

# GOVERNMENT FINANCE

## OVERALL TRENDS

The on-going policy adjustments towards fiscal consolidation suffered a set-back in 1994 in the wake of national elections, seriously undermining macro economic stability in the country. Under the impact of various discretionary changes in taxation and the relaxation of government expenditure restraints, the revenue/GDP ratio declined to 19.0 per cent in 1994 from 19.7 per cent in 1993, while the current expenditure/GDP ratio increased from 20.5 per cent to 22.0 per cent. These developments resulted in a rise in the current account deficit from 0.8 per cent of GDP in 1993 to 2.9 per cent of GDP in 1994 reflecting a high consumption orientation in government fiscal operations. Moreover, in spite of a reduction in public investment in relation to GDP from 8 per cent in 1993 to 7 per cent in 1994, total expenditure/GDP ratio remained high at 29.0 per cent of GDP in 1994 in comparison to 28.1 per cent of GDP in 1993 owing to the enhanced level of current expenditure in the budget. Overall revenue and expenditure flows generated a budget deficit of 10 per cent of GDP in 1994 as against 8.4 per cent in 1993. The overall deficit in 1994 was slightly higher than the average deficit of 9.7 per cent in the 1989 - 1993 period. A persistently high budget deficit has been a major concern in macro economic management in recent years, particularly in the context of a sustained high demand for credit from the private sector and large capital inflows in a liberalised economic environment.

## FISCAL OUT-TURN

Government revenue at Rs.110,038 million in 1994, recorded a growth of 12 per cent as against 15 per cent in 1993. The growth in government revenue was far short of the nominal growth in GDP and resulted in a reduction in the revenue/GDP ratio from 19.7 per cent in 1993 to 19.0 per cent in 1994 - well below the annual average revenue/GDP ratio of 20.6 per cent realised during the 1989 - 1993 period. The weakening of the Government's revenue effort, which has been evident in the systematic fall in the Revenue/GDP ratio in recent years, not only underscored the inherent inelastic nature of the government revenue structure but was also a reflection of the adverse impact of the continued erosion of the country's tax base due to various exemptions and other discretionary measures extended on an ad-hoc basis during the year, particularly on the eve of national elections. Thus, in spite of an additional revenue effort made through the defence levy and excise tax on selected commodities at the beginning of the year, the overall revenue effort continued to deteriorate in 1994 - a worrisome development in government fiscal operations, particularly in the context of high demands on current expenditure.

Meanwhile, under the impact of a high cost of domestic debt, enhanced expenditure on government salaries and pensions and very high household transfers on account of various welfare programmes, current expenditure rose to Rs.127,084 million in 1994 from Rs.102,288 million in 1993 - an increase of 24 per cent. Consequently, current expenditure as a proportion of GDP rose from 20.5 per cent in 1993 to 22.0 per cent in 1994, almost of the same order of magnitude as the annual average current expenditure/GDP ratio of 22.8 per cent realised during the 1989-1993 period.

In the context of a weaker revenue effort and high current expenditure, the current account of the budget produced an unprecedentedly high deficit of Rs.17,046 million - a major reversal of the recent healthy trends towards reducing the deficit in current account operations. Thus, the current account deficit, which declined from 0.9 per cent of GDP in 1992 to 0.8 per cent of GDP in 1993, rose to 2.9 per cent of GDP in 1994 undermining the country's domestic savings effort. Meanwhile, public investment (capital expenditure and on-lending to commercial public enterprises funded

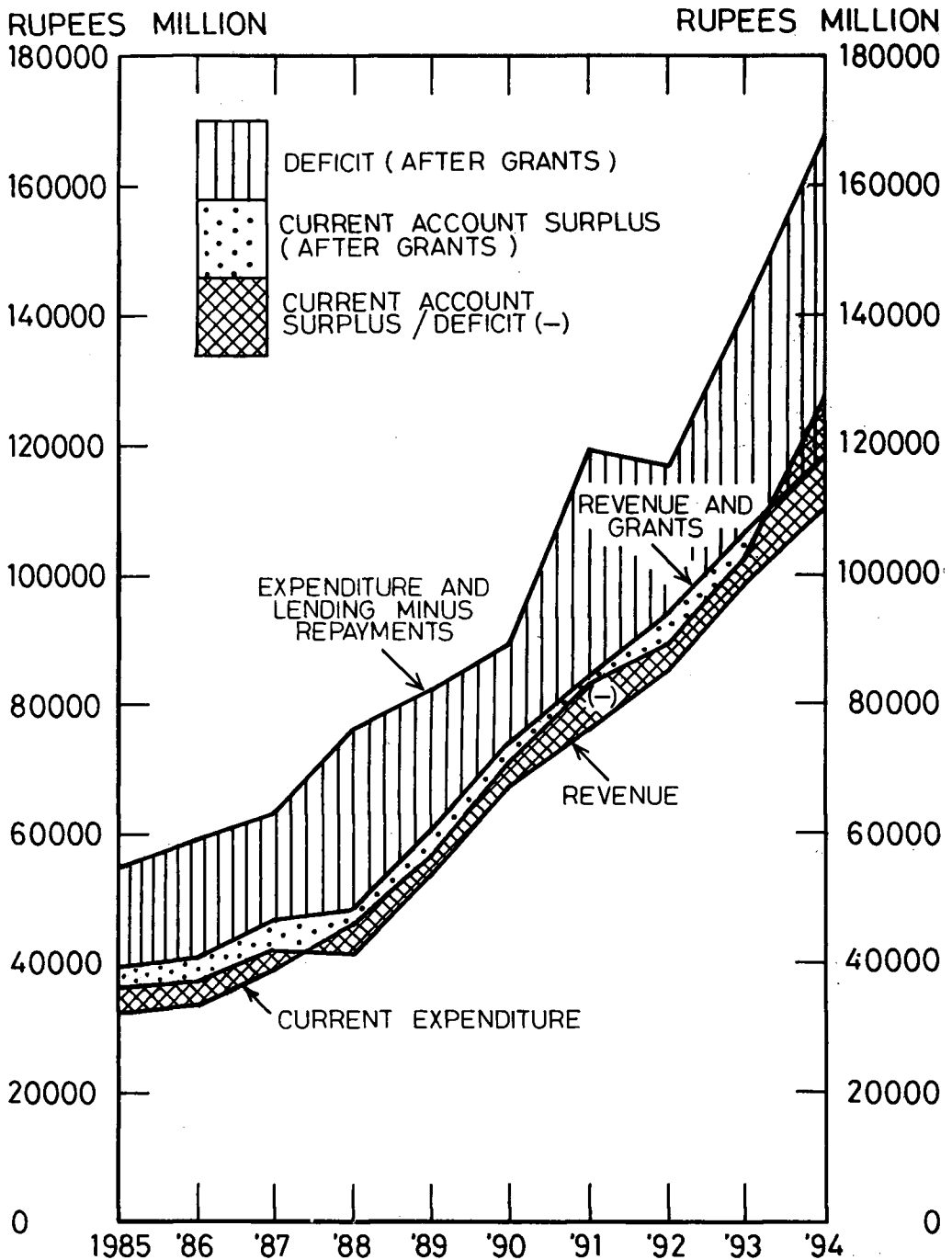
**TABLE 1.58**  
**Summary of Government Fiscal Operations**

Rs. Million

Item	1990	1991	1992	1993	1994 Approved Estimates	1994 Provi- sional	1995 Approved Estimates
Total Revenue and Grants	74,662	84,049	94,061	106,364	123,220	118,295	146,040
Total Revenue	67,964	76,179	85,781	98,339	115,634	110,038	137,110
Tax Revenue	61,206	68,157	76,353	85,891	105,276	99,417	121,324
Non-Tax Revenue	6,758	8,022	9,428	12,448	10,358	10,621	15,786
Grants	6,697	7,870	8,280	8,025	7,586	8,257	8,930
Expenditure and Lending minus Repayments	99,814	119,527	116,973	140,460	154,219	167,768	186,595
Current	71,771	83,756	89,639	102,288	109,367	127,084	133,424
Capital	19,529	25,304	24,948	33,662	35,233	30,391	42,668
Lending minus Repayments	8,514	10,467	2,386	4,510	9,619	10,293	10,503
Current Account Surplus/Deficit (-)	-3,807	-7,577	-3,858	-3,949	6,267	-17,046	3,680
Budget Deficit (before grants)	-31,850	-43,348	-31,192	-42,121	-38,585	-57,730	-49,485
Budget Deficit (after grants)	-25,153	-35,478	-22,912	-34,096	-30,999	-49,473	-40,555
Financing	25,152	35,478	22,913	34,096	30,999	49,474	40,555
Foreign Borrowings	11,644	19,329	7,361	9,855	18,241	11,778	18,382
Domestic Borrowings	13,508	16,149	15,552	24,241	12,758	37,696	22,173
Non-Market Borrowings	305	691	-3,205	2,012	-	-666	-
Market Borrowings	13,203	15,458	18,757	22,229	12,758	38,362	22,173
Non Bank	12,946	15,423	21,079	28,308	12,758	37,205	29,578
Bank	257	35	-2,322	-6,079	-	1,157	-7,405
As a percentage of GDP							
Total Revenue and Grants	23.2	22.6	22.1	21.4	21.7	20.4	22.2
Total Revenue	21.1	20.4	20.2	19.7	20.3	19.0	20.8
Tax Revenue	19.0	18.3	17.9	17.2	18.5	17.2	18.4
Non-Tax Revenue	2.1	2.2	2.2	2.5	1.8	1.8	2.4
Grants	2.1	2.1	1.9	1.6	1.3	1.4	1.4
Expenditure and Lending minus Repayments	31.0	32.1	27.5	28.1	27.1	29.0	28.3
Current	22.3	22.5	21.1	20.5	19.2	22.0	20.2
Capital	6.1	6.8	5.9	6.7	6.2	5.3	6.5
Lending minus Repayments	2.6	2.8	0.6	0.9	1.7	1.8	1.6
Current Account Surplus/Deficit (-)	-1.2	-2.0	-0.9	-0.8	1.1	-2.9	0.6
Budget Deficit (before grants)	-9.9	-11.6	-7.3	-8.4	-6.8	-10.0	-7.5
Budget Deficit (after grants)	-7.8	-9.5	-5.4	-6.8	-5.4	-8.5	-6.1
Financing	7.8	9.5	5.4	6.8	5.4	8.5	6.1
Foreign Borrowings	3.6	5.2	1.7	2.0	3.2	2.0	2.8
Domestic Borrowings	4.2	4.3	3.7	4.9	2.2	6.5	3.4
Non-Market Borrowings	0.1	0.2	-0.8	0.4	-	-0.1	-
Market Borrowings	4.1	4.1	4.4	4.4	2.2	6.6	3.4
Non Bank	4.0	4.1	5.0	5.7	2.2	6.4	4.5
Bank	0.1	...	-0.5	-1.2	-	0.2	-1.1

Source : Central Bank of Sri Lanka

## TRENDS IN FISCAL MAGNITUDES



Central Bank of Sri Lanka.

through the Government Budget) at Rs.40,455 million increased marginally in nominal terms, but declined sharply in relation to GDP from 8.0 per cent of GDP in 1993 to 7.0 per cent of GDP in 1994. In spite of only a marginal increase in public investment, the total expenditure of the budget rose from Rs.140,460 million (28.1 per cent of GDP) in 1993 to Rs.167,768 million (29.0 per cent of GDP) in 1994 due to a sharp rise in current expenditure.

Underscoring the inherent weakness in the revenue and expenditure structure as well as the resort to discretionary measures to provide temporary relief through ad-hoc revenue and expenditure measures, the fiscal operations in 1994 generated an overall deficit (before grants) of Rs.57,730 million, compared to a deficit of Rs.43,121 million in 1993. Consequently, the budget deficit/GDP ratio increased to 10.0 per cent from 8.4 per cent. With the use of foreign grants to the tune of Rs.8,257 million (1.4 per cent of GDP), the deficit (after grants) financed through foreign and domestic borrowings amounted to Rs.49,474 million (8.5 per cent of GDP) in 1994 compared to a deficit of Rs.34,096 million (6.9 per cent of GDP) in 1993. Although, concessionary foreign loans totalling Rs.11,778 million (2.0 per cent of GDP) together with Rs.4,797 million on account of project grants contributed towards financing about 41 per cent of public investment projects, domestic borrowings increased far in excess of the domestic resource requirement of capital projects, reaching Rs.37,696 million (6.5 per cent of GDP) in 1994 in comparison to Rs.24,241 million (4.9 per cent of GDP) in 1993, owing to the high current account deficit recorded in 1994. The adverse development in the current account operations of the budget led to a borrowing of Rs.1,157 million from the banking system, in addition to Rs.36,539 million from non-bank sources. This disturbing feature in deficit financing as such high borrowings not only pre-empt resources otherwise available to the private sector but also weaken macro economic management. Unlike in the previous five years, when the government budgetary operations relied entirely on non-bank sources, the 1994 budgetary operations resorted to the use of funds from the banking system, thereby exerting direct pressure on an already high expansion in monetary aggregates. This underscores the need for a concerted effort towards eliminating the current account deficit in government fiscal operations, if the Government is to reduce its borrowing requirement while maintaining a high level of public investment. A summary of government fiscal operations during 1990-1994 is given in Table 1.58.

## REVENUE

In 1994, government revenue totalled Rs.110,038 million registering an increase of 12 per cent in comparison with 15 per cent in the previous year. While the share of tax revenue in total revenue rose from 87 per cent in 1993 to 90 per cent in 1994, the importance of taxes on goods and services within the tax revenue structure also further heightened with its share increasing from 56 per cent in 1993 to 57 per cent in 1994. Underpinning this development was the increased revenue collection from the Defence levy and excise taxes. In spite of a nominal growth of 9 per cent in import duty collection, the share of such collection in total tax revenue, which dropped from 27 per cent in 1992 to 24 per cent in 1993, further declined to 23 per cent in 1994 owing largely to an erosion in the tax base for import duty which resulted from the grant of duty waivers and exemptions on a wide range of commodities. Meanwhile, under the influence of buoyant revenue growth of 22 per cent in income taxes, its share in total revenue increased from 13 per cent in 1993 to 14 per cent in 1994, in spite of a reduction in the maximum income tax rate from 40 per cent to 35 per cent in April, 1994.

Non-tax revenue at Rs.10,621 million, showed a decline of 15 per cent over the previous year. Interest income accounted for nearly 43 per cent of non-tax revenue, while profit transfers from the Central Bank, profits and dividends including the levies imposed under the Finance Act on the Ceylon Petroleum Corporation and the Sri Lanka Telecom and fees and charges generated a further 37 per cent of non-tax revenue in 1994.

**TABLE 1.59**  
**Summary of Revenue by Components**

Rs. Million

Item	1990	1991	1992	1993	1994 Approved Estimate	1994 Provi- sional	1995 Approved Estimates
<b>Tax Revenue</b>	<b>61,206</b>	<b>68,157</b>	<b>76,353</b>	<b>85,891</b>	<b>105,276</b>	<b>99,417</b>	<b>121,324</b>
Income Taxes	7,337	9,722	10,967	12,543	15,781	15,277	15,420
Personal	2,957	3,539	4,067	5,235	5,504	5,621	5,270
Corporate <sup>1</sup>	4,380	6,183	6,900	7,308	10,277	9,656	10,150
Taxes on Property	3,140	3,541	3,597	3,493	4,191	4,386	4,667
Tax on Treasury bills held by Central Bank	2,618	3,033	1,991	1,073	540	471	-
Taxes on Domestic Goods and Services	28,770	32,107	38,158	47,963	58,364	56,685	72,495
General Sales and Turnover Tax	20,291	21,430	24,095	29,663	35,401	32,300	39,005
Manufacturing	6,798	7,945	8,262	9,231	11,518	9,171	11,380
Non-manufacturing	3,726	2,974	3,546	4,825	4,134	6,445	8,180
Imports	9,767	10,511	12,287	15,607	19,749	16,684	19,445
Excise Tax	8,170	10,597	10,232	11,655	13,929	14,632	20,339
Liquor	2,657	3,126	3,434	4,063	5,013	4,686	5,410
Tobacco	5,461	6,884	5,573	6,866	7,148	7,888	10,232
Other	52	587	1,225	726	1,768	2,058	4,697
Defence Levy	-	-	3,764	6,589	8,759	9,693	10,887
Licence Fees	309	80	67	56	275	60	2,264
Taxes on International Trade	19,341	19,754	21,640	20,819	26,400	22,598	28,742
Imports	16,792	18,617	20,819	20,762	26,400	22,598	28,742
Exports	2,549	1,137	821	57	-	-	-
Tea	1,601	492	360	23	-	-	-
of which: ad-valorem	1,311	298	226	-	-	-	-
Rubber	747	476	318	16	-	-	-
Coconut	151	125	117	4	-	-	-
Other Exports	50	44	26	14	-	-	-
<b>Non Tax Revenue</b>	<b>6,758</b>	<b>8,022</b>	<b>9,428</b>	<b>12,448</b>	<b>10,358</b>	<b>10,621</b>	<b>15,786</b>
Property Income	4,192	5,964	6,262	8,154	6,879	7,459	10,622
of which: Central Bank Profits	500	500	1,150	1,000	1,000	1,200	1,200
Interest Income	1,143	2,617	3,596	4,390	4,406	4,560	5,635
Surplus of Trading Enterprises	2,235	2,612	1,179	-	-	-	-
Fees and charges	835	917	1,225	1,303	1,490	1,430	2,409
Other Non Tax Revenue	1,731	1,141	1,941	2,991	1,989	1,732	2,755
<b>Total Revenue</b>	<b>67,964</b>	<b>76,179</b>	<b>85,781</b>	<b>98,339</b>	<b>115,634</b>	<b>110,038</b>	<b>137,110</b>

(Contd.)

1. Inclusive of the withholding tax on bonds issued for bank restructuring purposes.

**TABLE 1.59 (Contd.)**  
**Summary of Revenue by Components**  
**(as a percentage of GDP)**

Item	1990	1991	1992	1993	1994 Approved Estimates	1994 Provi- sional	1995 Approved Estimates
<b>Tax Revenue</b>	<b>19.0</b>	<b>18.3</b>	<b>17.9</b>	<b>17.2</b>	<b>18.5</b>	<b>17.2</b>	<b>18.4</b>
Income Taxes	2.3	2.6	2.6	2.5	2.8	2.6	2.3
Personal	0.9	0.9	1.0	1.0	1.0	1.0	0.8
Corporate <sup>1</sup>	1.4	1.7	1.6	1.5	1.8	1.7	1.5
Taxes on Property	1.0	1.0	0.8	0.7	0.7	0.8	0.7
Tax on Treasury bills held by Central Bank	0.8	0.8	0.5	0.2	0.1	0.1	-
Taxes on Domestic Goods and Services	8.9	8.6	9.0	9.6	10.3	9.8	11.0
General Sales and Turnover Tax	6.3	5.8	5.7	5.9	6.2	5.6	5.9
Manufacturing	2.1	2.1	1.9	1.8	2.0	1.6	1.7
Non-manufacturing	1.2	0.8	0.8	1.0	0.7	1.1	1.2
Imports	3.0	2.8	2.9	3.1	3.5	2.9	2.9
Excise Tax	2.5	2.8	2.4	2.3	2.4	2.5	3.0
Liquor	0.8	0.8	0.8	0.8	0.9	0.8	0.8
Tobacco	1.7	1.8	1.3	1.4	1.3	1.4	1.5
Other	...	0.2	0.3	0.1	0.3	0.4	0.7
Defence Levy	-	-	0.9	1.3	1.5	1.7	1.6
Licence Fees	0.1	...	...	...	...	...	0.3
Taxes on International Trade	6.0	5.3	5.1	4.2	4.6	3.9	4.4
Imports	5.2	5.0	4.9	4.2	4.6	3.9	4.4
Exports	0.8	0.3	0.2	...	-	-	-
Tea	0.5	0.1	0.1	...	-	-	-
of which: ad-valorem	0.4	0.1	0.1	...	-	-	-
Rubber	0.2	0.1	0.1	...	-	-	-
Coconut	...	...	...	...	-	-	-
Other Exports	...	...	...	...	-	-	-
<b>Non Tax Revenue</b>	<b>2.1</b>	<b>2.2</b>	<b>2.2</b>	<b>2.5</b>	<b>1.8</b>	<b>1.8</b>	<b>2.4</b>
Property Income	1.3	1.6	1.5	1.6	1.2	1.3	1.6
of which: Central Bank Profits	0.2	0.1	0.3	0.2	0.2	0.2	0.2
Interest Income	0.4	0.7	0.8	0.7	0.8	0.8	0.9
Surplus of Trading Enterprises	0.7	0.7	0.3	-	-	-	-
Fees and charges	0.3	0.2	0.3	0.3	0.3	0.2	0.4
Other Non Tax Revenue	0.5	0.3	0.5	0.6	0.3	0.3	0.4
<b>Total Revenue</b>	<b>21.1</b>	<b>20.4</b>	<b>20.2</b>	<b>19.7</b>	<b>20.3</b>	<b>19.0</b>	<b>20.8</b>

Source : Central Bank of Sri Lanka.

1. Inclusive of the withholding tax on bonds issued for bank restructuring purposes.

## TAX REVENUE

Reflecting the increased importance of taxes on domestic goods and services in the tax structure, taxes levied on domestic goods and services generated a sum of Rs.56,685 million (9.8 per cent of GDP) in 1994 compared to Rs.47,963 million (9.6 per cent of GDP) in 1993. The enhanced importance of this source of taxation is attributed to the buoyant revenue from the Defence levy and turnover taxes on services, widening of the coverage of excise taxes and an increase in excise tax on cigarettes.

The Defence levy which is imposed on all goods and services other than on exports, generated Rs.9,693 million and recorded a significant growth of 47 per cent. The sharp rise in this source of revenue was partly attributed to an increase in the Defence levy from 3 per cent to 3.5 per cent in January, 1994 and partly to a rapid growth in the tax base. The Defence levy, which uses a single rate of tax on a broad tax base, in addition to its administrative convenience, also demonstrates that such tax measures are far superior to other taxes which are characterised by multiple rates and a narrow base in sustaining government revenue effort.

Turnover taxes at Rs.32,300 million, increased by 9 per cent compared to a rise of 23 per cent in the previous year. The slower growth in turnover tax was due to a decline in turnover tax on manufacturing activities by 1 per cent and slower growth in turnover tax on imports. In spite of the increase in the value of manufactured output and a substantial rise in the value of imports, the revenue performance under turnover taxes on these transactions was not satisfactory due to numerous exemptions granted from these taxes in 1994. However, in line with the robust expansion in service sector activities, particularly in banking and financial services, port, electricity and telecommunications, turnover taxes on non-manufacturing activities generating Rs.6,445 million, marking an increase of 34 per cent compared to 36 per cent in the previous year.

Revenue from excise taxes at Rs.14,632 million in 1994 registered an increase of 26 per cent compared to 14 per cent in the previous year. Excise taxes on liquor at Rs.4,686 million showed an increase of 15.3 per cent due to a rise in the sale of liquor while excise taxes on processed tobacco and cigarettes, at Rs.7,888 million, registered an increase of 14.9 per cent largely due to the increase in the excise tax on cigarettes from Rs.525 per 1000 cigarettes to Rs.700 per 1000 cigarettes in March, 1994. Following an increase in excise tax rates on washing machines, air conditioners, fans, electrical appliances etc. and the inclusion of several other consumer durable items under the Excise (Special Provision) Act, and the full year impact of the excise tax on petrol which was introduced in October, 1993, a further sum of Rs.2,058 million was raised in 1994 compared to Rs.726 million in 1993. The increased importance of excise tax revenue in government revenue underscored the shift towards domestic taxes from international trade related taxes, which formed a strong source of revenue, particularly prior to 1990 when exports of primary commodities were subject to high export taxes and customs tariffs.

In spite of an increase in the total value of imports by 22 per cent in 1994, revenue collections through customs tariffs rose only by 8.5 per cent to Rs.22,598 million. Consequently, the average import duty rate, the ratio of import duty collection to total imports, declined to 9.6 per cent in 1994 from 10.8 per cent in 1993. The average import duty rate, which was 14.7 per cent in 1991, fell to 13.6 per cent in 1992. Although, the decline in the average incidence of import duty is consistent with the gradual reduction in customs tariffs in recent years, the sharp fall in customs collection was largely attributed to the grant of duty waivers on a wide range of commodities and various duty concessions extended to export industries and BOI enterprises during the year. Thus, in spite of an increase in the value of imports from Rs.193,550 million in 1993 to Rs.236,030 million in 1994, the total value of dutiable imports rose only marginally from Rs.86,455 million in 1993 to Rs.98,871 million in 1994.

The changing structure of imports was also a contributory factor in the reduction in the average incidence of import duties. Investment goods which carry low import duty increased by 33 per cent and accounted for 29 per cent of total imports in 1994 compared to 26 per cent in 1993. Moreover, of the total intermediate goods valued at Rs.119,970 million, around 50 per cent of total imports nearly half was on account of textiles, fertilizer and wheat grain which were not subject to customs tariffs. Although, customs tariffs were rationalised in November, 1993 within a four band rate structure of 10, 20, 35 and 45 per cent for items other than motor vehicles, liquor and tobacco, the grant of duty waivers and exemptions and the creation of a new rate band of 5 per cent in mid-1994 led to a substantial erosion in the revenue base undermining both trade policy objectives and the revenue objectives of customs tariffs. The creation of the new rate band of 5 per cent for selected items was also meant to provide an exemption for such items from turnover tax on imports.

Income taxes, which have become a buoyant source of revenue in recent years in spite of a gradual reduction in the maximum income tax rate from 50 per cent in 1993 to 35 per cent in 1994, continued to remain buoyant with a revenue yield of Rs.15,277 million - an increase of 22 per cent in comparison to a rise of 14 per cent in 1993. In spite of an increase in the PAYE tax exemption limit in May, 1994, personal income tax revenue at Rs.5,621 million, showed an increase of 7 per cent owing to increased remuneration of private sector employees and the rise in interest income received. Income tax on interest income of persons is largely collected through the withholding tax on bank deposits. Meanwhile, in spite of a reduction in the corporate tax rate from 40 per cent in 1993 to 35 per cent in 1994, corporate income tax yield at Rs.9,656 million, showed an increase of 32 per cent largely due to high corporate sector profits recorded in 1994 and an improved tax administration through computerisation of large tax files.

Stamp duties at Rs.4,386 million recorded a 26 per cent increase in 1994 largely on account of stamp duties on Letters of Credit on imports. As a result of the depleted stock of Treasury bills in the Central Bank's portfolio, the tax levied on Central Bank holdings of Treasury bills declined to Rs.471 million from Rs.1,073 million in 1993. A statistical summary of Government Revenue is given in Table 1.59.

## **FOREIGN GRANTS**

Total foreign grants utilised for budgetary purposes during 1994 at Rs.8,257 million, was an increase of 3 per cent in contrast to a decline of 3 per cent in the previous year. However, total foreign grants in relation to GDP declined from 1.6 per cent in 1993 to 1.4 per cent in 1994. Receipts on account of project grants, which funded public investment projects, totalled Rs.4,797 million.

## **EXPENDITURE**

Total government expenditure at Rs.167,768 million recorded an increase of 19 per cent compared to a rise of 20 per cent in the previous year. Current expenditure amounting to Rs.127,084 million, accounted for 76 per cent of the total expenditure in comparison to 73 per cent in the previous year. Meanwhile, public investment at Rs.40,455 million (which was largely concentrated on infrastructure projects), when defined in relation to GDP, declined to 7 per cent in 1994 from 8 per cent in 1993.

## **CURRENT EXPENDITURE**

Current expenditure at Rs.127,084 million showed a sharp increase of 24 per cent in 1994 in comparison to a 14 per cent growth in the previous year. The expenditure on account of salaries,

**TABLE 1.60**  
**Economic Classification of Expenditure and Lending Minus Repayments**

Item	Rs. Million						
	1990	1991	1992	1993	1994 Approved Estimates	1994 Provi- sional	1995 Approved Estimates
<b>Current Expenditure</b>	<b>71,771</b>	<b>83,756</b>	<b>89,638</b>	<b>102,288</b>	<b>109,367</b>	<b>127,084</b>	<b>133,424</b>
Expenditure on Goods and Services	30,167	35,848	39,691	44,895	47,936	54,700	55,280
Salaries and wages	15,748	17,985	20,793	26,332	27,851	29,309	32,898
Other Goods and Services	14,419	17,863	18,898	18,563	20,085	25,391	22,382
Interest Payments	20,668	22,073	25,940	30,203	33,862	38,031	37,204
Foreign	3,678	4,113	4,739	5,102	5,904	5,511	6,361
Domestic	16,990	17,960	21,201	25,101	27,958	32,520	30,843
Current Transfers and Subsidies	20,936	25,835	24,007	27,190	27,570	34,353	40,940
To Public Corporations	2,639	1,743	1,428	1,571	2,196	2,634	7,757
To Public Institutions	1,811	1,405	1,649	2,031	2,360	1,976	2,360
To Other Levels of Government	1,237	1,050	1,111	896	1,060	1,307	1,250
To households and other sectors	15,249	21,637	19,819	22,335	21,954	28,263	29,305
Food stamps, Food subsidy etc.	5,122	4,023	4,466	4,580	3,609	4,654	4,750
Jana Saviya	2,912	3,407	3,098	3,685	3,906	5,369	4,600
Pensions	4,490	8,832	8,099	10,516	10,877	13,271	14,394
Fertilizer Subsidy	-	-	-	-	-	630	1,500
Other	2,725	5,375	4,156	3,554	3,562	4,339	4,061
Provision for Under Expenditure	-	-	-	-	-	-	-
<b>Capital Expenditure</b>	<b>19,529</b>	<b>25,305</b>	<b>24,949</b>	<b>33,662</b>	<b>35,233</b>	<b>30,391</b>	<b>42,668</b>
Acquisition of Real Assets	12,025	14,072	12,604	19,719	20,595	16,747	24,894
Capital Transfers	7,504	11,233	12,345	13,943	14,638	13,644	17,774
To Public Corporations	1,249	2,993	4,610	4,311	4,139	4,246	5,230
To Public Institutions	5,303	6,990	6,663	8,551	9,673	8,433	11,383
To Other Levels of Government	843	950	1,028	1,036	708	914	1,112
Other	109	300	44	45	118	51	49
<b>Lending Minus Repayments</b>	<b>8,514</b>	<b>10,467</b>	<b>2,386</b>	<b>4,510</b>	<b>9,619</b>	<b>10,293</b>	<b>10,503</b>
Advance Accounts	1,699	1,819	-150	410	250	2,462	500
On-lending	7,219	7,286	6,246	6,265	12,013	10,064	13,761
Restructuring Cost	-	3,335	1,750	1,465	3,392	3,739	3,392
Privatisation Proceeds	-	-841	-2,850	-1,200	-3,000	-2,996	-4,500
Loan Repayments	-404	-1,132	-2,610	-2,430	-3,036	-2,976	-2,650
<b>Total Expenditure and net Lending</b>	<b>99,814</b>	<b>119,528</b>	<b>116,973</b>	<b>140,460</b>	<b>154,220</b>	<b>167,768</b>	<b>186,595</b>

(Contd.)

**TABLE 1.60 (Contd.)**  
**Economic Classification of Expenditure and Lending Minus Repayments**  
**(as a percentage of GDP)**

Item	1990	1991	1992	1993	1994 Approved Estimates	1994 Provi- sional	1995 Approved Estimates
<b>Current Expenditure</b>	<b>22.3</b>	<b>22.5</b>	<b>21.1</b>	<b>20.5</b>	<b>19.2</b>	<b>22.0</b>	<b>20.2</b>
Expenditure on Goods and Services	9.4	9.6	9.3	9.0	8.4	9.5	8.4
Salaries and wages	4.9	4.8	4.9	5.3	4.9	5.1	5.0
Other Goods and Services	4.5	4.8	4.4	3.7	3.5	4.4	3.4
Interest Payments	6.4	5.9	6.1	6.0	6.0	6.6	5.7
Foreign	1.1	1.1	1.1	1.0	1.0	1.0	1.0
Domestic	5.3	4.8	5.0	5.0	4.9	5.6	4.7
Current Transfers and Subsidies	6.5	6.9	5.6	5.4	4.8	5.9	6.2
To Public Corporations	0.8	0.5	0.3	0.3	0.4	0.5	1.2
To Public Institutions	0.6	0.4	0.4	0.4	0.4	0.3	0.4
To Other Levels of Government	0.4	0.3	0.3	0.2	0.2	0.2	0.2
To households and other sectors	4.7	5.8	4.7	4.5	3.9	4.9	4.4
Food stamps,							
Food subsidy etc.	1.6	1.1	1.0	0.9	0.6	0.8	0.7
Jana Saviya	0.9	0.9	0.7	0.7	0.7	0.9	0.7
Pensions	1.4	2.4	1.9	2.1	1.9	2.3	2.2
Fertilizer Subsidy	-	-	-	-	-	0.1	0.2
Other	0.8	1.4	1.0	0.8	0.6	0.8	0.6
Provision for Under Expenditure	-	-	-	-	-	-	-
<b>Capital Expenditure</b>	<b>6.1</b>	<b>6.8</b>	<b>5.9</b>	<b>6.7</b>	<b>6.2</b>	<b>5.3</b>	<b>6.5</b>
Acquisition of Real Assets	3.7	3.8	3.0	3.9	3.6	2.9	3.8
Capital Transfers	2.3	3.0	2.9	2.8	2.6	2.4	2.7
To Public Corporations	0.4	0.8	1.1	0.9	0.7	0.7	0.8
To Public Institutions	1.6	1.9	1.6	1.7	1.7	1.5	1.8
To Other Levels of Government	0.3	0.3	0.2	0.2	0.1	0.2	0.2
Other	-	0.1	-	-	-	-	-
<b>Lending Minus Repayments</b>	<b>2.6</b>	<b>2.8</b>	<b>0.6</b>	<b>0.9</b>	<b>1.7</b>	<b>1.8</b>	<b>1.6</b>
of which; Advance Accounts	0.5	0.5	...	0.1	...	...	...
<b>Total Expenditure and net Lending</b>	<b>31.0</b>	<b>32.1</b>	<b>27.5</b>	<b>28.1</b>	<b>27.1</b>	<b>29.0</b>	<b>28.3</b>

Source : Central Bank of Sri Lanka.

travelling, supplies and requisites etc. totalling Rs.54,700 million (of which defence expenditure accounted for nearly 50 per cent), recorded a 22 per cent increase compared with 13 per cent in the previous year due to an increased level of defence expenditure and enhanced outlays on general administration. Reflecting the high cost of successive budget deficits which resulted in high borrowings, interest payments on government debt at Rs.38,031 million, of which 86 per cent was on domestic debt which recorded an increase of 26 per cent in 1994. Under the impact of the high cost of pensions and expansion in various welfare expenditure programmes during the year, particularly after the announcement of the relief measures in May, 1994, total transfer payments to households, including pensions and welfare expenditure programmes at Rs.28,263 million, witnessed a rise of 27 per cent.

In the context of a continued expansion in government sector employment, the full year impact of the 30 per cent wage increase announced in 1993 to government sector employees and implemented in several stages between 1993 and 1994 to cover all government employees, and the grant of permanent status for casual employees following the May-Day relief package, the total cost of personal emoluments reached Rs.29,309 million, an increase of 11 per cent over and above the previous year's rise of 27 per cent. These expenditures were around 5 per cent of GDP in 1994. A high level of expenditure on personal emoluments in the context of a limited scope for a further increase in government revenue clearly points to the fact that a further expansion in government sector employment and increases in government salaries are not sustainable in the future unless such measures are accompanied by a considerable reduction in the present level of government sector employment.

In spite of the inherent difficulties in meeting the estimated budgetary provisions for non-wage operational expenditure due to lack of funds on a day to day basis, which eventually resulted in some under expenditure, the non-wage operational expenditure also remained high at Rs.25,391 million. This showed an increase of 37 per cent, reflecting a high level of defence and security related expenditure and lax fiscal discipline in the midst of national elections. A restraint on these outlays is a necessity in containing the growth in current expenditure given the limited scope for expenditure reduction in other areas.

Interest payments on government debt at Rs.38,031 million in 1994, was an increase of 26 per cent in comparison to a 16 per cent rise in the previous year. In spite of a large foreign debt stock of Rs.300,174 million in 1994, interest expenditure on foreign debt at Rs.5,511 million, showed a modest increase of 8 per cent reflecting the highly concessionary elements of Sri Lanka's foreign debt. The average interest on these loans has been around 1.8 per cent - well below the market rate for commercial loans. In contrast, interest payments on domestic debt totalling Rs.32,520 million recorded an alarming increase of 30 per cent and caused the interest on domestic debt to GDP ratio to rise from 5.0 per cent in 1993 to 5.6 per cent in 1994. The average interest rate, measured by the ratio between domestic interest payments and total domestic debt, stood at 13 per cent compared to 12 per cent in 1993.

The increased cost of domestic debt was evident in both short term (Treasury bills) as well as medium and long term (Rupee securities) debt. Although, the market rate of interest on Treasury bills declined to a range of 12.20-19.36 per cent in 1994 from a range of 17.82-21.98 per cent per annum in 1993 and the stock of outstanding Treasury bills increased only marginally from Rs.97,196 million to Rs.98,896 million, the interest cost of Treasury bills at Rs.17,916 million, recorded a notable rise of 38 per cent in 1994, reflecting the high interest rates on Treasury bills that prevailed in 1993 due to aggressive open market operations. Thus, the average interest rate - the ratio between interest payments on Treasury bills and total outstanding Treasury bills, increased to 18.1 per cent from 13.3 per cent in 1993. Meanwhile, the interest cost on Rupee loans also rose from Rs.11,739 million in 1993 to Rs.16,680 million in 1994 due to the enhanced level of borrow-

**TABLE 1.61**  
**Functional Classification of Expenditure**

Rs. Million

Item	1990	1991	1992	1993	1994 Approved Estimates	1994 Provi- -sional	1995 Approved Estimates
<b>Current Expenditure</b>							
General Public Services	17,942	19,811	24,453	27,564	27,214	30,444	33,049
Civil Administration	6,622	5,612	7,099	7,405	8,517	4,637	10,182
Defence	6,736	10,317	12,876	15,413	13,351	19,415	16,750
Public Order and Safety	4,585	3,882	4,478	4,746	5,346	6,392	6,118
Social Services	24,449	31,594	32,700	37,477	39,604	47,656	53,032
Education	8,529	7,951	10,533	11,225	12,355	14,836	12,732
Health	3,685	4,110	4,518	5,711	6,471	7,666	8,627
Welfare	11,973	19,266	17,378	20,255	20,250	24,560	30,926
Housing	-	-	-	-	-	-	-
Community Services	262	267	271	285	528	593	747
Economic Services	5,137	3,925	3,834	4,328	5,590	6,195	7,173
Agriculture & Irrigation	982	912	1,398	1,483	2,017	2,506	2,968
Fisheries	46	98	68	107	83	99	133
Manufacturing and Mining	181	231	349	403	356	351	651
Energy and Water Supply	345	659	133	93	297	518	997
Transport & Communication	2,600	1,308	1,208	1,346	1,944	2,024	1,517
Trade & Commerce	159	137	232	203	158	72	105
Other	824	580	446	693	735	625	802
Other	24,241	28,425	28,652	32,920	36,961	42,789	40,170
of which; Interest	20,668	22,073	25,940	30,203	33,862	38,031	37,204
Provision for under Expenditure	-	-	-	-	-	-	-
<b>Total Current Expenditure</b>	<b>71,770</b>	<b>83,756</b>	<b>89,639</b>	<b>102,288</b>	<b>109,367</b>	<b>127,084</b>	<b>133,424</b>
<b>Capital Expenditure and Lending</b>							
General Public Services	3,617	2,422	1,970	4,085	3,522	2,390	5,006
Civil Administration	1,599	1,680	1,256	3,463	2,719	1,753	3,626
Public Order and Safety	2,018	742	714	622	803	637	1,380
Social Services	3,019	2,964	6,137	6,075	8,056	7,677	11,140
Education	1,042	1,178	2,008	2,845	3,014	2,877	4,126
Health	1,279	1,119	2,023	1,353	2,460	1,519	3,075
Welfare	25	15	1,191	1,084	1,289	1,681	289
Housing	513	535	767	604	1,070	802	2,099
Community Services	160	117	148	189	223	798	1,551
Economic Services	18,798	26,022	20,444	29,600	34,844	29,304	40,148
Agriculture & Irrigation <sup>a</sup>	5,215	6,071	5,890	5,682	5,308	5,179	6,171
o/w Mahaweli Project	1,810	2,410	2,670	2,810	2,504	2,598	2,764
Fisheries	133	181	175	124	381	368	189
Manufacturing and Mining	120	171	184	1,471	72	22	273
Energy and Water Supply	6,132	6,181	5,527	4,728	7,831	5,518	7,884
Transport & Communication	4,319	10,921	4,363	10,165	15,923	14,522	18,639
Trade & Commerce	205	218	365	364	413	182	427
Other	2,674	2,279	3,940	7,066	4,916	3,513	6,565
Other	952	1,250	1,072	1,081	826	1,084	1,161
<b>Total Capital Expenditure and Lending</b>	<b>26,387</b>	<b>32,658</b>	<b>29,622</b>	<b>40,841</b>	<b>47,247</b>	<b>40,455</b>	<b>57,455</b>

Source : Central Bank of Sri Lanka.

ings through the Rupee Loan Programme and the rise in interest rates to a range of 15.0-18.5 per cent during the past 2 years following high rates of interest on short term debt instruments. The total Rupee loans raised during 1994 was Rs.46,878 million compared to Rs.28,205 million in the previous year. The interest cost of Rupee loans raised during the second half of 1994 will also be reflected in 1995 as interest payments on Rupee securities are made bi-annually.

The high interest cost on domestic debt was a cause for concern due to several reasons. First, it accounted for a fourth of total current expenditure and absorbed 30 per cent of government revenue imposing a severe strain on fiscal management. Second, the high interest cost tended to crowd out other government expenditure, particularly productive government expenditure under various programmes seriously undermining the role of the Government in such activities. Third, as markets have become competitive and government debt instruments are traded in the market, cost of interest on government debt is likely to remain high compared to the past when debt was raised at administered rates of interest. Under these circumstances, concerted action is required to reduce government borrowings in order to correct structural imbalances in government fiscal operations.

Total transfer payments at Rs.34,353 million, showed a rise of 26 per cent in 1994 in comparison to an increase of 14 per cent in the previous year. Consequently, transfer payments in relation to GDP rose from 5.4 per cent in 1993 to 5.9 per cent in 1994. The bulk of the increase in transfer payments was due to the sharp increase in pension payments from Rs.10,516 million in 1993 to Rs.13,271 million in 1994. The 26 per cent increase in pension payments in 1994 in comparison to the 30 per cent rise in the previous year, was the combined outcome of the full year impact of the grant of Rs.260 per month on account of cost of living allowance since 1993, the payment of arrears on account of the correction of anomalies of pension payments following the May-Day package, and the new government's decision to pay arrears of cost of living allowance which was frozen in 1988. Meanwhile, in the context of an increased life expectancy and a large number of retirees each year, the total number of pensioners also continued to grow from about 319,000 in 1993 to about 330,000 in 1994. The increase in retirement benefits in 1990, under the new pension scheme, has also contributed to a high cost of government pensions. In fact, expenditure on government pensions showed almost a three-fold increase between 1990 and 1994, suggesting the need for a long term structural reform in the government Pension Scheme.

Meanwhile, outlays on the Government's three major welfare programmes, namely, food and kerosene stamps, school mid-day meal, uniforms and the Janasaviya, totalled Rs.10,355 million in 1994 compared to Rs.8,441 million in 1993. As a proportion of GDP, such expenditure rose from 1.7 per cent to 1.8 per cent. Expenditure on account of food and kerosene stamps showed a decrease of 3 per cent, while outlays under the Janasaviya and school mid-day meal and uniforms programmes expanded by a noteworthy 35 per cent following the Government's decisions to expand these programmes in May, 1994. The new government implemented a 30 per cent fertilizer subsidy scheme in October, 1994 costing Rs.630 million to the budget for a period of three months. Expenditure on other household transfers including outlays on refugees in the North and East, school season tickets and free text books amounted to Rs.4,637 million as against Rs.3,378 million in the previous year.

In terms of functional classification, current expenditure incurred for the provision of social services comprising education, health, welfare, housing and community services totalled Rs.47,656 million - an increase of 27 per cent over the previous year. This increase was largely attributed to the increased expenditure on account of the school mid-day meal, the expansion in the Janasaviya Programme and a sharp rise in pension payments. Thus, underscoring a bias towards welfare expenditure in the Government's resource allocation, expenditure on social services as a proportion of GDP rose to 8.2 per cent in 1994 from 7.5 per cent in 1993. Current outlays on public administration and defence at Rs.30,444 million, showed an increase of 10 per cent almost entirely due to a

sharp rise in defence and security related expenditure from Rs.20,159 million (4.0 per cent of GDP) in 1993 to Rs.25,807 million (4.5 per cent of GDP) in 1994. Meanwhile, current expenditure provided for the operation and maintenance of economic services such as agriculture and irrigation, fisheries, transport, trade and commerce and the provision of producer subsidies totalling Rs.6,195 million, showed an increase of 43 per cent largely due to the grant of the fertilizer subsidy in October, 1994. A functional classification of Government Expenditure is presented in Table 1.61.

## **CAPITAL EXPENDITURE AND NET LENDING**

Capital expenditure and net lending in 1994 amounted to Rs.40,684 million or 7.0 per cent of GDP compared with Rs.38,172 million or 7.6 per cent in the previous year. Public investment totalled Rs.40,455 million (7.0 per cent of GDP) in 1994 compared to Rs.39,927 million (8.0 per cent of GDP) in 1993. Other liabilities netted at Rs.229 million due to a high level of lending through advance account operations (Rs.2,462 million), restructuring cost of the two state banks and other enterprises (Rs.3,739 million), receipts on account of the privatisation programme (Rs.2,996 million) and loan recoveries (Rs.2,976 million) from past on-lending to commercial public enterprises.

Under the Public Investment Programme, capital expenditure directly incurred by line ministries and departments for the construction and rehabilitation of capital assets declined from Rs.19,719 million in 1993 to Rs.16,747 million in 1994. Public investment projects undertaken by Statutory Boards and Public Corporations utilised Rs.13,644 million - slightly lower than the amount utilised in the previous year. Meanwhile, on-lending to commercial public enterprises such as the Ceylon Electricity Board (CEB), Sri Lanka Ports Authority (SLPA) to implement public investment projects amounted to Rs.10,064 million although budgetary provisions for these projects totalled Rs.12,013 million.

In terms of the functional classification of capital expenditure and on-lending, public investment in economic infrastructure facilities totalled Rs.29,304 million (5.1 per cent of GDP) in 1994 in comparison to Rs.29,600 million (5.9 per cent of GDP) in 1993. Reflecting a high concentration of public investment on infrastructure facilities, the expenditure on economic infrastructure accounted for nearly 72 per cent of public investment. Public investment in energy and water supply and drainage and port services showed a significant increase. Public investment for the provision of infrastructure facilities in housing and community services too increased in 1994. Capital expenditure on education and health at Rs.4,396 million showed only a modest rise of 4.7 per cent. Consequently, such expenditure in relation to GDP declined to 0.76 per cent in 1994 from 0.84 per cent in 1993.

The low level of public investment was a matter for serious concern. In recent years, the level of public investment drastically declined. The public investment/GDP ratio fell from 10.5 per cent in 1989 to 7.0 per cent in 1994. The public investment during the past five year period averaged at 8.6 per cent of GDP compared to 13.5 per cent in the preceding five year period. The low level of public investment was due to several reasons. First, the fiscal adjustments towards lower budget deficits since 1989 were largely at the expense of public investment. Second, there has been a considerable under utilisation of foreign funded public investment projects in electricity and telecommunications due to complex tender procedures which have delayed the speedy implementation of such projects. Third, projects with large domestic resource content particularly in the field of education and health suffered due to lack of funds on a regular basis as government cash management was under tremendous stress on account of day to day operational expenses. This situation has also been compounded by lower disbursement on account of reimbursible foreign aid as there has been considerable slippages in the implementation of projects. Fourth, there has been a considerable weakening in the monitoring of public investment projects and taking remedial steps

to overcome implementation delays. In the context of considerable donor support for Sri Lanka's public investment, it is essential that these shortcomings are addressed on a priority basis as country is losing considerable volume of concessional foreign aid.

Privatisation proceeds amounted to Rs.2,996 million in 1994. These proceeds were derived from the enterprises such as Puttalam cement that were privatised during late 1993 and early 1994. However, with national elections and the change of Government in August, 1994, the on-going privatisation programme suffered a set-back during the year. Meanwhile, loan repayments by public enterprises to the Government amounted to Rs.2,976 million. A bulk of these repayments came from the Ceylon Electricity Board.

The cost of interest payments on account of bonds issued under the restructuring programme of the two state banks, and the restructuring expenditure of public enterprises under the on-going privatisation programme totalled Rs.3,739 million. Lending under Advance Account operations also increased in 1994, as the Government relaxed its credit facilities to government employees following the announcement of the May-Day relief measures and increased its outlays under general stores and the Railway Department Advance Accounts. Net lending under Advance Accounts amounted to Rs.2,462 million in 1994 compared to Rs.410 million in the previous year.

## **FINANCING OF THE BUDGET DEFICIT**

The budget deficit (after grants) at Rs.49,473 million in 1994, was an increase of 45 per cent over the previous year's deficit of Rs.34,096 million. Although, gross foreign borrowings at Rs.19,384 million, showed an increase of 15 per cent in 1994, the net borrowings from foreign sources amounted to Rs.11,778 million as against Rs.9,855 million in 1993 due to an increase in foreign loan repayments from Rs.6,984 million in 1993 to Rs.7,606 million in 1994. Net foreign borrowings as a proportion of GDP were 2.0 per cent as was in the previous year. Reflecting a large resource gap in government budgetary operations, particularly in current account transactions, net foreign borrowings as a share of deficit (after grants) declined from 29 per cent in 1993 to 24 per cent in 1994. Thus, net domestic borrowings at Rs.37,696 million showed a phenomenal rise of 56 per cent in 1994. Consequently, domestic financing in relation to GDP increased from 4.9 per cent in 1993 to 6.5 per cent in 1994, adding a further debt burden on the budget.

Gross borrowings through Rupee Loans raised a sum of Rs.46,878 million compared to Rs.28,205 million in the previous year. However, with repayments of Rs.14,956 million, net borrowings through the Rupee Loan Programme amounted to Rs.31,922 million as against Rs.7,974 million in the previous year. As in previous years, over 95 per cent of the Employees' Provident Fund (EPF) funds were invested in Rupee securities. Gross investment by the EPF in Rupee securities amounted to Rs.25,352 million in 1994 in comparison to Rs.21,359 million in 1993. The NSB also shifted from Treasury bills to Government Rupee Loans investing Rs.19,595 million in 1994, due to more attractive interest rates on Rupee Loans in 1994.

In the wake of a large resource gap in fiscal operations in 1994, the Government had to resort to borrowing from the banking system for financing the budget deficit. In spite of a build up of government cash balances of Rs.1,011 million with the Central Bank, the use of Central Bank provisional advances to the value of Rs.1,864 million, a further borrowings through Treasury bills to the tune of Rs.1,145 million and other transactions resulted in a net borrowing of Rs.1,157 million in 1994 contributing to an expansion in reserve money (high powered money) in the economy.

However, net credit to government from commercial banks declined by Rs.605 million, owing to a build up of government deposit balances by Rs.2,986 million in 1994, in spite of an increase in

government borrowings from the commercial banks by Rs.2,381 million. The build up of government deposit balances in both the Central Bank and commercial banks to the extent of Rs.3,997 million in the context of high domestic borrowings through the issue of government securities at high interest rates suggests that government cash management requires further improvements in order to reduce the high interest burden on government budgetary operations.

## **GOVERNMENT DEBT**

The outstanding government debt at the end of 1994 at Rs.549,292 million, was an increase of 14 per cent. The total debt/GDP ratio was 95 per cent in 1994 compared to 97 per cent in 1993. The total domestic debt, which accounted for 45 per cent of the government debt, rose by 17 per cent from Rs.213,685 million at the end of 1993 to Rs.249,118 million at the end of 1994, while foreign debt increased by 11 per cent from Rs.270,224 million to Rs.300,174 million. The total domestic debt in relation to GDP remained at the previous year's level of 43 per cent. Medium and long term domestic debt rose by Rs.28,552 million to Rs.140,392 million at the end of December, 1994, while short term debt increased by Rs.6,881 million to Rs.108,726 million, reflecting a structural shift in the government debt profile towards medium and long term debt. As a result, the proportion of long term debt in total domestic debt increased from 52 per cent in 1993 to 56 per cent in 1994.

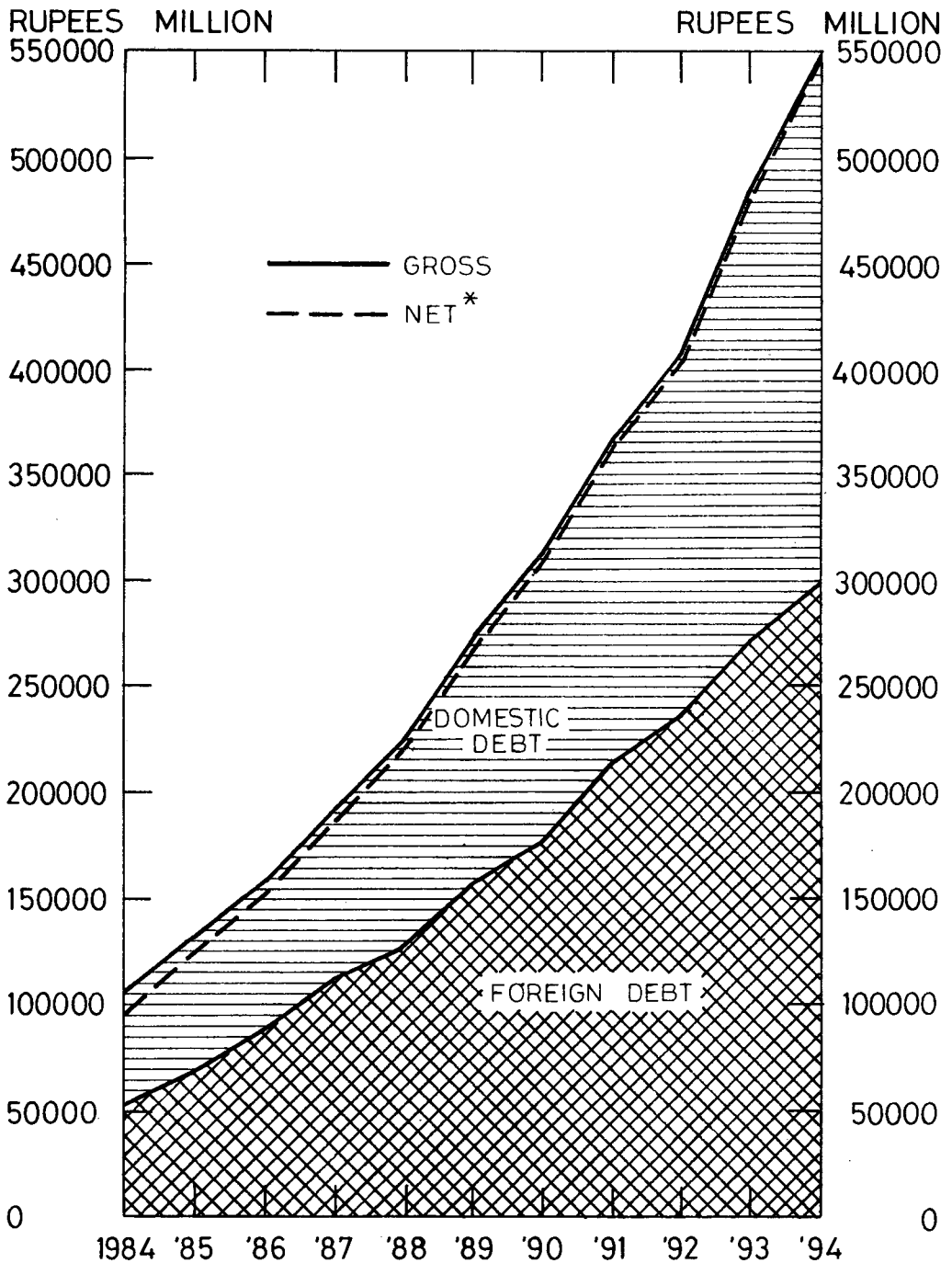
The outstanding liability on account of foreign debt increased by Rs.29,950 million to Rs.300,174 million at the end of 1994. However, Rs.18,172 million or 61 per cent of the enhanced liability on foreign debt was due to exchange rate variations. Foreign debt accounted for 55 per cent of the total debt outstanding at the end of 1994, as against 56 per cent at the end of 1993. In 1994, nearly 97 per cent of foreign debt outstanding was on concessional terms, obtained through multi-lateral or bilateral loan sources. Foreign debt in relation to GDP marginally declined from 54.1 per cent in 1993 to 51.9 per cent in 1994.

## **DOMESTIC DEBT**

Domestic debt at Rs.249,118 million at the end of 1994 registered an increase of 17 per cent over the debt stock of Rs.213,685 million at the end of 1993. Short term debt (of one year or less than one year maturity) at Rs.108,726 million registered an increase of 7 per cent in comparison to a growth of 4 per cent in 1993. The outstanding liability on account of short term Treasury bills at Rs.96,360 million, formed 89 per cent of the total short term debt. Together with Rs.2,535 million worth of Treasury bills of two year maturity, this constituted the total outstanding liability on account of Treasury bills. Total liability rose from Rs.97,196 million at the end of 1993 to Rs.98,895 million at the end of 1994. Central Bank provisional advances, which accounted for the balance of the short term debt of the Government, increased by Rs.1,864 million to Rs.12,366 million at the end of 1994.

The outstanding liability on Rupee loans which included Rs.24,088 million of long term (30 year maturity) bonds issued under the restructuring programme of the two state commercial banks in 1993, stood at Rs.137,554 million accounting for 98 per cent of the total long and medium term bonds. As the bulk of the domestic borrowing requirement of the Government was raised through the issuance of Rupee loans, the outstanding liability on account of Rupee loans recorded an increase of Rs.31,847 million or 30 per cent over the figure of Rs.105,707 million at the end of the previous year. This increase resulted from the issue of Rupee loans amounting to Rs.46,878 million and the repayment of Rs.14,956 million during 1994. Over 60 per cent of the Rupee loans floated during 1994, with a maturity period of 4-5 years, carried an interest rate of 16 per cent per annum. About 27 per cent of the new issues, floated with a maturity period over 6 years, carried interest rates in the range of 14.0-14.5 per cent while the balance was with 3-4 year maturity and carried interest rates in the range of 14.5-15.0 per cent. The EPF and National Savings Bank (NSB)

# COMPOSITION OF GOVERNMENT DEBT



\* Gross domestic debt less sinking funds.

Central Bank of Sri Lanka.

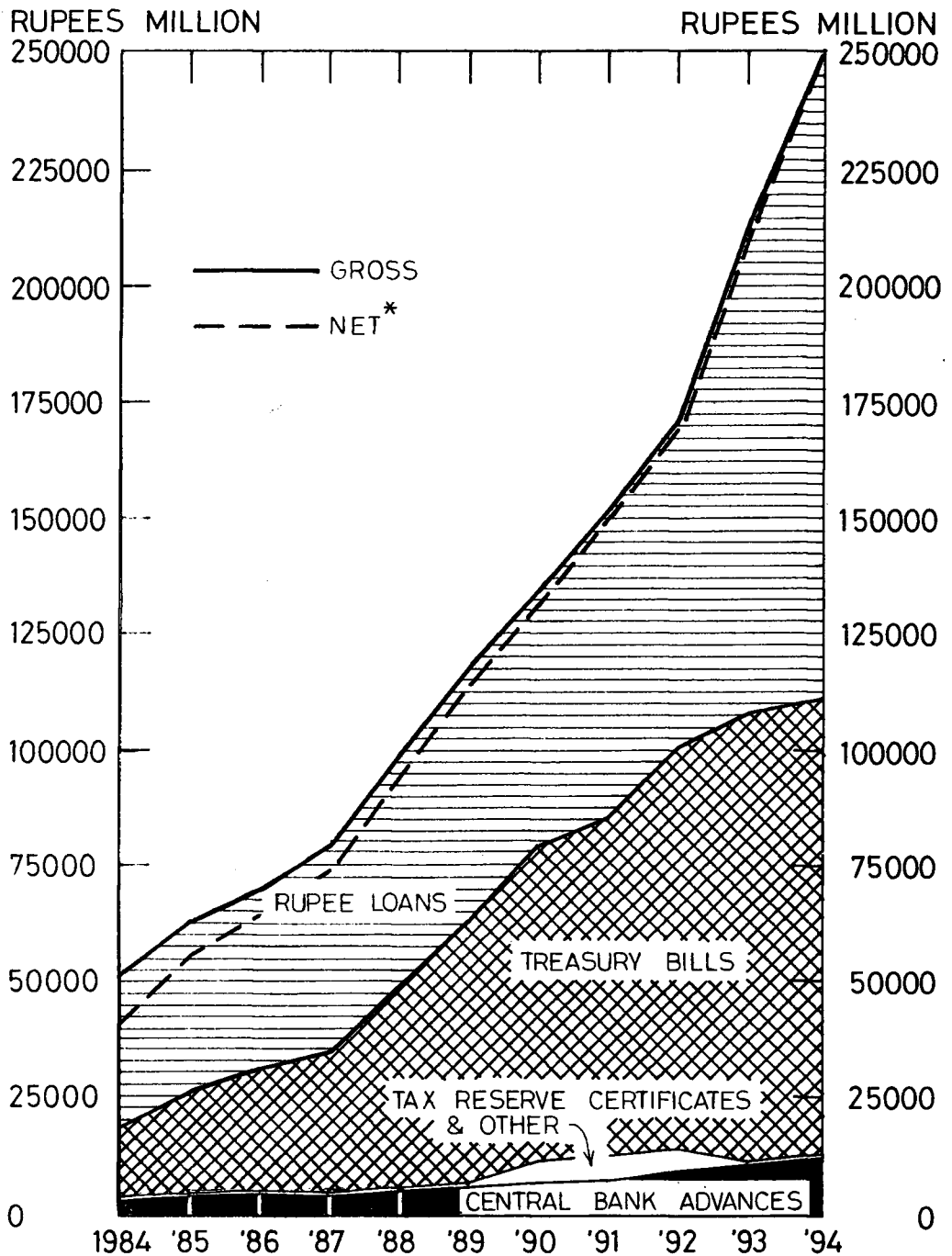
**TABLE 1.62**  
**Outstanding Central Government Debt (as at end of year)**

	Rs. Million				
	1990	1991	1992	1993	1994 Provisional
<b>Total Domestic Debt</b> .....	133,898	152,119	170,020	213,685	249,118
<b>Short-Term</b> .....	74,376	84,412	97,924	101,845	108,726
Treasury Bills .....	67,968	72,968	84,996	91,343	96,360
Rupe Securities .....	-	4,000	4,000	-	-
Provisional Advances .....	6,408	7,444	8,928	10,502	12,366
<b>Medium and Long-Term</b> .....	59,522	67,707	72,096	111,840	140,392
Rupe Securities (a) .....	54,677	62,823	65,180	105,707	137,554
Treasury Bills .....	-	-	2,100	5,853	2,535
National Defence Bonds .....	4,532	4,532	4,532	-	-
Treasury Certificates of Deposit .....	109	153	102	114	145
Tax Reserve Certificates .....	9	9	8	8	7
Other .....	195	190	174	158	151
<b>By Debt Instruments</b> .....	133,898	152,120	170,020	213,685	249,118
Rupe Securities .....	54,676	66,823	69,180	105,707	137,554
Treasury Bills .....	67,968	72,968	87,096	97,196	98,896
National Defence Bonds .....	4,532	4,532	4,532	-	-
Treasury Certificates of Deposit .....	109	153	102	114	145
Tax Reserve Certificates .....	9	9	8	8	7
Provisional Advances .....	6,408	7,444	8,928	10,502	12,366
Other .....	196	191	174	158	151
<b>By Institutions</b> .....	133,898	152,120	170,020	213,684	249,118
<b>Banks</b> .....	48,254	52,145	58,111	90,134	100,043
Central Bank .....					
By Debt Instruments .....	37,080	42,486	34,932	16,480	21,345
Rupe Loans .....	18	10	6	-	-
Treasury Bills .....	30,654	35,032	25,998	5,978	8,979
Provisional Advances .....	6,408	7,444	8,928	10,502	12,366
Commercial Banks .....					
By Debt Instruments .....	11,175	9,659	23,179	73,654	78,698
Rupe Loans .....	565	414	413	24,088	24,840
Treasury Bills .....	10,604	9,239	22,760	49,566	53,858
National Defence Bonds .....	5	5	5	-	-
Other .....	1	1	1	-	-
By Institutions .....	11,175	9,659	23,179	73,654	78,698
Bank of Ceylon .....	6,841	6,791	15,753	40,333	39,469
People's Bank .....	2,062	2,182	2,938	15,690	18,363
Other .....	2,272	686	4,488	17,630	20,867
Sinking Fund .....	1,662	840	359	239	137
Rupe Loans .....	1,662	840	359	239	137
<b>Non-Bank Sector</b> .....					
By Debt Instruments .....	83,982	99,134	111,550	123,311	148,938
Rupe Loans .....	52,432	65,559	68,402	81,379	112,577
Treasury Bills .....	26,710	28,697	38,338	41,652	36,059
National Defence Bonds .....	4,527	4,527	4,527	-	-
Treasury Certificates of Deposit .....	109	153	102	114	145
Tax Reserve Certificates .....	9	9	8	8	7
Other .....	195	190	173	158	151
By Institutions .....	83,982	99,134	111,551	123,311	148,939
National Savings Bank .....	24,089	26,558	30,782	37,767	46,407
Savings Institutions & Individuals .....	13,018	13,031	14,981	13,165	15,813
Employees' Provident Fund .....	36,851	45,862	54,563	65,645	79,745
Insurance Institutions .....	3,426	4,074	4,035	244	312
Finance Companies .....	1,446	2,427	3,131	5,868	5,942
Other .....	5,153	7,182	4,060	622	720
Departmental & Official Funds .....	62	34	428	453	556
Foreign Administrative Borrowings .....	195	190	174	158	151
Other .....					
<b>Total Foreign Debt</b> .....	176,883	214,579	235,538	270,224	300,174
<b>By Type</b> .....	176,883	214,579	235,538	270,224	300,174
Project Loans .....	132,338	166,149	185,003	216,355	244,819
Non-Project Loans .....	44,545	48,430	50,536	53,869	55,355
Commodity .....	43,393	46,037	48,550	52,120	53,727
Other .....	1,152	2,393	1,986	1,749	1,629
<b>By Institutions</b> .....	176,883	214,579	235,538	270,224	300,174
Concessional Loans .....	168,202	202,554	225,132	260,557	291,437
Multilateral .....	59,526	78,084	91,067	109,283	122,852
Bilateral .....	106,677	124,470	134,065	151,273	168,585
Commercial Loans .....	10,680	12,024	10,406	9,667	8,737
External Supplier's Credit .....	107	1,260	1,094	1,065	950
<b>Total Outstanding Govt. Debt</b> .....	310,780	366,698	405,558	483,909 *	549,292
<b>Total Outstanding Govt. Debt Net of Sinking Fund</b> .....	309,119	365,858	405,199	483,589	549,246

(a) Inclusive of Rs. 24,088 million of Long Term Bonds in 1993.

Source: Central Bank of Sri Lanka.

# COMPOSITION OF DOMESTIC DEBT



\* Gross Domestic debt less sinking funds.

Central Bank of Sri Lanka.

continued to be the two major subscribers to the Rupee Loan Programme accounting for nearly 80 per cent of the total outstanding Rupee Loans at the end of 1994.

## FOREIGN DEBT

The outstanding liability on foreign debt at Rs.300,174 million at the end of 1994, was an increase of Rs.29,950 million or 11 per cent over the previous year. The increase in the foreign debt was the net result of a gross borrowing of Rs.19,384 million, a repayment of Rs.7,606 million and an increase in the outstanding liability due to exchange rate variation by Rs.18,172 million. The outstanding liability on account of concessional loans at Rs.291,437 million, increased by Rs.30,880 million over the previous year and accounted for 97 per cent of the total outstanding foreign debt compared to 96 per cent at the end of 1993. Bilateral loans at Rs.168,585 million, constituted 58 per cent of concessional loans, while the balance Rs.122,852 million had been obtained through multilateral agreements.

**TABLE 1.63**  
**Effect of Exchange Rate Variation on Foreign Loans 1990 – 1994 (a)**

Rs. Million					
Item	1990	1991	1992	1993	1994*
1. Gross receipts	16,550	25,969	15,316	16,839	19,384
2. Repayments	4,451	4,881	7,955	6,984	7,606
3. Net Receipts	12,099	21,088	7,361	9,855	11,778
4. Change in liability due to Exchange rate variations	8,486	16,607	13,599	24,831	18,172
5. Liability as at end of period	176,883	214,578	235,538	270,224	300,173

(a) Data is based on value date recording system.

Source : Central Bank of Sri Lanka.

\* Provisional.

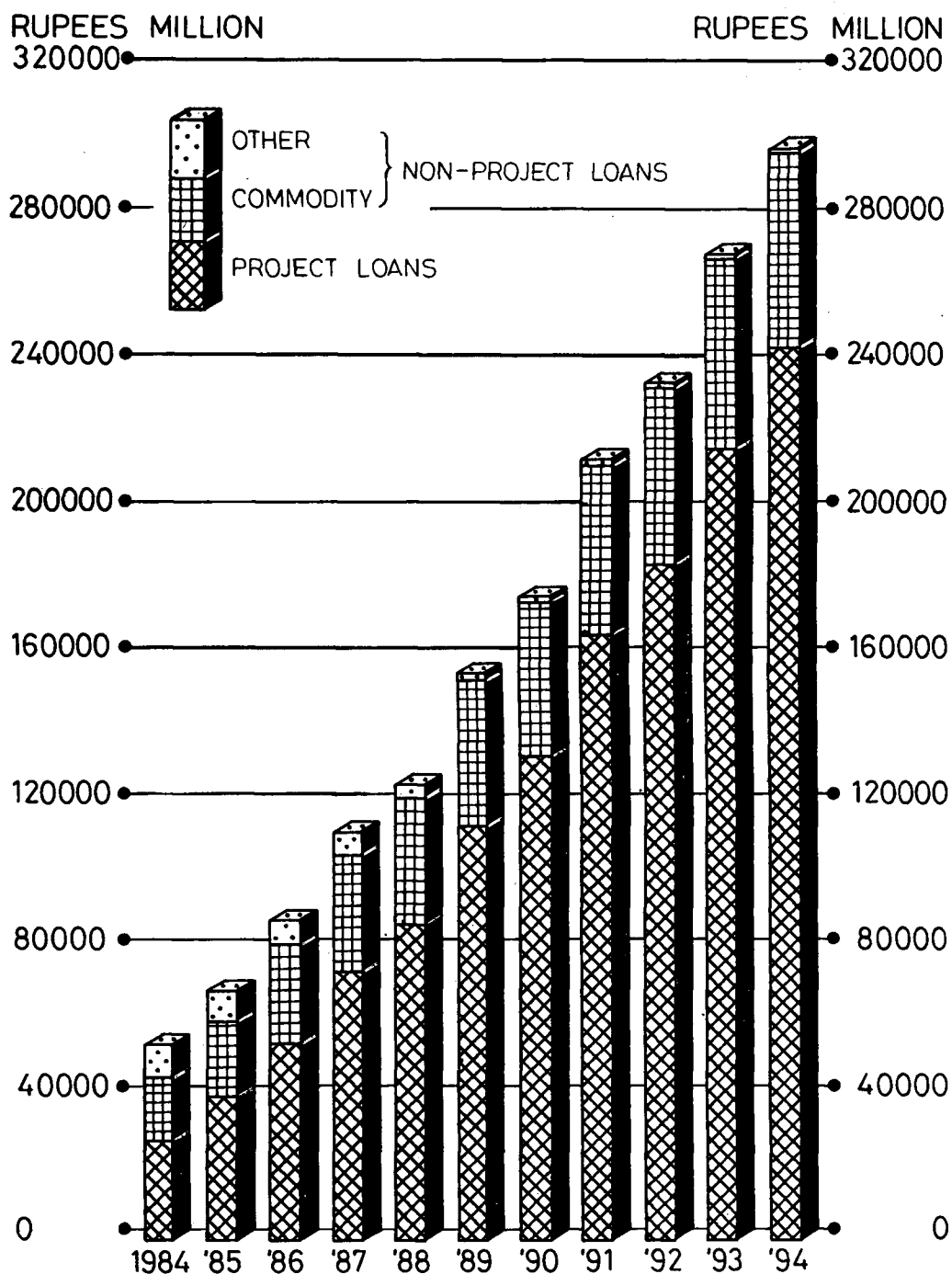
Liabilities on account of project and programme loans stood at Rs.244,819 million at the end of 1994 and included a net borrowing of Rs.12,995 million during the year while an additional liability of Rs.14,775 million resulted from exchange rate variations. The outstanding liability on commodity loans rose to Rs.53,727 million from Rs.52,120 million as at end December, 1993. Ninety seven per cent of the project loans and almost the entirety of the commodity loans were of a concessory nature. The effect of exchange rate variations on foreign debt is given in Table 1.63.

## GOVERNMENT DEBT SERVICE PAYMENTS

The debt service payments of the Government consisting of Rs.22,671 million of amortisation payments and Rs.38,031 million of interest payments, totalled Rs.60,702 million and registered an increase of 6 per cent over the previous year. Debt service payments as a ratio of GDP declined marginally to 10.5 per cent in 1994 from 11.5 per cent in 1993, largely due to a lower volume of maturing debt on account of Rupee securities. Debt repayment on account of foreign debt at Rs.7,606 million, marked an increase of 9 per cent over 1993.

Owing to high yields on Treasury bills in 1993, interest payments on short term debt at Rs.18,712 million in 1994, increased by 40 per cent compared to a rise of 12 per cent witnessed

# COMPOSITION OF FOREIGN DEBT



Central Bank of Sri Lanka.

**TABLE 1.64**  
**Government Debt Service Payments 1990 – 1994**

	Rs. Million				
Item	1990	1991	1992	1993	1994*
Debt Service Payments	32,878	39,885	52,018	57,286	60,702
(i) Amortization Payments	12,210	17,782	26,078	27,290	22,671
(a) Domestic	7,304	12,901	18,123	20,327	15,065
(b) Foreign	4,906	4,881	7,955	6,963	7,606
(ii) Interest Payments	20,668	22,073	25,940	30,203	38,031
(a) Domestic	16,990	17,960	21,201	25,101	32,520
Short Term	9,563	10,410	11,923	13,351	18,712
Medium & Long Term	7,427	7,550	9,278	11,750	13,808
(b) Foreign	3,678	4,113	4,739	5,102	5,511
Interest / Current Expenditure (%)	28.8	26.4	28.9	29.9	29.9
Debt Service / GDP (%)	10.2	10.7	12.2	11.5	10.5

\* Provisional

Source: Central Bank of Sri Lanka.

during 1993. Interest payments on medium and long term debt amounting to Rs.13,808 million, rose by 18 per cent in 1994 compared to 27 per cent in 1993. This growth was due to the higher interest rates offered on Rupee loans in the latter part of 1993 and a high volume of outstanding debt during 1994.

Interest payments on foreign loans increased by 8 per cent to Rs.5,511 million in 1994. The comparable figure for 1993 was Rs.5,102 million which was 8 per cent higher than the interest payment on foreign debt in 1992. A statistical summary of government debt service payments is given in Table 1.64.

## FISCAL POLICY

There was a relaxation of fiscal policy in 1994 as events unfolded towards national elections. In spite of the commitment to consolidate government fiscal operations by generating a surplus in current account operations equivalent to 1.1 per cent of GDP and containing the overall budget deficit at 6.8 per cent of GDP, a weakening of revenue efforts and relaxed expenditure policies led to a considerable increase in the current account deficit to 2.9 per cent of GDP, and overall budget deficit to 10.0 per cent of GDP requiring a very high level of domestic borrowings. The government revenue effort was weakened due to various concessions extended through the reduction in import duties, turnover taxes and income taxes, while there was an escalation of current expenditure largely on account of various relief measures. These developments not only exerted considerable demand pressure on the economy, but also further complicated the structural problems in the government budget through the erosion in tax base and high cost on account of pensions, salaries, household transfers and interest payments. The on-going structural reforms in regard to public sector employment, rationalisation of cadre positions, administrative price corrections and the rationalisation of welfare programmes etc. to consolidate government fiscal operations thus suffered a set-back in 1994, making future fiscal adjustment more difficult.