March 2020.

Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

in Sri Lanka comprises nine Provincial Councils (PCs) and 341 Local Government authorities (LGs). By end 2019, the LG system comprised 24 Municipal Councils, 41 Urban Councils and 276 Pradeshiya Sabhas. With the view of ensuring a balanced regional development, the Ministry focused on identifying the development needs at the sub national government level while facilitating investments through effective donor coordination during the year. Meanwhile, a significant amount of grants was provided by the central government to fulfill the budgetary requirements of the sub national governments.

Development projects were mainly directed towards developing infrastructure facilities in the sub national governments during the year. Accordingly, the Local Government Enhancement Sector Project (Pura Neguma programme) continued in 2019, which helped improve access to safe and affordable drinking water. Further, the Primary Health Care System Strengthening Project and the General Education Modernisation Project were implemented during the year with the objective of upgrading health and educational facilities. Moreover, several road development projects were carried out during the year in order to upgrade the transport network of the country. In addition, the Greater Colombo Waste Water Management/ Investments/ Improvement Project continued during the year.

With the view of achieving well balanced regional development, the Finance Commission (FC) recommended several measures in 2019. Accordingly, policy recommendations on allocating funds to PCs for the year 2020 were submitted to H.E. the President in November 2019 and the same were approved by the Cabinet of Ministers on 19 February 2020. Meanwhile, the FC initiated a comprehensive, uniform planning system for all the provinces in order to improve coordination in the decision making process in national and sub national government levels. In line with this, the FC recommended establishing a common framework for decision making in the national and sub national governments. Moreover, the FC made recommendations on providing adequate funds for development activities under the devolved subjects to be channelled through the PCs, thereby to allocate resources effectively and ensure transparency and accountability. Further, considering the suboptimal distribution of ministries in the PCs, the FC recommended designing the portfolio of five ministries appropriately enabling the PCs to function in an efficient and effective manner while improving on the management, coordination and compatibility among the PCs. Moreover, highlighting the importance of enhancing the revenue generation of PCs and reducing the burden on the central government budget, the FC made recommendations on the need to study and explore avenues for the PCs to introduce new revenue generating measures. In addition, the FC recommended to introduce a contributory system for expenditure in the health sector in particular, in order to ease the burden on government expenditure.

Budgetary Operations in Provincial Councils

The total revenue of PCs increased marginally in nominal terms and remained unchanged as a percentage of GDP in 2019 compared to the previous year. Accordingly, total revenue of PCs increased by 1.3 per cent to Rs. 89.8 billion in 2019 from Rs. 88.7 billion in 2018, reflecting the increase in non tax revenue amidst the decline in tax revenue in 2019. However, as a percentage of GDP, total revenue remained unchanged at 0.6 per cent in 2019. Tax revenue declined to Rs. 81.1 billion in 2019 from Rs. 82.2 billion in 2018, reflecting a decline in revenue collection from stamp duty. Accordingly, revenue from stamp duty declined by 4.5 per cent to Rs. 32.6 billion in 2019 from Rs. 34.1 billion in 2018. Meanwhile, transfers of NBT revenue from the central government increased by 3.9 per cent to Rs. 35.3 billion in 2019 from Rs. 33.9 billion in 2018. Revenue from the transfers of NBT revenue and stamp duty from the central government accounted for 43.5 per cent and 40.1 per cent of total tax revenue of PCs, respectively. In nominal terms, non tax revenue increased to Rs. 8.7 billion in 2019 in comparison to Rs. 6.5 billion recorded in 2018 due to the increase in revenue collection from fees and charges, which accounts for around 75 per cent of total non tax revenue of PCs. The share of revenue of the Western Provincial Council of the total revenue collection by all PCs declined to 48.3 per cent in 2019 from 51.4 per cent in 2018. Of the revenue collection by the other PCs, the North Western and Southern provinces accounted for 9.7 per cent and 9.4 per cent of the total revenue, respectively. Meanwhile, the share of revenue collected from the Sabaragamuwa province increased to 5.1 per cent in 2019 from 4.4 per cent in 2018.

During the year, recurrent expenditure of PCs increased in nominal terms, while in GDP terms it remained unchanged. Accordingly, in nominal terms, recurrent expenditure increased by 9.8 per cent to Rs. 276.2 billion in 2019 mainly due to higher expenditure on personal emoluments. However, as a percentage of GDP, recurrent expenditure remained unchanged at 1.8 per cent in 2019. During 2019, personal emoluments amounted to Rs. 216.5 billion, recording an increase of 9.3 per cent and continued to be the single largest item in the recurrent expenditure accounting for 78.4 per cent of the total recurrent expenditure of PCs. The education and health sectors absorbed

Table 6.10
Budget Outturn of Provincial Councils

Rs. million

Item	2016	2017	2018 (a)	2019 (b)
Total Revenue	**79,595**	**86,978**	**88,689**	**89,826**
Tax Revenue	70,942	77,691	82,228	81,144
Non Tax Revenue	8,653	9,287	6,461	8,682
Total Expenditure	**276,147**	**287,838**	**292,265**	**308,606**
Recurrent Expenditure	237,664	241,338	251,552	276,215
o/w Personal Emoluments	182,497	187,367	198,129	216,508
Capital Expenditure	38,483	46,500	40,713	32,391
Central Government Transfers	**196,552**	**200,860**	**203,576**	**218,780**
Block Grants	169,106	166,348	180,095	199,968
Criteria Based Grants	3,035	3,236	2,462	2,205
Province Specific Development Grants	12,177	20,250	13,536	11,376
Foreign Grants for Special Projects	12,234	11,025	7,483	5,230

(a) Revised
(b) Provisional

Sources: Ministry of Finance, Economic and Policy Development
Ministry of Public Administration, Home Affairs, Provincial Councils and Local Government

around 90 per cent of the personal emoluments of PCs. The functional basis, recurrent expenditure on social services increased to Rs. 204.0 billion, while recurrent expenditure on provincial administration and economic services declined to Rs. 16.3 billion and Rs. 4.1 billion, respectively. Among the high spending PCs in 2019, the Western, the Central and the North-Western provinces accounted for 21.3 per cent, 12.5 per cent and 11.8 per cent of total recurrent expenditure of PCs, respectively.

In 2019, capital expenditure of PCs declined both in nominal terms and as a percentage of GDP reflecting the decline in all subsectors of capital expenditure. Accordingly, capital expenditure declined to Rs. 32.4 billion in 2019 from Rs. 40.7 billion in 2018, of which expenditure on acquisition of capital goods declined to Rs. 11.8 billion in 2019 from Rs. 14.3 billion in 2018. In addition, expenditure on Province Specific Development Projects (PSDP), capital transfers to local governments and special projects also declined during the year. Meanwhile, as a percentage of GDP, capital expenditure declined marginally to 0.2 per cent in 2019 from 0.3 per cent in 2018.

Transfers from the central government to PCs increased during the year both in terms of GDP share and in nominal terms. The central government transfers increased to Rs. 218.8 billion in 2019 from Rs. 203.6 billion in 2018 due to the increase in block grants amidst the decline in grants for special projects, Province Specific Development Grants (PSDGs) and Criteria Based Grants (CBGs). As a percentage of GDP, the transfers from the central government increased to 1.5 per cent in 2019 from 1.4 per cent recorded in 2018. Block grants, the major form of central government transfers to PCs, amounted to Rs. 200.0 billion, representing 91.4 per cent of the total transfers, which were provided to meet the resource gap in the recurrent expenditure programme of PCs. The transfers under PSDGs, grants for special projects and CBGs amounted to Rs. 11.4 billion, Rs. 5.2 billion and Rs. 2.2 billion, respectively. During the year, a share of 70.9 per cent of the expenditure of PCs was financed through central government transfers reflecting the need to enhance the revenue collection of PCs, thereby to ease the burden on the central government budget.